INDIAN ECONOMY

For Civil Services Examinations

SEVENTH EDITION

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Ramesh Singh

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To my parents for whom
educated children were better
than hefty bank deposits—they really are
visionaries in human
resource management and
pure applied economics

Preface to the Seventh Edition

It feels great to present the seventh edition of the book *Indian Economy* to the reader at a time when India is breaking into the highest growth rate in the world. Economic systems are too dynamic to be captured in words, pages and the writer's imagination.

In case of India, the last few months have been quite imaginative and dynamic. Starting with a government getting a decisive majority at the Centre, it seemed as if the times of coalition governments with their accompanying compulsions are over. With this mandate, we find a renewed synergy towards meaningful reforms. Most important of the steps promised by the new government has been its call to increase the 'ease of doing business' in the country. In this regard, the PM himself gave a call to make things easier—in a way, a promise and an attempt to get equated with the top-ranking economies in the World Bank's Doing Business Report. Business, media, experts and the politicians have mixed reactions to the government's one year peformance. A more balanced response comes from the RBI Governor Raghuram Rajan when he says that people had 'unrealistic expectations' from the Modi government.

Meanwhile, a subtle change ensued in the scheme of the Civil Services Examination. *Paper 2,* that is popular as the CSAT, has been announced to be of qualifying nature. Because of this, the relevance and importance of *Paper 1* has increased in an unprecedented manner—now, General Studies will decide the selection in the Preliminary Examination. As the questions on *Economic and Social Development* are a bit tougher for the aspirants, it will be advisable to take care of this segment more seriously. More questions are expected concerning the Indian economy in the Main Examination, as its significance has increased manifold in the government policy-making—right from welfare measures and foreign policy issues to the need for sustainable development.

The Main Examination of 2014 has indicated that unlike previous years, the aspirants might be asked few questions on the 'basic understanding' of Economics as a subject. The question on the dilemma of picking between 'manufacturing' and 'services' sectors in the case of India to promote growth and development was one such challenge. So that the aspirants are able to handle such questions, a fundamental understanding of Economics and Indian Economy is advisable. Now that aspirants are expected not to just 'write' but 'create' answers, *answer writing practice* has started playing a huge role.

This seventh edition has been duly revised and updated to suit the requirements of the aspirants in their forthcoming UPSC and other related examinations.

What is new in this edition?

- Other than a comprehensive revision of existing chapters, a new chapter titled *Services Sector* has been included.
- The chapter on *Human Development in India* has been re-written to incorporate the changing dimensions of human development, especially in the Indian context.
- The New National Account System, Insight into Human Behaviour have been added.

- Topics such as — An Epitaph to the Planning Commission; Inclusive Growth; Resource Mobilisation; Investment Models; Programme Evaluation Organisation; NITI Aayog have been added in the chapter on *Planning in India*.
- The chapter on *Inflation and Business Cycle* has been expanded by adding topics such as Inflation Targeting; New CPI; Government Steps to Control Inflation.
- The chapter on *Agriculture & Food Management* has been expanded by adding several new topics — revised Land Reforms; Cropping Patterns; Animal Rearing; Food Management; Market Intervention Scheme; new Buffer Stock; Decentralised Procurement System; Storage; Open Market Sale Scheme; Price Stabilisation Fund; Food Subsidy; Farm Subsidies; Restructuring of FCI (Shanta Kumar Committee); Agricultural Marketing; Upstream and Downstream Requirements; Supply Chain Management; Farm Mechanisation; Food Processing.
- The chapter on *Indian Industry & Infrastructure* has been further expanded by adding topics such as — New Steps to Boost Industry; Make in India; Restructuring the PPP; Boosting Energy Sector; Railways as a Growth Engine; Boosting Public Investment.
- Several new topics are added to the chapter on *Financial Sector* such as Liquidity Management Framework; Asset Liability Management; Willful Defaulter; Urjit Patel Committee; Nachiket Mor Committee; Small & Payment Banks; Pradhan Mantri Jan-Dhan Yojana; New Initiatives in Banking Sector; Reform Initiatives in Insurance Sector; Real Estate Investment Trusts (REITs); Infrastructure Investment Trusts (InvITs).
- The chapter on *External Sector* has been expanded by adding new topics such as Optimum Forex, the Riddle; External Debt; Crude Oil Price Movements; Composition of Trade; Direction of Trade; Recent Steps to Promote Trade; New Foreign Trade Policy (2015–20).
- Topics such as The Bali Conference of WTO; BRICS Bank (New Development Bank – NDB); Asian Infrastructure Investment Bank (AIIB) have been added in the chapter on *International Organisations & India*.
- The chapter on *Tax Structure* has been expanded by adding topics such as Minimum Alternate Tax; Recommendations of the 14th Finance Commission; Concepts Related to the Finance Commission.
- The chapter on *Public Finance & Government Budgeting* has been enhanced with topics like Expenditure Management Commission; Fiscal Performance of States; Consolidated General Government; Major Issues in 2015-16; Need & Role of Public Investment.
- The chapter on *Climate Change and Sustainability in India* has been expanded by addition topics such as COP20 at Lima; 17 Sustainable Development Goals (Rio+20); Fifth Assessment Report of the IPCC.
- Topics such as Human & Gender Development; Population Policy, Women & Child Sex Ratio; Poverty Estimates; Strengthening the PRIs; Demographics; Socio-Economic and Caste Census; Educational Issues; PISA; ASER; Employment Issues; Labour Reforms; Health Sector; Social Sector Expenditure; Restructuring of the CSSs (Complete List) have been added and updated in the chapter on *Human Development in India*.

- Besides revision, Bullet Repayment; Khilji Effect; Net Worth are new topics added to the chapter on *Concepts & Terminologies*.
- Six new Model Answers are added, together with revision and updation of the answers in the chapter *Model Answers to Selected Questions*.
- At the end, the new *Union Budget 2015–16; Railway Budget 2015–16* and a synoptic view of the *Economic Survey 2014–15* have been provided.

With the hope that this edition serves its purpose to the readers, I wish all the best to the aspirants appearing for their examinations in the forthcoming months!

Constructive suggestions from the readers are always welcome.

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Preface to the First Edition

I felt my first serious inclination towards writing when my first article was published in the journal *Mainstream* way back in 1988 while pursuing my post graduation studies at the Delhi School of Economics. My interaction with students inside and outside the classroom in 1990–91, when India faced a serious financial crisis, made me realise that there was an immediate need of a book on Indian economy, which could educate the students about the various aspects and challenges of the Indian economy in a simple and lucid manner. It took nearly two decades to fulfil this dream of mine.

The book has been designed to cater to the requirements of the General Studies paper for various Civil Services Examinations (Union as well as the States), and the optional Economics. It would also be useful for graduate and postgraduate courses in Economics of various universities. Adequate and required notes and references have been given after consulting and referring to an array of sources. I have taken care of both the objective as well as the subjective aspects based on my classroom experience of interacting with the students.

I am grateful to Prof. Majid Husain for the inspiration and motivation I got from him to complete this work. I have especially learnt the art and importance of work, punctuality and honesty in a very practical way from him.

Thanks are also due to Mr. Rajesh Kumar Baghel, Mr. Rakesh Kumar, Md. Ishtiaq, and Mr Vikash. I am indebted to my wife, Mrs Ila Singh, for her full support and my two little daughters, Medha and Smiti, for providing the sparkle in an otherwise monotonous work.

Finally, my special thanks to the team from McGraw-Hill, who took great pains to finalise the project and complete it in a record time with all the possible expertise. I welcome from the readers constructive advice, and comments, which could guide me in further revision of this book.

RAMESH SINGH

ABOUT THE CIVIL SERVICES EXAMINATION

The Civil Services examination comprises two successive stages:

(i) Civil Services (Preliminary) Examination (Objective Type) for the selection of candidates for Main Examination; and

(ii) Civil Services (Main) Examination (Written and Interview) for the selection of candidates for the various services and posts.

Scheme and subjects for the Preliminary and Main Examination.

A. PRELIMINARY EXAMINATION

The Examination shall comprise of two compulsory Papers of 200 marks each.

Note :

(i) Both the question papers will be of the objective type (multiple choice questions).

(ii) The question papers will be set both in Hindi and English. However, questions relating to English Language Comprehension skills of Class X level will be tested through passages from English language only without providing Hindi translation thereof in the question paper.

B. MAIN EXAMINATION

The written examination will consist of the following papers:

Qualifying Papers:

Paper A: (One of the Indian Language to be selected by the candidate from the Languages included in the Eighth Schedule to the Constitution). **300 Marks**

Paper B : English **300 Marks**

The papers on Indian Languages and English (Paper A and Paper B) will be of Matriculation or equivalent standard and will be of qualifying nature. The marks obtained in these papers will not be counted for ranking.

Papers to be counted for merit

Paper I: Essay **250 Marks**
Paper II: General Studies–I **250Marks**
(Indian Heritage and Culture, History and Geography of the World and Society)
Paper III: General Studies –II **250 Marks**
(Governance, Constitution, Polity, Social Justice and International relations)
Paper IV: General Studies –III **250 Marks**
(Technology, Economic Development, Bio-diversity, Environment, Security and Disaster Management)
Paper V: General Studies –IV **250 Marks**
(Ethics, Integrity and Aptitude)

Paper VI: Optional Subject – Paper 1 **250 Marks**
Paper VII: Optional Subject – Paper 2 **250 Marks**
Sub Total (Written test): 1750 Marks
Personality Test: 275 Marks
Grand Total: 2025 Marks

Candidates may choose any one of the optional subjects from amongst the list of subjects given below:

List of optional subjects for Main Examination:

(i) Agriculture
(ii) Animal Husbandry and Veterinary Science
(iii) Anthropology
(iv) Botany
(v) Chemistry
(vi) Civil Engineering
(vii) Commerce and Accountancy
(viii) Economics
(ix) Electrical Engineering
(x) Geography
(xi) Geology
(xii) History
(xiii) Law
(xiv) Management
(xv) Mathematics
(xvi) Mechanical Engineering
(xvii) Medical Science
(xviii) Philosophy
(xix) Physics
(xx) Political Science and International Relations
(xxi) Psychology
(xxii) Public Administration
(xxiii) Sociology
(xxiv) Statistics
(xxv) Zoology
(xxvi) Literature of any one of the following

Assamese, Bengali , Bodo, Dogri, Gujarati, Hindi, Kannada, Kashmiri, Konkani, Maithili, Malayalam, Manipuri, Marathi, Nepali, Oriya, Punjabi, Sanskrit, Santhali, Sindhi, Tamil, Telugu, Urdu and English.

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CHAPTER

1

INTRODUCTION

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*Economics is the study of how goods and services are produced, distributed and consumed. As resources are always in short supply, the British economist Lionel Robbins in 1935 described the discipline as 'the science of scarcity'.**

** See David Orrel and Borin Van Loon, **Introducing Economics: A Graphic Guide**, Faber & Faber, London, 2011, p. 3*

ECONOMICS—THE DISCIPLINE

The study of every discipline starts with the process of defining it. Economics is no exception to this. But the challenge of articulating an over-arching definition of any discipline has never been an easy task, and at the end one has to be satisfied with a partial definition. Different economists have seen the discipline with differing perspectives and have been coming up with differing definitions—at times a large number of such definitions became either narrow or incomprehensible. But it is quite necessary to come out with a working definition of the subject one intends to study.

Before coming out with our own working definition of the subject, we may cite here two highly acclaimed and internationally established attempts in this direction:

1. Economics is the study of how societies use scarce resources to produce valuable commodities and distribute them among different people.[1]

As per the definition there are two key ideas in economics—that goods are scarce and that society must use its resources efficiently. Indeed, economics is an important subject because of the fact of scarcity and the desire for efficiency.

Over the last half-century, the study of economics has included such varied topics that the subject serves different purposes to different students of economics. Some study it to make money (basically, most of its students in the developed world do study economics to enrich themselves. But the same is not correct in the case of the developing world. The truth is that in the developing world economics has only been read and taught, not applied—if we do a sweeping generalisation). Others study economics to know about poverty, unemployment, human development, shares and debentures, banking norms, prices and their movements, e-commerce, etc. Still others might be studying the discipline to enhance their knowledge of economics.

2. Economics studies how individuals, firms, government, and other organisations within our society make choices and how these choices determine society's use of its resources.[2]

Human life depends on consumption of various materials which are made up of the resources available on earth. As there is no limit to human wants, we need infinite resources to gratify our needs and wants. But the resources are limited! Now it is upto the individual and humanity at large as to how they try to satisfy their competing needs to get fulfilled by the limited resources. It means we need to make some choices before we utilise the scarce resources by prioritising some of our needs. In this process, some needs might never get fulfilled. At the same time, there might be some needs which may be fulfilled again and again with the available resources.

Economics is the discipline which studies how individual, society and the government make their prioritised choices in the process of using the scarce resources to gratify the various needs and wants of life. Making such choices is an art as well as a science. As time changes the choices change. As space changes human needs change and so modify the choices. After studying and surveying the various choices made by humanity at large in differing time and space, there developed the discipline of economics. As economics is an exercise in the *space-time continuum* and it deals with living human beings it is a very dynamic subject and should only be read in this perspective to have the real feel.

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1. Samuelson, P.A and Nordhaus, W.D., ***Economics***, Tata McGraw-Hill Pub. Company Ltd., N. Delhi, 2005, p.4.
2. Stiglitz, J.E and Walsh, C.E., ***Economics,*** W.W. Norton & Company, New York, 2006, p.6.

A Working Definition

It is essential to feel the subject one intends to study. The fundamental way of doing this is starting with the definition of the subject. But the definition, at times or better say most of the times, becomes very abstract, jargon-laden and technical. Such a definition might not give a proper feel and understanding of the subject to a person who does not belong to economics. Most of the students of economics face difficulty in making out a complete meaning of the definition. That is why a very *general* and *layman's* definition is needed.

Human beings in their day-to-day lives are busy doing so many things. There are different activities we are involved in throughout our lives. These activities fall under different categories.

Economics studies the economic activities of mankind. Similarly, political, social and administrative activities of mankind are studied by Political Science, Sociology and Public Administration, respectively. That is why these disciplines are broadly categorised as **humanities** as all of them study human activities. There are many more specialised human activities which are studied under many more disciplines.

Which activities of mankind are ***economic activities?*** The activities which involve profit, loss, livelihood, occupation, wage, employment, etc., are economic activities. Economics studies all these activities. Today, economics has many branches and studies highly diverse subject matters, right at the global, macro and micro levels.

Why some people go for fuel-efficient cars while others go for fuel-guzzling sports cars? Why the poor are poor? Is capitalism doomed to intensify economic inequality? Will the process of globalisation be able to bridge the poor–rich divide and have a universal homogenising impact on the world? Such varied and many more questions fall under the domain of economics. These days we also can see information technology giving a typically new dimension to economics.

Economics and The Economy

The relation between economics and the economy, simply saying, is that of theory and practice. While the former is a discipline studying economic behaviour of human beings, the latter is a still-frame picture of it. Economics will come out with theories of market, employment, etc., and an economy is the real picture of the things which emerge after the application to the same theories in certain areas.

Economy is economics at play in a certain region. This region is best defined today as a country, a nation—the Indian Economy, the Russian Economy, the French Economy, etc. Economy as such means nothing. It gets meaning once it is preceded by the name of a country, a region, a block, etc. When we say developed economies, we mean economies of developed countries.

Countries of the world might be facing some common economic challenges. At the same time, they might be facing some highly specific challenges. Economists, during the period of evolution of economics, have suggested some fixed number of theories and methods of solving those economic challenges. Now it depends upon the choice of the countries as to which set of principles and theories they select for solving their economic challenges. Further, many countries selecting same remedy and tools to fight the same problems might have similar or dissimilar results during a given period. At the same time, two economies selecting different tools to solve the same economic problems might experience the same results or completely different results. Why is this so?

Basically, economic theories are expectations of human behaviour about their economic activities and as human behaviour depends

greatly on many internal and external factors, the results are likely to show diversities. The level and quality of natural resources, the quantity and quality of human resources, the socio-political milieu, the historical background, the psychic make of the human resource, etc., are some of the factors which individually as well as collectively impact an economy while carrying out economic activities. These things make it highly difficult for economists to say and forecast the kind of impact a particular economic policy will have on a particular economic setting. Ultimately, implementation and delivery systems, also play a highly vital role in solving economic challenges in a country, which economists started studying after the 1960s. Therefore, it is correct to say that economics has less diversity than the economies. There will not be any exaggeration if we say that no two economies of the world are exactly the same, though we might classify them into broader terms like developed and developing, agrarian and industrial, etc.

This diversity makes economics a highly interesting discipline. And via the diverse faces of the economies, the economists have been able to modify and remodify their ideas on the subject of economics. The evolutionary history of economics is nothing but modifications in the past theories on the basis of contemporary results and experiences of the economies. It is right to say that economics has developed out of real life practices and especially from practice to theory. As practices will be having newer dimensions, the theories of economics will also have newer and more imaginative dimensions.

Focus of Economics

What is the real purpose of studying economics? What ultimately economists have been trying to articulate? And what has been the focus of economics and the economists since the birth of the discipline?

Though economics today studies a wide range of issues and topics, if we take an overall picture, its essence has been very simple—the betterment of human life on earth. Improving living conditions of the humanity at large has been the real and the ultimate goal of the discipline. In this process, economists have been articulating a number of theories and propositions as to how an economy may maximise its economic potential and worth. The first and the most famous work in this direction was by the Scottish philosopher-economist, Adam Smith in *The Wealth of Nations* (1776). We trace the origin of the classical school to this work. Similarly, in the following years and centuries many masterpieces were produced by a great many economists who were trying to improvise better ways of maximising the fruits of economic activities. Economics and the economists have common goals, searching for possible alternatives for the betterment of human life.

Challenge of the Economies

The main challenge of any economy is to fulfil the needs of its population. Every population needs to be supplied with some **goods** and **services** for its survival and well-being. These goods might include basic needs such as food, shelter, garments, etc., while it might also consist of refrigerators, air conditioners, cars, medicines, computers, etc. Similarly, the services people need may range from healthcare, drinking water supply, education to advanced and highly sophisticated services like banking, insurance, airways, telephones, internet, etc. As an economy moves on the ladder of development, the process of fulfilling the needs of the population becomes a never-ending phenomenon. As an economy achieves success in supplying one set of goods and services to its population, the population starts demanding another set of goods and services which are of a

higher order. And thus goes on the struggle of the economy—solving one challenge and focusing on another. Standard of living of one set of population varies from another depending upon the attempts and the successes of the concerned economies as to which comparative extent they have been able to fulfil the needs of their population.

There are two aspects of this challenge. First, the availability of the goods and services required by the population and second, the presence of the supply network. Every economy has to, at first, guarantee the required level of goods and services out of its production process. For this, proper level of production capacity should be built which requires a particular level of capital formation or investment. From where the investible funds will be managed is altogether a separate question. Whether the investment will come from the government, the domestic private sector or the foreigners? Once these details are cleared and selected as per the socio-economic condition of the economy, a proper distribution network for goods and services produced is assured.

DISTRIBUTION NETWORK MODELS

In the arena of ***distribution network***, we have three historically existing models—**state**, **market** and **state–market mix**. In the first type of distribution system, the state (i.e., the government) takes the sole responsibility of supplying goods and services required by the population with no payments being done by the consumer—the former Soviet Union and Communist China being the best examples. In the second category comes the market mode of distribution which functions on the basis of price mechanism. In this system, goods and services are made available in the market and on the basis of their demand and supply, their prices are determined in the open market and finally they get distributed to the population. This was the distribution system of the capitalist economies—the whole of Euro-America till the 1930s. The third and the most prevalent mode of distribution, the state-market mix, developed out of the experiences of the former two systems. This distribution system has certain goods and services which might be made available to the population freely or at the subsidised prices by the state and some might be supplied by the market for which consumers need to pay. Almost all economies of the world today follow one or the other kinds of distribution system. As the socio-economic composition of the population of an economy changes the mixture of the goods and services to be supplied by the state and the market get redefined in the economies from time to time.

ORGANISING AN ECONOMY

Any one issue which has affected civilised history of mankind the most and has been a contentious issue is the way the production process in an economy should be organised. Whether the production should be the sole responsibility of the state/government or should it be left altogether to the private sector? Again, will it be better to carry on production with a joint effort—a mixture of state and private enterprises?

Depending upon the dominant view of the time in a particular country, different forms of production patterns evolved and different economic systems finally came up, providing alternative ways of organising an economy. The three models of economic systems which we see coming up are basically the different stages in the evolutionary process of our experiments which define a better way of organising our economy. We must have a concise overview of this evolutionary process:

1. CAPITALISTIC ECONOMY

The capitalistic form of economy has its origin in the famous work of Adam Smith—*Wealth*

of Nations (1776). Adam Smith (1723–1790), the Scottish philosopher-economist professor at University of Glasgow whose writings formed the basis of classical economics had stressed certain fine ideas which were to take fancy among some of the western countries and finally capitalism took birth. He raised his voice against the heavy-handed government regulation of commerce and industry of the time which did not allow the economy to tap its full economic worth and reach the level of well-being. Stressing 'division of labour', an environment of 'laissez faire' (non-interference by the government), he proposed that the 'invisible hand' of 'market forces' (price mechanism) will bring a state of equilibrium in the economy and a general well-being to the countrymen. For such an economy to function for public well-being, he has acknowledged the need of *competition* in the *market*.

Once the USA attained Independence the ideas of Adam Smith were made part of its public policy—just one year after *Wealth of Nations* was published. From here the idea spread to other parts of Euro-America—by 1800 the economic system called 'capitalism' was established which was later known by different names—Private Enterprise System, Free Enterprise System, Market Economy.

The decisions of what to produce, how much to produce and at what price to sell are taken by the market, by the private enterprises in this system, with the state having no economic role.

2. State Economy

Rooted in the ideas of historical change proposed by the German philosopher Karl Marx (1818–1883) more specifically, this kind of economic system first came up in the erstwhile USSR after the Bolshevik Revolution (1917) and got its ideal shape in the People's Republic of China (1949). This form of economic system also spread to other countries in Eastern Europe. Here we see two versions of the state economy—in erstwhile USSR known as the *socialist economy* and in pre-1985 China as the *communist economy*. While socialistic economy emphasised the collective ownership of the means of production (property and assets) and it also ascribed a large role to the state in running the economy, communist economy advocated state ownership of all properties including labour and absolute power to state in running the economy. Though for Marx, Socialism was a transitional stage to communism, it never did happen in reality.

Basically, this form of economy came in reaction to the prevalent popular economic system of capitalism and proposed just the opposite. The decisions related to production, supply and prices were all suggested to be taken by the state only. Such economies were also known as Centralised Economy, Centrally Planned Economy, Non-market Economy.

The socialist and communist economies used to criticise capitalistic economics of being based on exploitation. In response, the capitalist economies called them the practioners of 'state capitalism', where the states were the sole exploitators. The communist and anti-communist propagandas resulted in serious intellectual discussions almost upto the mid-1980s.

3. Mixed Economy

The belief in the self-correcting quality of the market and the 'invisible hand' of Adam Smith got a major setback in early 20th century during the Great Depression (1929). The impact of the depression spread from the USA to other economies of Western Europe escalating large scale unemployment, downfall in demand and economic activities and lockouts in industrial enterprises. The prevailing Smithonian macro ideas failed to check the crisis. A new approach was needed which came in the famous work, *The General Theory of Employment, Interest and Money*

(1936) by the English economist at Cambridge University, John Maynard Keynes (1883–1946).

Keynes questioned the very principles of 'laissez-faire' and the nature of the 'invisible hand'. He even opined that the invisible hand brings equilibirium to the economy but by 'strangulating the poor'. He suggested that prices and wages are not flexible enough to provide employment to all. It means there will be some people unemployed when the economy will be at its full potential. Ultimately, a fall in demand will be imminent resulting in recession and if unchecked, in depression which happened in 1929. Questioning the limitations of the market mechanism, Keynes suggested *strong government intervention* in the economy. To get the economy out of the depression, he suggested an increase in government expenditures, discretionary fiscal policy (fiscal deficit, lower interest rates, cheap money supply, etc.) to boost the demand of goods and services as this was the reason behind the depression. As Keynesian policies were followed, the concerned economies were successfully pulled out of the Great Depression.

While Keynes was inquiring into the causes and cures of the Great Depression he questioned the capitalist economic system being practised throughout Euro-America. He suggested the capitalistic order to assimilate the goals of the socialistic economy (economic ideals of the socialists, i.e., the ex-USSR). In the capitalist economies of the time, all the basic goods and services were part of the market mechanism, i.e., being produced and supplied by the private sector. It meant that almost everything the people required was supplied by the private enterprises via the market which was ultimately an undimensional movement of money and wealth (from the mass of people to the few who controlled the production and supply chain) and the masses were going through the process of pauperisation every day, thereby weakening their purchasing power. In the end, it affected overall demand and culminated in the Great Depression.

As a follow up to the Keynesian advices, many trendsetting economic policies were initiated throughout the capitalist economies. One very important initiative which came out was the government's active role in the economy. The governments started producing and supplying some basic goods and services which are known as 'public goods'. These goods basically intended to guarantee minimum level of nutrition to all, healthcare, sanitation, education, social security, etc. The expenditure on public goods were incurred on the public exchequer even if it required deficit financing. Starting from 1930s upto 1950s, almost 50 per cent of the GDP in the Euro-America was spent by the governments on public goods which also become popular as the ***social sector.*** The essential goods and services which were till date being purchased by the people as 'private goods', were soon made available by the state 'free-of-cost' giving people more spare money to create demand for the goods and services which were part of the market.

The above instance has been cited here to just show the process as to how capitalism redefined itself by including some useful traits of the non-market economy, i.e., the state economy. The ***mixed economy*** arrived in this way and the classical capitalistic economy was challenged by it.

On the margins of the developments given above, it is interesting to note the developments in the state economies of the time. It was **Prof. Oscar Lange (1904–65),** the Polish philosopher, who in 1950s suggested the same thing for the socialist economy as Keynes had for the capitalist. Prof. Lange praised the state economy for many of its good things, but also suggested inclusion of some of the good things of the capitalistic economy.[3] He advised the *state economies* to

3. J.K. Galbraith, ***A History of Economics***, Penguin Books, London, 1991, p. 188–89.

adopt 'market socialism' (the term was coined by him). His suggestions were outrightly rejected by the state economies as such compromises in the socialistic economic order were blasphemous at that time (this was ultimately a suggestion towards democracy from dictatorship).

As Keynes has suggested that the capitalist economy should move few steps towards socialistic economy, Prof. Lange was suggesting just the same in the case of the state economies. Democracies are flexible thus they were able to go for an experiment which paid them in coming times. But as the socialist and communist political systems had been stubborn by nature, they did not go for any experiment and thus started moving towards their economic decay.

It was in the communist China, under the leadership of Mao Tse Tung, where the first opinion came against the total state economic control. And the ultimate example of the state economy (i.e., China) started its preparation towards a limited market economy under the political design of dictatorship. In 1985, China announced its 'open door policy', the first experiment in 'market socialism'—Prof. Lange had the last laugh. Other state economies, though caught unprepared, followed the Chinese experiment towards market socialism. However, the switch over to market socialism has not been smooth for most of the state economies. The efforts towards market socialism in the Soviet Union, fuelled by the lofty ideas of 'glasnost' (openness) and 'prestroika' (restructuring), resulted in the very *disintegration* of the nation-state. The experts consider it 'a political fallout of an economic mismanagement'. The other state economies experienced major economic breakdowns in their transition phases to market socialism. Basically, for smooth transition to market socialism some prerequisites were required to be put in place aforehand. China was well ahead doing this homework since Mao's time (specially since 1975 onwards) which emerged as a real winner—the ideal type example of state economy getting smoothly metamorphosed into a giant market economy.

These two events spanning many decades were nothing but timely and rational selections of economic traits from each other's economic systems and experiences. The world by the late 1980s was having neither a pure example of capitalistic economy nor a pure example of state economy.

There were many states of the world that opted for a mixed economy in the post-Second World War period after coming out of the colonial rule, such as India, Malaysia, Indonesia, etc., to name a few. The leadership of these countries could be considered visionaries which was to be proved by the mid-1990.

Though at a practical level, the world looked flat for the mixed economy, a formal opinion on the goodness, immediacy and the ultimate viability of the mixed economy was yet to emerge. The first such authoritative opinion, in this direction, came from the World Bank which accepted the goodness and the need of 'state intervention' in the economy.[4] This was a turning point in the world economic thinking as the World Bank (WB) and the International Monetary Fund (IMF) were ardent votaries of the virtues of the free market economy.

The concluding consensus emerged with the publication of the World Development Report (1999) titled *Entering the 21st Century* in which the WB said, "Governments play a vital role in development, but there is no simple set of rules that tells them what to do." The WB went on to suggest in this important document that every country should determine the **areas** and the **extent** of the market and the state intervention, depending upon its own stage of economic

4. ***The East Asian Miracle,*** W.B. Study, 1993.

development, socio-political and other historical factors.

The last WB document had basically rejected both the historically existing economic orders, namely the free-market economy, and the state economy—which meant Adam Smith and Karl Marx were cancelled and rejected outrightly, that too on the basis of the historical experiences of both the worlds. Rather, the document advocates for a 'mixture' of both the economic orders, i.e., the mixed economy. The long-standing ideological dilemma as to whether the market economy or the state economy was the better or the best way of organising the economy was solved for all times to come. The document pin-pointed good things of both the systems and concluded that they don't have the relationship of dichotomy but that of complimentarity. The real issue is not whether to have market or the state but having both of them together makes more sense. Market economy might suit one economy while it might not suit another—due to the different socio-economic conditions of the economies in reference. Similarly, the state economy model might serve one economy but might not serve the other.

The real answer seems going for neither the market nor the state but a judicious combination of both. As the state-market mix depends upon the socio-economic and political conditions of an economy, there can never be a mechanical prototype of the mixed economy, which could be applied upon every economy universally. Every economy needs to explore its own mixture of market and state. Again, the same state might need to redefine composition of the state-market mix in the coming times according to its changed socio-eco-political scenario.

The process of economic reforms in India started in 1991. It was infact the search for a new 'state-market mix', while India had been a mixed economy since Independence.

After Independence, India opted for the mixed economy when the state-market dilemma was at its peak in the world. In the process of organising the economy, some basic and important infrastructural economic responsibilities were taken up by the state/governments (centre and state) and rest of the economic activities were left to private enterprise, i.e., the market. The kind of state-market mix for which India went was thought to be fit for the socio-economic and political conditions of the time. Once the country started the process of economic reforms in early 1990s, the prevailing state-market mix was redefined and a new form of mixed economy began to be practised. As the socio-economic conditions had changed, the state-market mix also changed. The redefined mixed economy for India had a declared favour for the market economy. Many economic roles which were under complete government monopolies were now opened for participation by the private sector. Examples are many—telecommunication, power, roads, oil and natural gas, etc. At the same time, the responsibilities which were till date being shouldered by the state alone and which could be taken up by the state only were given extra emphasis. In this category comes the whole social sector—education, healthcare, drinking water, sanitation, nutrition, social security, etc.

The economic system of India was a mixed economy in the pre-1991 years as it is in the post-1991 years, but the composition of state-market mix has gone for a change. In future, as the socio-economic and political factors will be changing, India will be redefining its mixed economy, accordingly.

The emergence and evolution of the mixed economy was thus able to settle the long-standing debate as to what was the best way to organise an economy. Starting in 1776 with the *Wealth of Nations* of Adam Smith, it continued till we had the *World Development Report* of 1999 by

the WB.[5] The dilemma continued for almost two and a quarter centuries (1776–2000). Today, once the World Trade Organization (WTO) has taken over the world economy, the brand of the mixed economy it advocates, is more inclined towards the free market economy. However, it does not propagate to make the state an economic non-entity, i.e., it leaves scope for greater state intervention in required areas if needed.

ROLE OF THE STATE IN AN ECONOMY

The dilemma of searching the ideal way of organising an economy, as it evolved, was also going to solve another riddle. This riddle was the role of the state in an economy.[6] If we look back into the economic history of the world, we see *three* possible roles for the state/government in the economy:

(i) As a **regulator** of the economic system (where the state takes important economic decisions, announces the required kind of economic policies, takes the sole responsibility to get them implemented and controlling and punishing those who don't oblige to those economic decisions).

(ii) As a producer and/or supplier of **'private goods and services'** (these include all those goods and services which constitute the part of market and which will be distributed among the needy according to the principles of market mechanism. Here the state earns profit as a private enterprise).

(iii) As a producer and/or supplier of **'public goods'** or **'social goods'** (these include goods and services which look essential from the perspective of social justice and well-being for the people. Education, healthcare, sanitation, drinking water, nutrition, caring for the handicapped and old, etc., come under this category. These goods which are generally distributed free of cost at times might reach the beneficiaries at subsidised prices. The loss incurred by the state in this way is paid out of the public exchequer which means that the whole economy pays for the cause of a few people).

As different economies select different roles for the state according to their socio-political ideologies, the world had differing ways of organising the economy and had resulted in the different economic systems in the past.

On the issue of regulating the economy there has been no debate, as we see all economic systems being regulated by the state only. But the selection of other two functions of the state in an economy made the real difference. The economy which selected both the roles (ii and iii) for the state under monopoly we called them the state economies. This category of economy had two variants in the socialist economy at least the labour was not owned and exploited by the state unlike the other—the communist economy where labour used to be under complete state control. These economies had almost no market.

The economic system which left both the roles (ii and iii) as the sole responsibilities of the private sector was called the capitalistic economic system. Here the state had almost no economic role but played a passive role as the regulator.

Mixed economies had at least kept one economic role fixed for them (i.e., iii) while they played the sole role of supplying public goods to the needy people. In some of the mixed economies the state went on to take some of the roles of

5. World Bank, ***World Development Report,*** 1999.
6. A highly concise and to-the-point idea on the issue comes from Joseph. E. Stiglits, **The Role of Government in Economic Development,** the keynote address at the Annual World Bank Conference on Development Economics, 1996.

supplying the private goods (i.e., ii) even by carrying heavy burdens of subsidies.

The WB document—the *World Development Report*, 1999 was a judgement on the possible and suitable roles of the state in the economy, which suggested a timely shuffling of state's role in the economy as per the socio-economic and political needs of the economy. We may understand the moot question via Keynes for whom the political problem of mankind is to combine three things:

(i) economic efficiency,
(ii) social justice, and
(iii) individual liberty

In the process of realising the above-mentioned three objectives, an economy cannot go for either allowing only state's role in the economy or only the market's role in the economy. These challenges could only be faced properly once the state and the market both are given a balanced role in an economy—the balance to be defined by its present condition and the direction of future goal of the economy. Striking the right balance between the role of the state and the market in the economies came to be known as the process of economic reforms in the post-WTO world.

If we analyse the need of an economy, we see some compulsory roles for the state in it:

(i) If the regulation and control of an economy is left to the private individuals or groups (i.e., firms) they will be using the regulatory powers to maximise their profits and returns at the cost of others. That is why this role must rest with the state. It looks more logical in the democratic political set-ups, wherein the interest of the largest numbers is being represented in the regulatory provisions.

(ii) The responsibility of producing and distributing private goods to the people could be well handled by the private sector as this is a profit-fetching area. The state should not burden itself with this responsibility as this could be well taken up by the private sector. But in the absence of the proper presence of the private sector in an economy, many countries in the world gave this responsibility also to the state; India being one among them. But as the private sector became capable, in some countries this responsibility was given up by the state in favour of the private sector and better development has been possible in those economies. In this sense, India delayed this process while in Indonesia, Malaysia, Thailand and South Korea the state did give up this responsibility allowing the entry of the private sector.

(iii) The responsibility of producing and supplying the social/public goods to the needy people cannot be left to the private sector as this is a loss-making exercise. It means, the state will have to take the sole responsibility or may need to expand its role in such areas—as we see in post-reform India.

As the private sector becomes capable of playing the proper role in producing and supplying the private goods, state saves its important human and economic resources which is transferred to take care of the production and distribution of public goods.

Basically, the WB study, the *East Asian Miracle* (1993) recognises the above-given shift of one kind of mixed economy to the another kind of mixed economy—in the cases of the Malaysian, Thai and South Korean economies—taking place since the mid-1960s. Experts believe that this shift could not take place in time in India. And once it started (1991–92) it was too late and this choice was not voluntary but obligatory. The East Asian economies had gone for the same kind of reform process but by their choice.

WASHINGTON CONCENSUS

The term 'Washington Consensus' was coined by the US economist John Williamson[7] (in 1989) under which he had suggested *a set of policy reforms* which most of the official in Washington (i.e. International Monetary Fund and World Bank) thought would be good for the crisis-driven Latin American countries of the time. The policy reforms included **ten** propositions:

(i) Fiscal discipline
(ii) A redirection of public expenditure priorities toward fields offering both high economic returns and the potential to improve income distribution, such as primary health care, primary education, and infrastructure.
(iii) Tax reform (to lower marginal rates and broaden the tax base)
(iv) Interest rate liberalisation
(v) A competitive exchange rate
(vi) Trade liberalisation
(vii) Liberalisation of FDI inflows
(viii) Privatisation
(ix) Deregulation (in the sense of abolishing barriers to entry and exit)
(x) Secure property rights

However, in coming times, the term got used synonymous to *neo-liberalism* (in Latin America), *market fundamentalism* (as George Soros told in 1998) and even *globalisation* across the world. It has often been used to describe an extreme and dogmatic commitment to the belief that **markets can handle everything**.

But the reality has been different—these *set of polices* were already being recommended by the IMF (International Monetary Fund) and the WB (World Bank) together with the US Treasury, especially during the period of the eighties and early nineties.[8] The prescriptions were originally intended to address the very real problems occurring in Latin America at the time, and their use later to handle a wide array of other situations has been criticized even by original proponents of the points. The name of the Washington Consensus has often been mentioned as being somewhat unfortunate, especially by its creator. John Williamson[9], says that audiences the world over seem to believe that this signifies a set of neo-liberal policies that have been imposed on hapless countries by the Washington-based international financial institutions and have led them to crisis and misery—there are people who cannot utter the term without foaming at the mouth. He further adds that many people feel that it gives the impression the points outlined represent a set of rules imposed on developing nations by the United States. Instead, Williamson always felt that the prescriptions represented a consensus precisely because they were so universal. Many proponents of the plan do not feel that it represents the hard-line *neo-liberal* agenda that anti-free-trade activists say it does, instead presenting it as a relatively conservative assessment of what policies can help bring a country to economic stability.

7. John Williamson, **What Washington Means by Policy Reform**, Chapter 2 in *Latin American Adjustment: How Much Has Happened?*, John Williamson (ed.), 1990; Institute for International Economics and John Williamson, **What Should the Bank Think About the Washington Consensus**, Background Paper to the World Bank's *World Development Report 2000*, Washington DC, July 1999.
8. J. E. Stiglitz, **Initiative for Policy Dialogue**, a paper presented at the conference *From the Washington Consensus towards a new Global Governance*, Barcelona, September 2004. The conference was sponsored by the Ford Foundation, the MacArthur Foundation, and the Mott Foundation.
9. J. Williamson, **Did the Washington Consensus Fail?**, Institute for International Economics, Washington DC, 2002.

But the policy prescriptions led to the processes which are known as Liberalisation, Privatisation, Globalisation, cutting down the role of the State in the economy, etc.—across the world—more so in the nations who got developmental funding from the WB or went to the IMF in times of the Balance of Payment crises (as in the case of India which commenced its reform process in 1991 under the 'conditions' of the IMF). It was as if the Adam Smith's prescription of 'free market' (liberalism) has taken its rebirth (in neo-liberalism).

Many scholars believe today that the recent financial crises of the US and the European nations are somehow born out of the ideas rooted in the Consensus. In the aftermath of the Great Recession (after the 'US sub-prime' crisis) in the Western economies, it is believed that dependence on market to correct the growth and development may not sustain any longer – and the world might agree a bit in favour of a *development state* as in the case of the East Asian nations who never went for the Consensus for their robust growth. The Keynesian idea of 'interventionist state' seems the ultimate alternative in the present times, as is suggested by the US Nobel economist Paul Krugman and being followed by the Japanese Prime Minister, Shinzo Abe (the *Three Arrows of Abenomics*).

SECTORS OF AN ECONOMY

Every economy tries to maximise the returns of economic activities in which it is involved. Whatever be the organising principles of an economy, the economic activities are broadly classified into three broad categories which are known as the three sectors[10] of the economy.

1. Primary Sector

This sector includes all those economic activities where there is the direct use of natural resources as agriculture, forestry, fishing, fuels, metals, minerals, etc. In some of the economies, mining activities are considered a part of the secondary sector, though we see direct use of natural resources here. Broadly, such economies term their agricultural sector as the primary sector. This is the case in India.

2. Secondary Sector

This sector is rightly called the manufacturing sector which uses the produce of the primary sector as its raw materials. Since manufacturing is done by the industries, this sector is also called the industrial sector—bread and biscuits, cakes, automobiles, textiles, etc.

3. Tertiary Sector

This sector includes all those economic activities where different 'services' are produced such as education, banking, insurance, transportation, tourism, etc. This sector is also known as the services sector.

TYPES OF ECONOMIES

Depending upon the shares of the particular sectors in the total production of an economy and the ratio of the dependent population on them for their livelihood, economies are given different names, such as:

1. Agrarian Economy

An economy is called agrarian if the share of its primary sector is 50 per cent or more in the total output (the GDP) of the economy. At the time of Independence, India was such an economy. But now it shows the typical symptom of a service economy with the primary sector's contribution falling to almost 18 per cent of its total produce, while almost 60 per cent of their population

10. Michael P. Todaro and Stephen C. Smith, ***Economic Development***, Pearson Education, 8th Ed., N. Delhi, p. 440.

depends on the primary sector for its livelihood. Thus, in *monetary terms* India is no more an agrarian economy, the dependency ratio makes it so—India being the first such example in the economic history of the world.

2. Industrial Economy

If the secondary sector contributes 50 per cent or more to the total produce value of an economy, it is an industrial economy. Higher the contribution, higher is the level of industrialisation. The western economies who went for early industrialisation earning faster income and developing early known as developed economies. Most of these economies have crossed this phase once the process of industrialisation saturated.

3. Service Economy

An economy whose 50 per cent or more produce value comes from the tertiary sector is known as the service economy. First lot of such economies in the world were the early industrialised economies. The tertiary sector provides livelihood to the largest number of people in such economies. In the last decade (2003–04 to 2012–13), growth has increasingly come from the services sector,[11] whose contribution to overall growth of the economy has been 65 per cent, while that of the industrial and agricultural sectors has been 27 per cent and 8 per cent respectively.

By the end of the 19th century it was a well-established fact, at least in the western world, that industrial activities were a faster way to earn income in comparison to agrarian activities. The Second World War had established the fact for the whole world—and almost every country started their preparation for the process of industrialisation. As country after country successfully industrialised, a pattern of population shift occured from one to another sector of the economy, which was known as the ***stages of growth*** of an economy.[12] With the intensification of industrialisation, dependency on the primary sector for livelihood decreased and dependency on the secondary sector increased consistently. Similarly, such economies saw a population shift from the secondary to the tertiary sector—and these were known as the 'post-industrial' societies or the services societies. Almost the whole Euro-America falls under this category—these economies are having over 50 per cent of their total produce value being contributed by their tertiary sector and over half of the population depend on this sector for their livelihood. Many other countries which started the process of industrialisation in the post-war period did show abberations in this shift of the population and the income—India being one among them.

THE IDEA OF NATIONAL INCOME

Income is probably the most frequently used term in economics, used by experts and lay men. Income level is the most commonly used tool to determine the well-being and happiness of nations and their citizens. This remains true even today, Even if we know that 'income' is not an exhaustive idea to know about the well-being of the society. There has been some reason for such a perception about the concept of income. Basically, when the idea of 'human development' came into being by the early 1990s, the concept of the 'human development index' ultimately was heavily dependent on the level of 'income' of an individual in a country. Education and life expectancy can only be enhanced once the required amount of 'investment' (expenditure on them) could be

11. Ministry of Finance, **Economic Survey 2012-13**, Government of India, New Delhi, 2013, p. 30
12. Walt W. Rostow, ***The Stages of Economic Growth: A Non-Communist Manifesto,*** Cambridge University Press, London, 1960, pp. 1–5.

mobilised. Thus, somehow, income came to be established as the 'focal point' of 'development/ human dvelopment'.

As income of a single person can be measured, it can be measured for a nation and the whole world, although the method of calculating may be a little bit complex in the latter's case. In due course, *four ideas/ways* to calculate the income of a nation[13] developed, which are the subject matter of the 'national income accounting'—an area to which the disciplines Commerce and Statistics are closely associated. These four ways to look upon 'income' of an economy, although different from each other in some ways, are the concepts of GDP, NDP, GNP and NNP. All are a form of the national income, but are different from one another. They all say a different story about the income of a nation in their own specific way. Here, we will objectively discuss each one of them.

GDP

Gross Domestic Product (GDP) is the value of the all *final* goods and services produced within the boundary of a nation during one year period. For India, this calendar year is from 1st April to 31st March.

It will be better to understand the terms used in the concept, *'gross'* means same thing to Economics and Commerce as 'total' means to Mathematics; *'domestic'* means all economic activities done inside the boundary of a nation/ country and by its own capital; *'product'* is used to define 'goods and services' together; and *'final'* means the stage of a product after which there is no known chance of value addition in it.

The ***different uses*** of the concept of GDP are as given below:

(i) Per annum percentage change in it is the 'growth rate' of an economy. For example, if a country has a GDP of Rs. 107 which is 7 rupees higher than the last year, it has a growth rate of 7 per cent. When we use the term 'a growing' economy, it means that the economy is adding up its income, i.e., in quantitative terms.

(ii) It is a 'quantitative' concept and its volume/size indicates the 'internal' strength of the economy. But it does not say anything about the 'qualitative' aspects of the produced goods and services.

(iii) It is used by the IMF/WB in the comaparative analyses of its member nations.

NDP

Net Domestic Product (NDP) is the GDP calculated after adjusting the weight of the value of 'depreciation'. This is, basically, *net form* of the GDP, i.e., GDP minus the total value of the 'wear and tear' (depreciation) that happened in the assets while the goods and services were being produced. Every asset (except human beings) go for depreciation in the process of their uses, which means they 'wear and tear'. The governments of the economies decide and announce the rates by which assets depreciate (done in India by the Ministry of Commerce and Industry) and a list is published, which is used by the different sections of the economy to determine the real levels of depreciations in different assets. For example, a residential house in India has a rate of 1 per cent per annum depreciation, an electric fan has 10 per cent per annum, etc., calculated in terms of the asset's price. This is ***one way*** how depreciation is used in economics. The ***other way*** it is used in the external sector while the domestic currency floats freely in front of the foreign currencies, If the value of the domestic currency falls following

13. The discussion on National Income Accounting is based on several textbooks of economics and the documents released by the ***International Monetary Fund (IMF)*** and the ***World Bank (WB)*** in the areas of ***Comparative Economics*** and ***International Economics.***

market mechanism in front of a foreign currency, it is the situation of 'depreciation' in the domestic currency, calculated in terms of loss in value of the domestic currency.

Thus, *NDP = GDP – Depreciation.*

This way, NDP of an economy has to be always lower than its GDP for the same year, since there is no way to cut the depreciation to zero. But mankind has achieved too much in this area through developments, such as 'ball-bearing', 'lubricants', etc., all innovated to minimise the levels of depreciation.

The **different uses** of the concept of NDP are as given below:

(a) For domestic use only: to understand the historical situation of the loss due to depreciation to the economy. Also used to understand and analyse the sectoral situation of depreciation in industry and trade in comparative periods.

(b) To show the achievements of the economy in the area of research and development, which have tried cutting the levels of depreciation in a historical time period.

However, NDP is not used in comparative economics, i.e., to compare the economies of the world. Why this is so? This is due to different rates of depreciation which is set by the different economies of the world. Rates of depreciation may be based on logic (as it is in the case of houses in India—the cement, bricks, sand and iron rods which are used to build houses in India can sustain it for the coming 100 years, thus the rate of depreciation is fixed at 1 per cent per annum). But it may not be based on logic all the time, for example, upto February 2000 the rate of depreciation for heavy vehicles (vehicles with 6-wheels and above) was 20 per cent while it was raised to 40 per cent afterwards—to boost the sales of heavy vehicles in the country. There was no logic in doubling the rate. Basically, depreciation and its rates are also used by modern governments as a tool of economic policymaking, which is the ***third way*** how depreciation is used in economics.

GNP

Gross National Product (GNP) is the GDP of a country added with its 'income from abroad'. Here, the trans-boundary economic activities of an economy is also taken into account. The items which are counted in the segment 'Income from Abroad' are:

(i) *Trade Balance:* the net outcome at the year end of the total exports and imports of a country may be positive or negative accordingly added with the GDP (in India's case it has always been negative except the three consecutive years 2000-03 when it was positive, due to high levels of 'services sector' export during the years, courtsey the booming BPO industry).

(ii) *Interest of External Loans:* the net outcome on the front of the interest payments, i.e., balance of the inflow (on the money lend out by the economy) and the outflow (on the money borrowed by the economy) of the external interests. In India's case it has always been negative as the economy has been a 'net borrower' from the world economies.

(iii) *Private Remittances:* the net outcome of the money which inflows and outflows on account of the 'private transfers' by Indian nationals working outside India (to India) and the foreign nationals working in India (to their home countries). On this front India has been always a gainer-till the early 1990s from the Gulf region (which fell down afterwards in the wake of the heavy country-bound movements of Indians working there due to the Gulf War) and afterwards from the USA and other European nations. Today, India is the highest recipient of private

remittances in the world—as per the World Bank projected at $71 billion in 2014 (in 2013 it was $70 billion, the year's highest). China falls second ($ 64 billion) in 2014.

Ultimately, the balance of all the three components of the 'Income from Abroad' segment may turn out to be positive or negative. In India's case it has always been negative (due to heavy outflows on account of trade deficits and interest payments on the foreign loans). It means, the 'Income from Abroad' is subtracted from India's GDP to calculate its GNP.

The normal formula is *GNP = GDP + Income from Abroad*. But it becomes GNP = GDP + (– Income from Abroad) = GDP – Income from Abroad, in the case of India. This means that India's GNP is always lower than its GDP.

The **different uses** of the concept GNP are as given below:

(i) This is the 'national income' according to which the IMF ranks the nations of the world in terms of the volumes—at Purchasing Power Parity (at PPP). For a detailed discussion on PPP readers may *search for it alphabetically* in *Chapter 24*. India is ranked as the ***4th largest economy*** of the world (after the USA, China and Japan), while as per the nominal/ prevailing exchange rate of rupee, India is the ***11th largest economy***.

(ii) It is the more exhaustive concept of national income than the GDP as it indicates towards the *'quantitative'* as well as the *'qualitative'* aspects of the economy, i.e., the *'internal'* as well as the *'external'* strength of the economy.

(iii) It enables us to learn several facts about the production behaviour and pattern of an economy, such as, how much the outside world is dependent on its product and how much it depends on the world for the same (numerically shown by the size and net flow of its 'balance of trade'); what is the standard of its human resource in international parlance (shown by the size and the net flow of its 'private remittances'); what position it holds regarding financial support from and to the world economies (shown by the net flow of 'interests' on external lending/ borrowing).

NNP

Net National Product (NNP) of an economy is the GNP after deducting the loss due to 'depreciation'. The formula to derive it may be written like:

NNP = GNP – Depreciation

or,

NNP = GDP + Income from Abroad – Depreciation.

The **different uses** of the concept of NNP are as given below:

(i) This is the **'National Income' (NI)** of an economy. Though, the GDP, NDP and GNP, all are 'national income' they are not written with capitalised 'N' and 'I'.

(ii) This is the *purest form* of the income of a nation.

(iii) When we divide NNP by the total population of a nation we get the ***'per capita income'*** (PCI) of that nation, i.e., 'income per head per year'. A very basic point should be noted here that this is the point where the rates of dipreciation followed by different nations make a difference. Higher the rates of depreciation lower the PCI of the nation (whatever be the reason for it logical or artificial as in the case of depreciation being used as a tool of policymaking). Though, economies are free to fix any rate of depreciation for different assets,

the rates fixed by them make difference when the NI of the nations are compared by the international financial institutions like the IMF, WB, ADB, etc.

The 'Base Year' together with the 'Methodology' for calculating the National Accounts were revised by the Central Statistics Office (CSO) in January 2015, which is given in the forthcoming pages. So that readers are able to understand the 'main differences' in the accounting process, the literature related to the 'old methodology' is left unchanged in this edition. We may expect questions on their comparative aspects in the futre examinations.

Cost and Price of National Income

While calculating national income the issues related to 'cost' and 'price' also needs to be decided. Basically, there are two sets of costs and prices; and an economy needs to choose at which of the two costs and two prices it will calculate its national income. Let us understand the confusion and the relevance of this confusion.[14]

(i) *Cost:* Income of an economy, i.e., value of its total produced goods and services may be calculated at either the 'factor cost' or the 'market cost'. What is the difference between them? Basically, ***'factor cost'*** is the 'input cost' the producer has to incur in the process of producing something (such as cost of capital, i.e., interest on loans, raw materials, labour, rent, power, etc.). This is also termed as *'factory price'* or 'production cost/price'. This is nothing but 'price' of the commodity from the producer's side. While the ***'market cost'*** is derived after adding the indirect taxes to the factor cost of the product, it means the cost at which the goods reach the market, i.e., showrooms (these are the cenvat/central excise and the CST which are paid by the producers to the central government in India). This is also known as the *'ex-factory price'*. The weight of the state taxes are then added to it, to finally derive the 'market cost'. In general, they are also called *'factor price'* and *'market price'*.

In India, income is calculated at factor cost, and so is the case with most of the developing countries (but among the developed economies it is calculated at the market cost). The reasons are, lack of uniformity in taxes, goods are not printed with their prices, etc. In present time, we see a great degree of tax-related uniformity coming to India upto the extent of the central taxes only, but the state taxes are still neither single nor uniform. Once the GST is implemented this abberation will end. Though for statistical purposes, income at market cost is also released by the Central Statistical Organisation (CSO).

(ii) *Price:* Income can be derived at two prices constant and current. The difference in the constant and current prices is only that of the *impact of inflation.* Inflation is considered stand still at a year of the past (this year of the past is also known as the ***'base year'***) in the case of the constant price while in the current price the present day inflation is added. Current price is, basically, the maximum retail price (MRP) which we see printed on the goods selling in the market.

14. The informations on the issues like 'cost', 'price', 'taxes' and 'subsidies' are based on the different ***Discussion Papers*** released by the ***Central Statistical Organisation*** (GoI) from time to time.

As per the new guidelines the *base year* in India has been revised from the 1993–94 to 2004–05 (the data based on the new constant year is presently known as the 'new series' of data) — announced in September, 2010. *India calculates its national income at constant prices*—so is the situation among other developing economies, while the developed nations calculate it at the current prices. Though, for statistical purposes the CSO releases the national income data at the current prices, too. Why? Basically, inflation has been a challenging aspect of policymaking in India because of its level (i.e., range in which it dwindles) and stability (how stable it has been). In such situations the growth in the income levels of the population living below the poverty level (BPL) can never be measured accurately (due to higher inflation the section will show higher income) and the government will never be able to measure the *real* impact of the poverty alleviation programmes it runs for the population.

Here, one important aspect of income needs to be understood. Income of a person has three forms—the first form is ***nominal income*** (the wage someone gets in hand per day or per month), the second form is ***real income*** (this is nominal income minus the present day rate of inflation—adjusted in percentage form), and the last one is the ***disposable income*** (the net part of wage one is free to use which is derived after deducting the direct taxes from the real/nominal income, depending upon the need of data). What happens in practice is that while the nominal income might have increased by only 5 per cent, it looks 15 per cent if the inflation is at the 10 per cent level. Unlike India, among the developed nations, inflation has been around 2 per cent for many decades (it means it has been at lower levels and stable, too. This is why the difference between the incomes at constant and current prices among them are narrow and they calculate their national income at current prices. They get more reliable and realistic data of their income).

TAXES & NATIONAL INCOME

While accounting/calculating national income the taxes, direct and indirect, collected by the governments, needs to be considered. In the case of India, to the extent the **direct taxes** (individual income tax, corpoarate income tax, i.e., the corporate tax, divident tax, interest tax, etc.) are concerned, there is no need of adjustment whether the national income is accounted at factor cost or market cost. This is so because at both the 'costs' they have to be the same; besides these taxes are collected at the incomes of the concerned person or group.

But the amount of **indirect taxes** (cenvat, customs, central sales tax, sales tax/vat, state excise, etc.) needs to be taken care of if the national income is accounted at 'factor cost' (which is the case with India). If the national income is calculated at factor cost then the corpus of the total indirect taxes needs to be deducted from it. Why so? This is because, they have been added twice: once in the hands of the people/group who pay them (because they pay for it from their 'disposable income' while puchasing things) and other in the hands of the governments (as their income receipts). Collection/source of indirect taxes are the *'disposable income'* (which individuals and companies have with them after paying their direct taxes—from which they do any purchasing and finally, the indirect taxes reach the various governments). Thus, if the national income is calculated at factor cost, the formula to seek it will be:

National Income at Factor Cost = NNP at Market Cost – Indirect Taxes

However, if the national income is being derived at 'market cost', the indirect taxes do not need to be deducted from it. In this case, the

governments need not add their income accruing from indirect taxes to the national income either. It means, that the confusion in the case of national income accounting at factor cost is only related with indirect taxes.

Subsidies & National Income

Similar to the indirect taxes, the various subsidies which are forwarded by the governments need to be adjusted while calculating national income. They are added to the national income at market cost, in case of India. Subsidies are added in the national income at market cost to derive the national income at factor cost . This is because the price at which the subsidised goods and services are made available by the governments are not their real factor costs (subsidies are forwarded on the factor costs of the goods and services) otherwise we will have a distorted value (which will be less than its real value). Thus the formula will be:

National Income at Factor Cost = NNP at Market Cost + Subsidies

If the national income is derived at the market cost and governments forward no subsidies there is no need of adjustments for the subsidies, but after all there is not a single economy in the world today which does not forward subsidies in one or the other form.

Putting 'indirect taxes' and 'subsidies' together, India's National Income will be derived with the following formula (as India does it at factor cost):

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

Revision in the Base Year and Method of National Income Accounting

The Central Statistics Office (CSO), in January 2015, released the **new** and **revised** data of National Accounts, effecting two changes:

1. The *Base Year* was revised from 2004–05 to 2011–12. This was done in accordance with the recommendation of the National Statistical Commission (NSC), which had advised to revise the base year of all economic indices every five years.
2. This time, the *methodology* of calculating the National Accounts has also been revised in line with the requirements of the System of National Accounts (SNA)-2008, an internationally accepted standard.

The **major changes** incorporated in this revision are as given below:

(i) **Headline growth rate** will now be measured by *GDP at constant market prices*, which will henceforth be referred to as 'GDP' (as is the practice internationally). Earlier, growth was measured in terms of growth rate in *GDP at factor cost and at constant prices.*

(ii) Sector-wise estimates of Gross Value Added (GVA)[15] will now be given at **basic prices**[16] instead of factor cost. The relationship between GVA at factor cost, GVA at basic prices, and GDP (at market prices) is given below:

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15. GVA, which measures the difference in value between the final good and the cost of ingredients used in its production, widens the scope of capturing more economic activity than the earlier 'factor cost' approach—a sum of the total cost of all factors used to produce a good or service, net of taxes and subsidies.
16. The **basic price** is the amount receivable by the producer from the purchaser for a unit of a good or service produced as output minus any tax payable (such as sales tax or VAT the buyer pays), and plus any subsidy receivable, on that unit as a consequence of its production or sale; it excludes any transport charges invoiced separately by the producer. In other words, the basic price is what the seller collects for the sale, as opposed to what the buyer pays.

GVA at basic prices = CE + OS/MI + CFC + production taxes less production subsidies.

GVA at factor cost = GVA at basic prices – production taxes less production subsidies.

GDP = GVA at basic prices + product taxes – product subsidies.

[Where, **CE** : compensation of employees; **OS**: operating surplus; **MI**: mixed income; and **CFC**: consumption of fixed capital. **Production taxes** or **production subsidies** are paid or received with relation to production and are independent of the volume of actual production. Some examples of **production taxes** are *land revenues, stamps and registration fees* and *tax on profession*. Some **production subsidies** are subsidies to Railways, input subsidies to farmers, subsidies to village and small industries, administrative subsidies to corporations or cooperatives, etc. **Product taxes** or **subsidies** are paid or received on per unit of product. Some examples of product taxes are excise tax, sales tax, service tax and import and export duties. **Product subsidies** include food, petroleum and fertilizer subsidies, interest subsidies given to farmers, households, etc., through banks, and subsidies for providing insurance to households at lower rates].

(iii) Comprehensive coverage of the *corporate sector* both in manufacturing and services by incorporation of annual accounts of companies as filed with the Ministry of Corporate Affairs (MCA) under their e-governance initiative, MCA21. Use of MCA21 database for manufacturing companies has helped account for activities other than manufacturing undertaken by these companies.

(iv) Comprehensive coverage of the *financial sector* by inclusion of information from the accounts of stock brokers, stock exchanges, asset management companies, mutual funds and pension funds, and the regulatory bodies including the Securities and Exchange Board of India (SEBI), Pension Fund Regulatory and Development Authority (PFRDA) and Insurance Regulatory and Development Authority (IRDA).

(v) Improved coverage of activities of *local bodies* and *autonomous institutions*, covering around 60 per cent of the grants/ transfers provided to these institutions.

Owing to these changes, estimates of GVA both at aggregate and sectoral levels have undergone changes. The sector-wise shares in aggregate GVA have undergone significant revision especially in the case of manufacturing and services. Changes have also been observed in the growth rates in GVAs of individual sectors and contribution of each sector to overall GVA due to use of sales tax and service tax data for estimation in the years 2012-13 and 2013-14. Caution needed to be exercised while comparing estimates and growth rates from the earlier series to the new series, as per the CSO.

The lates set of data for the National Income of India for **2014–15** *(as per the revised Base Year and new Methodology of the CSO, announced in January 2015)* are as given below:

(i) **GDP** (at Constant Market Price): Rs. 1,06,56,925 and Growth Rate at 7.4 per cent.

(ii) **GVA** at Basic Price (at 2011–12 prices): Rs. 98, 57, 672 and Growth Rate at 7.5 per cent.

(iii) **Per Capita Net National Income** (at Current Market Prices): Rs. 88,533.

UNIQUENESS OF THE INDIAN ECONOMY

Indian economy did show some traits[17] which were unique:

(i) The contribution of the primary sector in the GDP has fallen down regularly and today it stands at 14.1 per cent, which is sufficient to conclude that it is no more an agrarian economy.

(ii) The share of its tertiary sector increased to over 66 per cent in the GDP by 2014–15. This proves India is a service economy.

(iii) The dependency of population on the primary sector for its employment still remains at over 56.8 per cent, a symptom of an agrarian economy. The expansion of industries was not sufficient to attract the labour force from the primary activities. India is still lagging on this front badly.

(iv) The share of the secondary sector in the GDP is at 18.4 per cent and never crossed 40 per cent.

(v) In the last decade (2003–04 to 2014–15), growth has increasingly come from the services sector, whose contribution to the overall growth of the economy has been 64 per cent, while that of the industry and agriculture sectors have been 26 per cent and 10 per cent, respectively.

(vi) India has been basically the first case which directly had either over 50 per cent of its GDP coming from the primary sector or the tertiary sector—an agrarian economy shifting directly to the service economy (at least partially, if we forget the dependency ratio of the population on the sectors). It means India jumped the stage of being a fully-developed industrial economy.

Without fully realising the industrial and manufacturing potential and directly converting into a service economy, has created tougher macro and micro challenges for policymakers in India.

17. As per information made available by the ***Central Statistical Organisation,*** Feb. 2014, GoI, New Delhi; ***Economic Survey 2014-15,*** MoF, GoI, New Delhi and the ***India 2015,*** Pub. Div., MoIB, GoI, New Delhi.

CHAPTER

2

GROWTH, DEVELOPMENT AND HAPPINESS

- Introduction
- Progress
- Economic Growth
- Economic Development
- Happiness

*Since 1971, Bhutan has rejected GDP as the only way to measure progress–in its place, it has championed a new approach to development, which measures prosperity through formal principles of gross national happiness (GNH) and the spiritual, physical, social and environmental health of its citizens and natural environment. For decades, this belief that wellbeing should take preference over material growth has remained a global oddity. Now, in a world beset by collapsing financial systems, gross inequity and wide-scale environmental destruction, this tiny Buddhist state's approach is attracting a lot of interest. In 2011, the UN adopted Bhutan's call for a holistic approach to development, a move endorsed by 68 countries. A UN panel is now considering ways that Bhutan's GNH model can be replicated across the globe.**

* *As Annie Kelly writes in* The Guardian, *Washington, DC, 1st December. 2012.*

INTRODUCTION

Similar to seers and philosophers economists were also party to human's quest for a better tomorrow. We have been a witness to a number of notions coming in from the literature of Economics in this area—starting with a very humble and layman's word like 'progress' to technical terms like 'growth', 'development' and 'human development'. With greater dependence on the idea of the 'economic man', the world created immense wealth in the post-War decades. It was in the 1980s that social scientists started finer studies in the area of mankind's actions, finally challenging the very idea of the 'economic man' ('rational man'). And there starts mankind's urge to introspect the lives of humanity on the planet earth. Meanwhile, humanity was faced with an unique riddle of climate change. By now, courtesy the UNO, the world has the World Happiness Report.

PROGRESS

Progress is a general term frequently used by experts to denote betterment or improvement in anything. In economics, the term was used for a long time to show the positive movement in the lives of people and in an economy. It had both quantitative and qualitative aspects to it. After a point of time, some economists started using all the three terms—progress, growth and development—interchangeably to mean almost the same thing. But it was only during the 1960s, 1970s and 1980s that a clear meanings of these terms really evolved.[1] The term 'progress' became a general term with no specific meaning in economics or denoting both growth and development. But growth and development were allotted their clear-cut meanings.

ECONOMIC GROWTH

A term coming from the life sciences, 'growth' in economics means economic growth. An increase in economic variables over a period of time is—economic growth. The term can be used in an individual case or in the case of an economy or for the whole world. The most important aspect of growth is its *quantifiability,* i.e., one can measure it in absolute terms.[2] All the units of measurement may be applied to show it, depending upon the economic variable, where the growth is being studied. We have a few examples:

(i) An economy might have been able to see growth in food production during a decade which could be measured in tonnes.

(ii) The growth of road network in an economy might be measured for a decade or any period in miles or kilometres.

(iii) Similarly, the value of the total production of an economy might be measured in currency terms which means the economy is growing.

(iv) Per capita income for an economy might be measured in monetary terms over a period.

We may say that ***economic growth is a quantitative progress.***

To calculate the ***growth rate*** of an economic variable the difference between the concerned period is converted into percentage form. For example, if a dairy farm owner produced 100 litre of milk last month and 105 litre in the following month, his dairy has a growth rate of 5 per cent. Similarly, we may calculate the growth rate of an economy for any given successive periods. Growth rate is an ***annual concept*** which may be used

1. Based on the analyses in Michael P. Todaro and Stephen C. Smith, ***Economic Development,*** Pearson Education, 8th Ed., New Delhi, 2004, pp. 9–11.
2. As the IMF and the WB considered this yardstick of development as quoted in Gerald M. Meier and James E. Rauch, ***Leading Issues in Economic Development,*** Oxford University Press, New Delhi, 2006, pp. 12–14.

otherwise with the clear reference to the period for which it is used.

Though growth is a value neutral term, i.e., it might be positive or negative for an economy for a period, we generally use it in the positive sense. If economists say an economy is growing it means the economy is having a positive growth otherwise they use the term '***negative growth***'.

Economic growth is a widely used term in economics which is useful in not only national level economic analyses and policymaking but also highly useful in the study of comparative economics. International level financial and commercial institutions go for policymaking and future financial planning on the basis of the growth rate data available for the economies of the world.

ECONOMIC DEVELOPMENT

For a comparatively longer period of time after the birth of economics, economists remained focused on aspects of expanding the quantity of production and income of a country's economy. The main issue economists discussed was—how to increase the quantity of production and income of a country or a nation-state. It was believed that once an economy is able to increase its production its income will also increase and there will be an automatic betterment (quality increase) in the lives of the people of the economy. There was no conscious discussion over the issue of quality expansion in the lives of the people. Economic growth was considered as a cause and effect for the betterment of lives of the people. This was the reason why economists till the 1950s failed to distinguish between growth and development though they knew the difference between these terms.

It was during the 1960s and in the later decades that economists came across many countries where the growth was comparatively higher, but the quality of life was comparatively low. The time had come to define economic development differently from what the world meant by economic growth. For economists, development indicates the quality of life in the economy which might be seen in accordance with the availability of so many variables such as:

(i) The level of nutrition
(ii) The expansion and the reach of healthcare facilities—hospitals, medicines, safe drinking water, vaccination, sanitation, etc.
(iii) The level of education among the people
(iv) Other variables on which the quality of life depends

Here, one basic thing must be kept in mind that if the masses are to be guaranteed with a basic minimum level of quality-enhancing inputs (above-given variables such as food, health, education, etc.) in their life, a minimum level of income has to be guaranteed for them. Income is generated from productive activities. It means that before assuring development we need to assure growth. Higher economic development requires higher economic growth. But it does not mean that a higher economic growth automatically brings in higher economic development—a confusion the early economists failed to clear. We may cite an example to understand the confusion: two families having same levels of income but spending differing amounts of money on developmental aspects. One might be giving little attention to health, education and going for saving and the other might not be saving but taking possible care of the issues of health and education. Here the latter necessarily will have higher development in comparison to the former. Thus, we may have some diverse cases of growth and development:

(i) Higher growth and higher development
(ii) Higher growth but lower development
(iii) Lower growth but higher development

The above-given combinations, though comparative in nature make one thing clear, that, just as for higher income and growth we need conscious efforts, same is true about the economic development and higher economic development.

Without a conscious public policy, development has not been possible anywhere in the world. Similarly, we can say, that without growth there cannot be development either.

The first such instance of growth without development, which the economists saw, was in the Gulf countries. These economies, though they had far higher levels of income and growth, the levels of development were not of comparable levels. Here started the branch of economics which will be known as *'development economics'*. After the arrival of the WB and the IMF, conscious economic policies were framed and prescribed for the growth and development of less developed economies.

We can say that ***economic development is quantitative as well as qualitative progress*** in an economy.[3] It means, when we use the term growth we mean quantitative progress and when we use the term development we mean quantitative as well as qualitative progress. If economic growth is suitably used for development, it comes back to accelerate the growth and ultimately greater and greater population brought under the arena of development. Similarly, high growth with low development and ill-cared development finally results in fall in growth. Thus, there is a circular relationship between growth and development. This circular relationship broke down when the Great Depression occurred. Once the concept of the *'welfare state'* got established, development became a matter of high concern for the governments of the world, policymakers and economists alike. A whole new branch of economics—***welfare economics*** has its origin in the concept of welfare state and the immediacy of development.

Measuring Development

Although economists were able to articulate the differences between growth and development (Mahbub ul Haq, a leading Pakistani economist had done it by the early 1970s), it took some more time when the right method of measuring development could be developed. It was an established fact that the goal of progress goes beyond mere 'increase in income'. International bodies such as the UNO, IMF and WB were concerned about the development of the comparatively underdeveloped regions of the world. But any attempt in this direction was only possible once there was a tool to know and measure the developmental level of an economy and the determinants which could be considered as the traits of development. The idea of developing a formula/method to measure the development was basically facing two kinds of difficulties:

(i) At one level it was difficult to define as to what constitutes development. Factors which could show development might be many, such as levels of income/consumption, quality of consumption, healthcare, nutrition, safe drinking water, literacy and education, social security, peaceful community life, availability of social prestige, entertainment, pollution-free environment, etc. It has been a real difficult task to achieve consensus among the experts on these determinants of development.

(ii) At the second level it looked highly difficult to quantify a concept as development constitutes quantitative as well as qualitative aspects. It is easy to compare qualitative aspects such as

3. *World Bank, **World Development Report 1991,*** Oxford University Press, New York, 1991, p. 4.

beauty, taste, etc., but to measure them we don't have any measuring scale.

HUMAN DEVELOPMENT INDEX

The dilemma behind comparatively measuring the developmental level of economies was solved once the United Nations Development Programme (UNDP) published its first Human Development Report (HDR) in 1990. The report had a human development index (HDI) which was the first attempt to define and measure the levels of development. The 'index' was a product of select team of leading scholars, development practioners and members of the Human Development Report office of the UNDP. The first such team which developed the HDI was led by **Mahbub ul Haq** and **Inge Kaul.** The term 'human development' is a corollary of 'development' in the index.

The HDR measures development by combining three indicators—*Health, Education* and *Standard of Living*—converted into a composite human development index, the HDI. The creation of a single statistic in HDI was a real breakthrough which was to serve as a frame of reference for both 'social' and 'economic' development. The HDI sets a minimum and a maximum for each dimension, called *goalposts*, and then shows where each country stands in relation to these goalposts, expressed as a value between 0 and 1 (i.e., the index is prepared on the *scale of one*). The *three* indicators[4] used to develop the composite index are as given below:

The **Education** component of the HDI is ***now*** (since HDR-2010) measured by two other indicators–

(i) **Mean of years of schooling (for adults aged 25 years):** This is estimated based on educational attainment data from censuses and surveys available in the UNESCO Institute for Statistics database and *Barro and Lee* (2010) methodology.

(ii) **Expected years of schooling (for children of school entering age):** These estimates are based on enrolment by age at all levels of education and population of official school age for each level of education. Expected years of schooling is capped at 18 years.

These indicators are normalised using a minimum value of zero and maximum values are set to the actual observed maximum value of mean years of schooling from the countries in the time series, 1980–2012, that is 13.3 years estimated for the United States in 2010. The *education index* is the geometric mean of two indices.

The **Health** component is measured by the *life expectancy* at birth component of the HDI and is calculated using a minimum value of 20 years and maximum value of 83.57 years. This is the observed maximum value of the indicators from the countries in the time series, 1980–2012. Thus, the longevity component for a country where life expectancy birth is 55 years would be 0.551.

The **Standard of Living** component is measured by ***GNI*** (Gross National Income/ Product) per capita at 'Purchasing Power Parity in US Dollars' (PPP $) instead of GDP per capita (PPP $) of past. The *goalpost* taken for minimum income is $100 (PPP) and the maximum is US $87,478 (PPP), estimated for Qatar in 2012. The HDI uses the logarithm of income, to reflect the diminishing importance of income with increasing GNI.

The scores for the three HDI dimension indices are then aggregated into a composite index using geometric mean. The HDI facilitates instructive comparisons of the experiences within and between different countries.

The UNDP ranked[5] the economies in accordance of their achievements on the above-

4. ***Human Development Report, 2013*** and ***Human Development Report, 2010,*** United Nations Development Programme, New York, USA, 2013.
5. Todaro and Smith, ***Economic Development***, p. 58.

given three parameters on the scale of one (i.e., 0.000–1.000). As per their achievements the countries were broadly classified into three categories with a range of points on the index:

(i) High Human Development Countries: 0.800–1.000 points on the index.

(ii) Medium Human Development Countries: 0.500–0.799 points on the index.

(iii) Low Human Development Countries: 0.000–0.499 points on the index.

The *Human Development Report, 2013* is discussed in Chapter 22 together with India's relative position in the world.

The Debate Continues

Though the UNDP commissioned team had evolved a consensus as to what constitutes development, academicians and experts around the world have been debating this issue. By 1995 economies around the world had officially accepted the concept of human development propounded by the UNDP. Basically, the UNDP designed HDR was used by the World Bank since the 1990s to quantify the developmental efforts of the member countries and cheap developmental funds were allocated in accordance. Naturally, the member countries started emphasising on the parameters of income, education and life expectancy in their policymaking and in this way the idea of HDI got obligatory or voluntary acceptance around the world.

For many years, experts and scholars came up with their own versions of defining development. They gave unequal weightage to the determinants defining development, as well as selected some completely different parameters which could also denote development in a more suitable way according to them. Since quality is a matter of value judgement and a normative concept, there was scope for this representation. Most of such attempts were not prescriptions for an alternative development index, but they were basically trying to show the incompleteness of the HDI, via intellectual satires. One such attempt was made by the economists and scholars of the London School of Economics in 1999 which concluded Bangladesh as the most developed country in the world with the USA, Norway, Sweden getting one of the lowest ranks in the index.

Basically, it is very much possible to come out with such an index. As for example, we may say that peace of mind is a necessary element of development and betterment in human life which depends heavily on the fact as to how much sleep we get everyday. Housetheft and burglary are major determinants of a good night sleep which in turn depends on the fact as how assured we go to sleep in our homes at night from burglars and thieves. It means we may try to know a good sleep by the data of thefts and burglaries in homes. Since minor housethefts and burglaries are under-reported in police stations, the surveyor, suppose tried to know such cases with data as how much 'locks' were sold in a country in a particular year. In this way a country where people hardly have anything to be stolen or no risk of being burgled might be considered having the best sleep in night, thus the best peace of mind and that is why this will be the most developed country.

Basically, the HDI could be considered as one possible way of measuring development which was evolved by the concerned group of experts with the maximum degree of consensus. But the index which calculates the development of economies on certain parameters might be overlooking many other important factors which affect the development of an economy and standard of living. As per experts, such other determinants affecting our living conditions might be:

(i) Cultural aspects of the economy,

(ii) Outlook towards aesthetics and purity of the environment,

(iii) Aspects related to the rule and administration in the economy,

(iv) People's idea of happiness and prestige,

(v) Ethical dimension of human life, etc.

INTROSPECTING DEVELOPMENT [6]

Confusion about the real meaning of development did start only after the World Bank and the International Monetary Fund came into being, i.e., post-war. As experts were studying the development process of the developing world, they were also surveying the performance reports of the developed world. As the western world had been declared the developed countries having top twenty ranks on the HDI, social scientists started evaluating the conditons of life in these economies. Most of such studies concluded that life in the developed world is every thing but happy. Crime, corruption, burglaries, extortion, drug trafficking, flesh trade, rape, homicide, moral degradation, sexual perversion, etc.—all kinds of the so-called vices were thriving in the developed world. It means development had failed to deliver them happiness, peace of mind, a general well-being and a feeling of being in good state. Scholars started questioning the very efforts being made for development around the world. Most of

6. There were diverse opinions about the real meaning of 'development'—by mid—1940s upto almost the whole 1950s it meant 5–7 per cent growth rate in an economy—even by the IMF and WB. By the late 1960s ***new views*** of development started emerging. **Arthur Lewis** had seen development in the sense of *human freedom* in 1963 itself when he concluded that "the advantage of economic growth is not that wealth increases happiness, but that it increases the range of human choice." For him development means a freedom from 'servitude'—mankind could be free to have choices to lead a life full of material goods or in spiritual contemplation (W. Arthur Lewis, ***The Theory of Economic Growth,*** Allen & Unwin, London, 1963, p. 420).

   For **Dudley Seers** development meant more employment and equality besides a falling poverty (***The Meaning of Development,*** a paper presented at the 11th World Conference of the Society for International Development, New Delhi, 1969, p. 3). Dudley Seers was later supported by many other economists such as **Denis Goulet** (***The Cruel Choice: A New Concept in the Theory of Development,*** Atheneum, New York, 1971, p. 23), Richard Brinkman (1995), P. Jegadish Gandhi (1996) and many others.

   The **International Labour Organization** (ILO) had also articulated by the mid-1970s that economic development must be able to deliver the economic ability that people can meet their basic needs (the concept of 'sustenance') besides the elimination of absolute poverty, creating more employment and lessening income inequalities (***Employment, Growth and Basic Needs,*** ILO, Geneva, 1976). **Amartya Sen** articulated a similar view via his ideas of 'capabilities' and 'entitlements' ("Development: Which Way Now?", ***Economic Journal 93,*** December 1983, pp. 754–57.).

   By 1994, the United Nations looked to including the element of 'capabilities' in its idea of development when it concludes that ***human beings are born with certain potential capabilities and the purpose of development is to create an environment in which all people can expand their capabilities in present times and in future. Wealth is important for human life. But to concentrate exclusively on it is wrong for two reasons. First, accumulating wealth is not necessary for the fulfillment of some important human choices.... Second, human choices extend far beyond economic well-being (Human Development Report 1994, UNDP,*** Oxford University Press, New York, 1994, pp. 13–15).

   The **World Bank** by 1991 had also changed its view about development and had concluded that for improving *quality of life* we should included education, health, nutrition, less proverty, cleaner environment, equality, greater freedom and richer cultural life as the goals of development.

   Amartya Sen, a leading thinker on the meaning of development attracted attention for articulating human goals of development. He opined that enhancing the lives and the freedoms, we enjoy should be the concerns of development known as the 'capabilities' approach to development (see his ***Commodities and Capabilities***, North Holland, Amsterdam, 1985 and ***Development as Freedom***. Alfred Knopf. New York, 1999.).

them have suggested a re-defining of development which could deliver happiness to mankind.

Why development has not delivered happiness to the developed world? The answer to this question does not lie in any one objective fact but touches so many areas of human life. First, whenever economists from the outset talked about progress they meant overall happiness of human life.

Social scientists, somehow have been using terms such as progress, growth, development, well-being, welfare as synonyms of ***'happiness'***. Happiness is a normative concept as well as a state of mind. Therefore, its idea might vary from one economy to the other.

Second, the period in which development was defined, it was considered that with the supply of some selected material resources human life can be improved. These resources were pin-pointed as, a better level of income, proper level of nutrition, healthcare facilities, proper levels of literacy and education, etc.

Happiness is a broader thing than development. The so-called 'development' for which the world has been striving hard for the last many decades is capable of delivering material happiness to mankind. Happiness has its non-material side also. It means while the world has been trying to maximise its developmental prospects, i.e., material happiness, it could not attend the non-material part of happiness. The non-material part of our life is rooted in ethics, religion, spiritualism and cultural values. As development or human development was defined in material terms, it could only deliver us material happiness which is visibly available in the developed world. Due to partial definition of development the developed world has been able to achieve development, i.e., happiness but only of material kind and for the non-material part of happiness, we naturally need to redefine our 'ideas' of development today or tomorrow.

Somehow a very small kingdom had been able to define development in its own way, which included material as well as non-material aspects of life into it and named it the Gross National Happiness (GNH). This country is Bhutan.

Gross National Happiness: Bhutan, a small Himalayan kingdom and an economic non-entity, developed a new concept of assessing development in the early 1970s—the Gross National Happiness (GNH). Without rejecting the idea of human development propounded by the UNDP, the kingdom has been officially following the targets set by the GNH. Bhutan has been following up the GNH since 1972 which has the following parameters to attain happiness/development:

(i) Higher real per capita income

(ii) Good governance

(iii) Environmental protection

(iv) Cultural promotion (i.e., inculcation of *ethical* and *spiritual* values in life without which, it says, progress may become a curse rather than a blessing)

At the level of real per capita income, the GNH and the HDI are the same. Though the HDI is silent on the issue of 'good governance', today it should be considered as being promoted around the world once the World Bank came with its report on it in 1995 and enforced it upon the member states. On the issue of protecting environment, though the HDI didn't say anything directly, the World Bank and the UNO had already accepted the immediacy of sustainable development by then and by early 1990s there was a seperate UN Convention on the matter (follow up on this convention has been really very low till date which is a different issue).

It means the basic difference between the GNH and the HDI looks at the level of assimilating the ethical and spiritual aspects into our (UNDP's) idea of development.

An impartial analysis sufficiently suggests that material achievements are unable to deliver us happiness devoid of some ethics at its base. And ethics are rooted in the religious and spiritual texts. But the new world is guided by its own scientific and secular interpretation of life and the world has always been suspicious about recognising the spiritual factor in the human life. Rather the western idea of secularism was defined after rejecting the very existence of anything like God and also rejecting the whole traditional hypothesis of spiritualism as instances of ignorance and orthodoxy. And there should not be any doubt in accepting it that the western ideology in the name of development has ultimately, dominated the modern world and its way of life. The idea of development which was followed by the larger part of the world has been cent per cent 'this-worldly'. And anybody can assess today what kind of happiness the world has been able to have for itself at the end.

A recent study by a senior economist from the UNDP on the Bhutanese development experience under the GNH has vindicated the idea of 'gross happiness' which development must result into. As per the study, the period 1984–98 has been spectacular in terms of development with life expectancy increasing by a hopping 19 years, gross school enrolment reaching 72 per cent and literacy touching 47.5 per cent (from just 17 per cent).[7]

After the terror attack on the World Trade Centre in the USA the whole world has gone for a psychic metamorphosis and at least the euphoria of development from this world to that world has been shaken from its very base. The world which is in the process of globalisation at one hand has started introspecting whether multicultural co-existence is possible. The Human Development Report of 2004 was titled as *Cultural Liberty in Today's Diverse World.* We may conclude that mankind is passing through a phase of serious introspection and transition where the dominant view in the world may metamorphose into redefining the very idea of development by including ethical values and spiritualism as important parts. But till now the proponents of development look shy in believing and accepting that there exists a non-material part of life, which needs to be realised to make our development result into happiness.

HAPPINESS

The *World Happiness Report 2013* was published by the United Nations Sustainable Development Solutions Network, in September 2013. The report—a 156-nation survey—is second of its kind (after the WHR 2012) released by a coalition of researchers.[8] The report measures *happiness* and *well-being* in countries around the world **to help guide public policy**. The Happiness report ranks nations on the basis of **six** key factors:

(i) GDP per capita,
(ii) Healthy life expectancy,
(iii) Someone to count on,
(iv) Perceived freedom to make life choices,
(v) Freedom from corruption, and
(vi) Generosity.

The happiest nation was Denmark followed by Norway, Switzerland, Netherlands, Sweden,

7. **Stefan Priesner**, a senior economist with the UNDP conducted the study for the John Hopkins University, USA, in 2005.
8. Both the WHRs have three editors: **1. John F. Helliwell**, Vancouver School of Economics, University of British Columbia, and the Canadian Institute for Advanced Research (CIFAR); **2. Richard Layard**, Director, Well-Being Programme, Centre for Economic Performance, London School of Economics; **3. Jeffrey D. Sachs**, Director, The Earth Institute, Columbia University. [The reports were written by a group of independent experts acting in their personal capacities—any views expressed in this report do not necessarily reflect the views of any organisation, agency or programme of the United Nations].

Canada, Finland, Austria, Iceland and Australia in the top 10 positions, respectively. Interestingly and ironically, the US was ranked number 17, just behind Mexico. Last year, the US was ranked 23. India is ranked 111.

The world is now in the midst of a major policy debate about the objectives of public policy. What should be the world's Sustainable Development Goals for the period 2015–2030—the *World Happiness Report (WHR)* of 2013 is offered as a contribution to that crucial debate. As per Jeffery Sachs, 'there is now a rising worldwide demand that policy be more closely aligned with what really matters to people as they themselves characterize their well-being'.

The Meaning of Happiness

The word 'happiness' is quite complex and is not used lightly. Happiness is an aspiration of every human being, and can also be a measure of social progress. Yet, are the citizens of different countries, happy? If they are not, what if anything can be done about it? The key to proper measurement must begin with the meaning of the word 'happiness.' As per the WHR 2013, the problem, of course, is that happiness is used in at least **two** ways :

(i) As an emotion ['Were you happy yesterday?'], and
(ii) As an evaluation ['Are you happy with your life as a whole?'].

If individuals were to routinely mix up their responses to these very different questions, then measures of happiness might tell us very little. Changes in reported happiness used to track social progress would perhaps reflect little more than transient changes in emotion. Or impoverished persons who express happiness in terms of emotion might inadvertently diminish society's will to fight poverty. Fortunately, respondents to the happiness surveys do not tend to make such confusing mistakes. Both the WHRs did show that the respondents of the surveys clearly recognise the difference between *happiness as an emotion* and *happiness in the sense of life satisfaction*. The responses of individuals to these different questions are highly distinct. A very poor person might report himself to be happy emotionally at a specific time, while also reporting a much lower sense of happiness with life as a whole; and indeed, people living in extreme poverty do express low levels of happiness with life as a whole. Such answers should spur our societies to work harder to end extreme poverty.

The ***WHR 2013*** is based on the primary measures of subjective well-being;[9] life evaluations;[10] life satisfaction;[11] and happiness with life as a whole.[12] Thus, happiness, appears twice, once as an emotional report, and once as part of a life evaluation, giving considerable evidence about the nature and causes of happiness in both its major senses.

Trends in Happiness

The report presents data for the world showing the levels, explanations, changes and equality

9. ***Guidelines on Measuring Subjective Well-being***, OECD, Paris, 2013.
10. Used in the ***World Values Survey***, the ***European Social Survey*** and many other national and international surveys. It is the core 'life evaluation' question recommended by the OECD (2013), and in the first ***World Happiness Report***.
11. The *Gallup World Poll (GWP)* – the GWP includes the 'life satisfaction' question on 0 to 10 scale on an experimental basis, giving a sample sufficiently large to show that when used with consistent samples the two questions provide mutually supportive information on the size and relative importance of the correlates.
12. The ***European Social Survey*** contains questions about 'happiness with life as a whole', and about life satisfaction, both on the same 0 to 10 numerical scale. The responses provide the scientific base to support the WHR findings that answers to the two questions give consistent (and mutually supportive) information about the correlates of a good life.

of happiness. The world has become a ***slightly happier*** and ***more generous*** place over the past five years despite the obvious detrimental happiness impacts of the financial crisis (2007-08), as per the report. Because of continuing improvements in most supports for better lives in Sub-Saharan Africa, and of continued convergence in the quality of the social fabric within greater Europe, there has also been some progress toward equality in the distribution of well-being among global regions. There have been important continental crosscurrents within this broader picture. Improvements in quality of life have been particularly notable in Latin America and the Caribbean, while reductions have been the norm in the regions most affected by the financial crisis, Western Europe and other western industrial countries; or by some combination of financial crisis, and political and social instability, as in the Middle East and North Africa.

The HDR Linkage

The *WHR 2013* investigates the conceptual and empirical relationships between 'human development' (the UNDP idea used in the *Human Development Report*) and 'life evaluation' approaches to understanding human progress. It argues that both approaches were, at least in part, motivated by a desire to consider progress and development in ways that went beyond GDP, and to put people at the centre. And while 'human development' is at heart a conceptual approach, and 'life evaluation' an empirical one, there is considerable overlap in practice—many aspects of human development are frequently used as key variables to explain subjective well-being. The two approaches provide complementary lenses which enrich our ability to assess whether life is getting better.

Conclusion

At the end, it may be concluded that there is now a rising worldwide demand that policy be more closely aligned with ***what really matters to people*** as they themselves characterise their lives. In past few years, more and more world leaders (such as the German Chancellor Angela Merkel, South Korean President Park Geun-hye and British Prime Minister David Cameron) have been talking about the importance of well-being as a guide for their nations and the world. The 2013 *World Happiness Report* has been published in support of these efforts to bring the study of happiness into public awareness and public policy. This report offers rich evidence that the systematic measurement and analysis of happiness can teach us much about ways to improve the world's well-being and sustainable development. Now it depends on the nations as how they use the findings of the *WHR*.

THE BACKGROUND

In July 2011 the UN General Assembly passed a historic resolution.[13] It invited member countries to measure the happiness of their people and to use this to help guide their public policies. This was followed in April 2012 by the **first** UN high-level meeting on happiness and well-being, chaired by the Prime Minister of Bhutan. At the same time the **first** *World Happiness Report* was published,[14] followed some months later by the OECD Guidelines setting an international standard for the measurement of well-being.[15]

REIMAGINING THE IDEA OF HAPPINESS

Search for a 'happier' life for humanity has been the ultimate aim of not only saints, seers, and philosophers but of economists too. The whole

13. UN General Assembly, **Happiness: Towards a Holistic Approach to Development,** 19 July 2011.
14. J. F. Helliwell, R. Layard & J. Sachs (Eds.), **World Happiness Report 2012,** Earth Institute, New York, USA, 2012.
15. **Guidelines on Measuring Subjective Well-being,** OECD, Paris, 2013.

gamut of economics literature on progress, growth, development is ultimately aimed at bringing more 'happiness' into the lives of human beings. Over the time, diverse ideological currents impressed upon the humanity to take variety of 'meanings' out of the highly subjective term 'happiness'—and finally, the humanity is where it is today.

A time also came when many scholars and world leaders raised the ultimate question—are we happier today? And in the wake of this increased 'scrutiny' around the world, there came the UN resolution of 2011 which invited member countries to measure the happiness of their people and to use this to help guide their public policies. The *WHR 2012* itself provides a very interesting and eye-opening inquiry into the state of human happiness in the world. To understand the 'shift' which is expected to take place among policymakers around the world in coming years, it will be better to ***lift some ideas*** from the **first *WHR***:[16]

(i) This is an age of stark contradictions. While at the one hand the world enjoys technologies of unimaginable sophistication at the other hand, at least one billion people ae living without enough to eat. The world economy is propelled to soaring new heights of productivity through ongoing technological and organisational advances; yet it is relentlessly destroying the natural environment in the process. Countries achieve great progress in economic development as conventionally measured; yet along the way countries succumb to new crises of obesity, smoking, diabetes, depression, and other ills of modern life. These contradictions would not come as a shock to the greatest sages of humanity, including **Aristotle** and the **Buddha**, who taught humanity, time and again, that material gain alone will not fulfil our deepest needs. Material life must be harnessed to meet these human needs, most importantly to promote the end of suffering, social justice and the attainment of happiness.

(ii) The *WHR 2012* takes one key example from the USA—the world's economic superpower—which has achieved striking economic and technological progress over the past half century without gains in the self-reported happiness of the citizenry with the following serious 'concerns' of today:

(a) uncertainties and anxieties are high,

(b) social and economic inequalities have widened considerably,

(c) social trust is in decline, and

(d) confidence in government is at an all-time low.

Perhaps for these reasons, life satisfaction in the USA has remained nearly constant during the decades of rising Gross National Product (GNP) per capita.

(iii) The realities of poverty, anxiety, environmental degradation, and unhappiness in the midst of great plenty should not be regarded as mere curiosities. They require our urgent attention, and especially so at this juncture in human history. For we have entered a new phase of the world, termed the *Anthropocene*[17] by the world's Earth system scientists. The

16. J. F. Helliwell, R. Layard & J. Sachs (Eds.), ***World Happiness Report- 2012,*** Earth Institute, New York, USA, 2012.

17. The Anthropocene is a newly invented term that combines two Greek words: 'anthropo' for human; and 'cene' for new, as in a new geological epoch. The Anthropocene is the new epoch in which humanity, through its technological prowess and population of 7 billion, has become the major driver of changes of Earth's physical systems, including the climate, carbon cycle, water cycle, nitrogen cycle and biodiversity.

Anthropocene will necessarily reshape our societies. If we continue mindlessly along the current economic trajectory, we risk undermining the Earth's life support systems—food supplies, clean water and stable climate—necessary for human health and even survival in some places. In years or decades, conditions of life may become dire in several fragile regions of the world. We are already experiencing deterioration of life support systems in the dry lands of the Horn of Africa and parts of Central Asia.

On the other hand, if we act wisely, we can protect the Earth while raising quality of life broadly around the world. We can do this by adopting *lifestyles* and *technologies* that improve **happiness** (or life satisfaction) while reducing human damage to the environment. Sustainable Development is the term given to the combination of human well-being, social inclusion and environmental sustainability. There is no doubt in concluding that the 'quest for happiness' is intimately linked to the 'quest for sustainable development'.

(iv) In an impoverished society, the urge for material gain typically makes a lot of sense. Higher household income (or higher per capita GNP) generally signifies an improvement in the life conditions of the poor. The poor suffer from dire deprivations of various kinds: lack of adequate food supplies, remunerative jobs, access to health care, safe homes, safe water and sanitation, and educational opportunities. As incomes rise from very low levels, human well-being improves. Not surprisingly, the poor report a rising satisfaction with their lives as their meager incomes increase.

On the opposite end of the income spectrum, for most individuals in the high-income world, the basic deprivations have been vanquished. There is enough food, shelter, basic amenities (such as clean water and sanitation), and clothing to meet their daily needs. In fact, there is a huge surfeit of amenities above basic needs. Poor people would swap with rich people in a heartbeat. Yet all is not well. ***The conditions of affluence have created their own set of traps.***

Most importantly, the lifestyles of the rich imperil the survival of the poor. Human-induced climate change is already hitting the poorest regions and claiming lives and livelihoods. It is telling that in much of the rich world, affluent populations are so separated from the poor that there is little recognition, practical or moral, of the adverse spillovers (or 'externalities') from their own behaviour.

(v) **Affluence** has also created its own set of afflictions and addictions (problems)—obesity, adult-onset diabetes, tobacco-related illnesses, eating disorders such as anorexia and bulimia, psychosocial disorders, and addictions to shopping, TV and gambling, are all examples of disorders of development. So too is the loss of community, the decline of social trust and the rising anxiety levels associated with the vagaries of the modern globalised economy, including the threats of unemployment or episodes of illness not covered by health insurance in the United States (and many other countries).

(vi) Higher average incomes do not necessarily improve average well-being, the US being a clear case in point, as noted famously by Professor Richard

Easterlin[18]—where GNP per capita has risen by a factor of three since 1960, while measures of average happiness have remained essentially unchanged over the half-century. The increased US output has caused massive environmental damages, notably through greenhouse gas concentrations and human-induced climate change, without doing much at all to raise the well-being even of Americans. Thus, we don't have a trade off between short-run gains to well-being versus long-run costs to the environment; we have a pure loss to the environment without offsetting short-term gains.

The ***paradox*** that Easterlin noted in the US was that at any particular time richer individuals are happier than poorer ones, but over time the society did not become happier as it became richer. This is due to ***four*** reasons:

(a) Individuals compare themselves to others. They are happier when they are higher on the social (or income) ladder. Yet when everybody rises together, relative status remains unchanged.

(b) The gains have not been evenly shared, but have gone disproportionately to those at the top of the income and education distribution.

(c) The other societal factors—insecurity, loss of social trust, declining confidence in government—have counteracted any benefits felt from higher incomes.

(d) Individuals may experience an initial jump in happiness when their income rises, but then at least partly return to earlier levels as they *adapt* to their new higher income.

(vii) These phenomena put a clear limit on the extent to which rich countries can become happier through the simple device of *economic growth*. In fact, there are still other general reasons to doubt the formula of ever rising GNP per person as the route to happiness. While higher income may raise happiness to some extent, the *quest* for higher income may actually reduce one's happiness. In other words, it may be nice to have more money but not so nice to crave it. **Psychologists** have found repeatedly that individuals who put a high premium on higher incomes generally are less happy and more vulnerable to other psychological ills than individuals who do not crave higher incomes. Aristotle and the Buddha advised humanity to follow a middle path between asceticism on the one side and craving material goods on the other.

(viii) Another problem is the creation of new material '**wants**' through the incessant ***advertising*** of products using powerful imagery and other means of persuasion. Since the imagery is ubiquitous on all of our digital devices, the stream of advertising is more relentless than ever before. Advertising is now a business of around US $500 billion per year. Its goal is to overcome satiety by ***creating wants and longings*** where none previously existed. Advertisers and marketers do this in part by preying on psychological weaknesses and unconscious urges.

18. Among the foremost contributor to the *Happiness Economics*, Easterlin is particularly known for his 1974 article **'Does Economic Growth Improve the Human Lot? Some Empirical Evidence'** (his idea, today known as the ***Easterlin Paradox,*** was proposed by him in this article). Here he concluded that contrary to expectation, happiness at a national level does not increase with wealth once basic needs are fulfilled.

Cigarettes, caffeine, sugar, and trans-fats all cause cravings if not outright addictions. Fashions are sold through increasingly explicit sexual imagery. Product lines are generally sold by associating the products with high social status rather than with real needs.

(ix) The thinking of becoming happier by becoming richer is challenged by the law of *diminishing marginal utility of income*[19]—after a certain point, the gains are very small. This means that poor people benefit far more than rich people from an added dollar of income. This is a good reason why tax-and-transfer systems among high-income OECD countries on balance take in net revenues from high-income households and make net transfers to low-income households. Put another way, the inequality of household income is systematically lower net of taxes and transfers than before taxes and transfers.[20]

(x) The ***Western economist's*** logic of ever higher GNP is built on a vision of humanity completely at variance with the wisdom of the sages, the research of psychologists, and the practices of advertisers. The economist assumes that individuals are '**rational decision-makers'** who know what they want and how to get it, or to get as close to it as possible given their budget. Individuals care largely about themselves and derive pleasure mainly through their consumption. The individual's preferences as consumers are a given or change in ways actually anticipated in advance by the individuals themselves. Some economists even say that drug addicts have acted 'rationally', consciously trading off the early benefits of drug use with the later high toll of addiction.

(xi) We understand that we need a very different model of humanity, one in which we are a complicated interplay of emotions and rational thought, unconscious and conscious decision-making, **fast** and **slow** thinking. Many of our decisions are led by emotions and instincts, and only later rationalised by conscious thought. Our decisions are easily "primed" by associations, imagery, social context and advertising. We are inconsistent or "irrational" in sequential choices, failing to meet basic standards of rational consistency. And we are largely unaware of our own mental apparatus, so we easily fall into *traps* and *mistakes*. Addicts do not anticipate their future pain; we spend now and suffer the consequences of bankruptcy later; we break our diets now because we aren't thinking clearly about the consequences. We also understand (again!) that we are **social animals** through and through. We learn through imitation, and gain our happiness through meeting *social norms* and having a sense of *belonging to the community*.

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19. Suppose that a poor household at Rs. 1,000 income requires an extra Rs. 100 to raise its life satisfaction (or happiness) by one notch. A rich household at Rs. 1,000,000 income (one thousand times as much as the poor household) would need one thousand times more money, or Rs. 100,000, to raise its well-being by the same one notch. Gains in income have to be of equal proportions to household income to have the same benefit in units of life satisfaction.

20. On an average across the OECD countries, cash transfers and income taxes reduce inequality by one third. Poverty is around 60 per cent lower than it would be without taxes and benefits. Even among the working-age population, government redistribution reduces poverty by about 50 per cent *(OECD, 2008).*

(xii) Human beings feel the pain of others, and react viscerally when others are sad or injured. We even have a set of 'mirror neurons' that enable us to feel things from the point of view of others. All of this gives us a remarkable capacity to ***cooperate*** even with strangers, and even when there is little chance of reward or reciprocity, and to punish 'non-cooperators', even when imposing punishment on others is costly or puts us at risk ourselves.

Of course there are limits to such cooperation and fellow feeling. We also cheat, bluff, deceive, break our word, and kill members of an out-group. We engage in identity politics, acting as cruel to outsiders as we are loving to our own group. All these lessons of human nature matter more than ever, more even than when the Buddha taught humanity about the illusions of transient pleasures, and the Greeks warned us against the tempting Siren songs that could pull us off our life's course. For today we have more choices than ever before. In the ancient world, the choice facing most of humanity most of the time was little choice indeed—to work hard to secure enough to eat, and even then to face the risk of famine and death from bad weather or bad luck.

(xiii) Today, we face a set of real choices. Should the world pursue GNP to the point of environmental ruin, even when incremental gains in GNP are not increasing much (or at all) the happiness of affluent societies? Should we cravefor for higher personal incomes at the cost of the community and social trust? Should our governments spend even a tiny fraction of the $500 billion or so spent on advertising each year to help individuals and families to understand better their own motivations, wants and needs as consumers? Should we consider some parts of our society to be "off bounds" to the profit motive, so that we can foster the **spirit of cooperation**, **trust**, and **community**? A recent analyst[21] of Finland's school system, for example, writes that Finland's excellence (ranking near the top of international comparisons in student performance) has been achieved by fostering a spirit of community and equality in the schools. This is in **sharp contrast** to the education reform strategy at work in the US, where the emphasis is put on *testing, measurement,* and *teacher pay* according to student test performance.

At the End

The introspecting studies of the *WHR 2012* simply conclude that there are enough reasons to believe that we need to **re-think** the economic sources of well-being, more so even in the rich countries than in the poor ones. High-income countries have largely ended the scourges of poverty, hunger and disease. Poor countries rightly yearn to do so. But after the end of poverty, what comes next? What are the pathways to well-being when basic economic needs are no longer the main drivers of social change? What will guide humanity in the Anthropocene: advertising, sustainability, community or something else? What is the path to happiness?

Most people agree that societies should foster the happiness of their citizens. The founding fathers of the US recognised the inalienable right to the pursuit of happiness. British philosophers

21. Pasi Sahlberg, '**Education Policies for Raising Student Learning: The Finnish Approach;** *Journal of Education Policy, 22*(2), March 2007, World Bank, Washington DC, pp. 147–171.

talked about the greatest good for the greatest number. Bhutan has famously adopted the goal of Gross National Happiness (GNH) rather than Gross National Product. China champions a harmonious society. Yet most people probably believe that happiness is in the eye of the beholder, an individual's choice, something to be pursued individually rather than as a matter of national policy. Happiness seems far too subjective, too vague, to serve as a touchstone for a nation's goals, much less its policy content. That indeed has been the traditional view. Yet the evidence is rapidly changing this view.

A generation of **studies** by psychologists, economists, pollsters, sociologists and others have shown that happiness, though indeed a subjective experience, can be objectively measured, assessed, correlated with observable brain functions, and related to the characteristics of an individual and the society. Asking people whether they are happy or satisfied with their lives, offers important information about the society. It can signal underlying crises or hidden strengths. It can suggest the need for change. Such is the idea of the emerging scientific study of happiness, whether of individuals and the choices they make, or of entire societies and the reports of the citizenry regarding life satisfaction—the *WHR 2012* summarises the fascinating and emerging story of these studies on **two** broad measurements of happiness:

(i) the ups and downs of daily emotions and

(ii) an individual's overall evaluation of life

The former is sometimes called 'affective happiness,' and the latter 'evaluative happiness.'

This is important to know that both kinds of happiness have predictable causes that reflect various facets of our human nature and our social life. *Affective happiness* captures the day-to-day joy of friendship, time with family, and sex, or the downsides of long work commutes and sessions with one's boss. *Evaluative happiness* measures very different dimensions of life, those that lead to overall satisfaction or frustration with one's place in society. Higher income, better health of mind and body, and a high degree of trust in one's community ('social capital') all contribute to high life satisfaction; poverty, ill health and deep divisions in the community all contribute to low life satisfaction.

Happiness differs systematically across societies and over time, for reasons that are identifiable, and even alterable through the ways in which public policies are designed and delivered. It makes sense, in other words, to pursue policies to raise the public's happiness as much as it does to raise the public's national income. **Bhutan** is on to something path breaking and deeply insightful. And the world is increasingly taking notice. A household's income counts for life satisfaction, but only in a limited way—other things matter more:

(i) community trust,

(ii) mental and physical health, and

(iii) the quality of governance and rule of law

Raising incomes can raise happiness, especially in poor societies, but fostering cooperation and community can do even more, especially in rich societies that have a low marginal utility of income. It is no accident that the happiest countries in the world tend to be high-income countries that also have a high degree of social equality, trust and quality of governance. In recent years, Denmark has been topping the list. And it's no accident that the US has not experienced *rise of life satisfaction for half a century, a period in which inequality has soared, social trust has declined, and the public has lost faith in its government.*

It is, of course, one thing to identify the correlates of happiness, and quite another to use **public policies** to bring about a society-wide rise in happiness (or life satisfaction). That is the goal of Bhutan's GNH, and the motivation of an increasing number of governments dedicated to measuring happiness and life satisfaction in a

reliable and systematic way over time. The most basic goal is that by measuring happiness across a society and over time, countries can avoid '***happiness traps***' such as in the USA in recent decades, where GNP may rise relentlessly while life satisfaction stagnates or even declines.

The idea of GNH in Bhutan tells a story of exploration and progress since its King declared (1972) the goal of happiness over the goal of wealth. For Bhutan happiness became much more than a guidepost or inspiration; it became an organising principle for governance and policymaking as well. The 'GNH Index' is the **first** of its kind in the world, a serious, thoughtful and sustained attempt to measure happiness, and use those measurements to chart the course of public policy. It is believed that in coming years many more countries in the world will be taking clues from Bhutan and the recently published two World Happiness Reports.

INSIGHTS INTO HUMAN BEHAVIOUR

The World Bank in its latest report (*World Development Report 2015: Mind, Society, and Behaviour)* said that development policies become more effective when combined with insights into human behaviour. It further adds that policy decisions informed by **behavioural economics** can deliver impressive improvements in promoting development and well-being in society. It sites some examples from India in the areas of healthcare and education:

- Open defecation dropped 11 per cent from very high levels after a Community-Led Total Sanitation (CLTS) programme was combined in some chosen villages with the standard approach of subsidies for toilet construction and information on the transmission of diseases.
- The likelihood of default on loans became three times less likely with a simple change in the periodicity of meetings between microfinance clients and their repayment groups to weekly rather than monthly.
- Research showed that boys from backward classes were just as good at solving puzzles as boys from the upper castes when caste identity was not revealed. However, in mixed-caste groups, revealing the boys' castes before puzzle-solving sessions created a significant "caste gap" in achievement with the boys from backward classes underperforming by 23 per cent (making caste salient to the test takers invoked identities, which in turn affected performance, as per the report).

The *Report* has recommended that the presence of a stereotype can contribute to measured ability differences, which in turn reinforce the stereotype and serve as a basis for exclusion, in a vicious cycle —finding ways to break this cycle could increase the well-being of marginalised individuals enormously.

SOCIAL NORMS, CULTURE AND DEVELOPMENT

Economic development depends not only on getting fiscal policy, monetary policy and taxation right; but it is also rooted in human psychology, sociology, culture and norms—in the economics profession, there has been a bit of resistance to this because it is sort of giving ground to the neighbouring disciplines.[22] The recent *World Development Report (WDR)* of 2015 focuses on the behavioural and social foundations of development, and has been very well received.

Government documents (generally, hard-nosed), usually, make no mention of the role of social norms and culture in promoting development

22. Kaushik Basu, Chief Economist, **World Bank**, *Livemint*, N. Delhi, February 3, 2015.

and economic efficiency. However, there is now a growing body of literature that demonstrates how certain social norms and cultural practices are vital ingredients for economic efficiency and growth. Groups and societies that are known to be honest and trustworthy tend to do better than societies that do not have this reputation. There have been broad cross-country studies and also laboratory experiments that illustrate this. More generally, what is being argued is that a nation's success depends of course on its resources, human capital and economic policies, for instance fiscal and monetary policies, but also on the cultural and social norms that permeate society. Societies that are endowed with personal integrity and trustworthiness have the natural advantage that no third party is required to enforce contracts. For outsiders the mere knowledge that a particular society is trustworthy is reason to do more business and trade with it. One reason why these 'social' causes of development do not get enough recognition in the literature on economic policy is that the science of *how* these economics-friendly social qualities are acquired is not yet fully understood. Fortunately, the new discipline of **behavioural economics** is beginning to give us some insights into the formation of customs and behaviour:[23]

- It is, for instance, known that buildings and office spaces which are cleaner and aesthetically better maintained result in individuals being more honest and desisting corrupt activity. It is almost as if we have a mental inclination not to defile a good ambience through acts of corruption.
- New York city's notorious high crime was controlled, among other things, by cleaning up the city and removing graffiti from the walls. New York's police department took a decision to deter vandalism and graffiti that scar public spaces. This act of making the cityscape more aesthetic somehow made potential criminals less prone to crime.
- One sees casual evidence of this in the behaviour of Delhites using the metro. It has been widely noted that people behave better when they travel on Delhi's well-maintained metro (postponing their bad behaviour to when they come up to the surface again, some would add).

All this is in keeping with the influential *broken windows* theory in sociology, which maintains that, if we control low level, anti-social behaviour and take small steps to improve the environment, this will have a natural deterrent effect on larger criminal behaviour and acts of corruption. Also, the sheer recognition and awareness that some collective qualities of citizens, such as honesty and trustworthiness, enable the entire society to do well prompts individuals to adopt those qualities and overcome the ubiquitous free-rider problem.

There is a growing literature[24] in economics arguing that **pro-social behaviour**, which includes *altruism* and *trustworthiness*, is innate to human beings and, moreover, forms an essential ingredient for the efficient functioning of economies. In other words, human beings have a natural ability to forego personal gains for the sake of other people or because that is what is required because of a promise the person had made. This trait may well have evolutionary roots but its existence is now well demonstrated in laboratory tests by recent studies.

23. ***Economic Survey 2009–10,*** Ministry of Finance, GoI, N Delhi, p. 34-35.
24. Over half a dozen contemporary works have been cited as references by the ***Economic Survey 2010–11,*** Ministry of Finance, GoI, N Delhi, p. 40)

Values and Economics

There is research[25] in psychology and evolutionary biology which shows that **morality**, **altruism**, and other-regarding **values** are an innate part of the human mind, even though the social setting in which a person lives can nurture or stunt these traits. However, the recognition that these human and moral qualities can have a large impact on economic development came relatively late to economics. Hence, the literature on this is relatively recent and brief. In fact, recent research shows that having a few 'good' human beings in society can give rise to dynamics through which we end up with an overall better society. There is also evidence that social norms and habits that at first sight seem ingrained in a society can change over short periods of time. By this argument it is possible for a country to nurture and develop the kinds of social norms that enable a more vibrant economy.

In talking about a nation's economic progress, all attention, including both praise and criticism, is usually focused on the government. It is, however, important to recognise that much also depends on civil society, the firms, the farmers, and ordinary citizens. The social norms and collective beliefs that shape the behaviour of these agents play an important role in how a nation does.

Honesty, punctuality, the propensity to keep promises, the attitude towards corruption are matters shaped in great part by norms and social beliefs and the behaviour patterns can become habitual. Moreover, in a democracy like India, what can be done by government depends in great measure on how ordinary people think and what people believe in. That is what electoral politics is all about. An important reason why this got so little attention in the past is because so much of traditional economics was written as if these non-economic facets of life did not matter. But we now know that a market economy cannot function if people are totally self serving. While self-interest is a major driver of economic growth, it is important to recognise that honesty, integrity, and trustworthiness constitute the cement that binds society. At times economists treated these social norms, preferences and customs as unalterable. If that were so, there would not be much point in analysing their effect. But we do know that these qualities in a people can be changed. Honesty and integrity can be nurtured and aversion to corruption can be shored up.

If these traits are absent or inadequate in a nation, it is likely that that nation will stagnate and remain in a chaotic poverty trap. Take for instance, **contracts** which enable markets to develop and form the basis of economic life. If the contractual system in a nation is so weak that when a bank gives a 20-year mortgage to a person for buying a house, there is high risk of default, the implication of this is not that banks in this country will make large losses. The implication is that banks will not give loans; and the housing market will remain severely underdeveloped and the total number of houses will be few and far between.

Enforcing complicated or large contracts, especially ones protracted over a long period of time, is the responsibility of the state. The state provides the laws and enforcement to enable people to sign contracts. However, economic life

25. Several recent literature have been quoted by the ***Economic Survey 2011-12***, Ministry of Finance, GoI, N Delhi, p. 44:
    (i) Fukuyama, F.(1996), ***Trust: The Social Virtues and the Creation of Prosperity***, Free Press, New York.
    (ii) Guha, A. S. and B. Guha, 'The Persistence of Goodness,' *Journal of Institutional and Theoretical Economics*, 2012.
    (iii) Hauser, M. D., ***Moral Minds***, Harper Collins, New York, 2012.
    (iv) Hashimoto, T. , 'Japanese Clocks and the History of Punctuality in Modern Japan,' *East Asian Science, Technology, and Society*, vol. 2, 2008.

is full of everyday 'contracts' (for example, you let me ride in your taxi, and I pay you at the end of it; I pay you money now and you paint my house over the next two days; or you paint my house over the next two days and I pay you after that). In these everyday situations it is too cumbersome to bring in the state and the law courts. Here the main guarantor has to be people's personal **integrity** and **trustworthiness**. Societies that have successfully nurtured these qualities have done well; societies that have done poorly on these, tend to do poorly in terms of economic progress.

It is not known precisely how these values can be inculcated in society. But, hopefully, writing about their importance will catalyse change, as ordinary people realise that for *economic* advancement these *social* qualities are as important as policies that concern directly with the economy—like running the stock market or setting the rules of market competition.

Further, basic literacy and better education are helpful since people can then, on their own, reason and reach these conclusions. Literacy has the added value that it implies ordinary people will demand policies which are truly better, rather than those that merely look good on the surface. And, in a democratic setting like India, this will incentivise politicians to adopt better policies. Finally, if the political leaders and policymakers act as *role models* in terms of these qualities of honesty, integrity and trustworthiness, that can set the ball rolling. Inclusion of the behavioural dimension of human existence in policymaking has potential to play a huge role in promoting well-being.

CHAPTER

3

EVOLUTION OF THE INDIAN ECONOMY

- The Background
- Prime Moving Force–Agriculture vs. Industry
- Planned and Mixed Economy
- Emphasis on the Public Sector

*After 1757, when the East India Company took over the governance of Bengal, the British relationship with India, became exploitative, as exports to Britain and opium exports to China were financed out of the tax revenue from Bengal. There is not much evidence of significant transfer of European technology to Asia. To understand why, it is useful to scrutinise the experience of China and India, as they accounted for three-quarters of the Asian population and GDP in 1500 AD.**

* *See Angus Maddison,* ***Growth and Interaction in the World Economy: The Roots of Modernity****, The AEI Press, Washington DC, 2005, p. 60.*

THE BACKGROUND

The economic profile of India was in complete distress at the time of independence. Being a typical case of colonial economy, India was serving a purpose of development not for herself but a foreign land—the United Kingdom. Both agriculture and industry were having structural distortions while the state was playing not even a marginal role. During the half century before India became independent, the world was having accelerated development and expansion in its agriculture and industry on the shoulders of the active role being played by the states, with the same happening in the UK itself.[1]

There was not only the unilateral transfer of investible capital to Britain by the colonial state (the 'drain of wealth'), but the unequal exchange was day by day crippling India's commerce, trade and the thriving handloom industry, too. The colonial state practiced policies which were great impediments in the process of development in the country. Throughout the colonial rule, the economic vision that the state had was to increase India's capacity to export primary products, and increase the purchase/import of the British manufactured goods and raise revenues to meet the drain of capital as well as meet the revenue requirements of the imperial defence.[2]

The social sector was a neglected area for the British rulers which had a negative impact on the production and productivity of the economy. India remained a continent of illiterate peasants under British rule. At the time of Independence, its literacy was only 17 per cent with 32.5 years of life expectancy at birth.[3]

Industrialisation of India was also neglected by the colonisers—the infrastructure was not built to industrialise India but to exploit its raw materials. Indian capitalists who did emerge were highly dependent on British commercial capital and many sectors of the industry were dominated by British firms, e.g., shipping, banking, insurance, coal, plantation crops and jute.[4]

The pre-independence period was altogether a period of near stagnation showing almost no change in the structure of production or in the levels of productivity—the aggregate real output during the first half of the 20th century estimated at less than 2 per cent a year or less.[5]

The overall economic performance of India under the British rule was very low. According to economic statistian Angus Maddison, there was no per capita growth in India from 1600 to 1870—per capita growth was a meagre 0.2 per cent from 1870 to 1947, compared with 1 per cent in the UK.[6] The per capita incomes of Rs. 18 for 1899 and Rs. 39.5 for 1895 in current prices say the true story of the abject poverty Indian masses were faced with.[7] The repeated famines and disease epidemics during the second half of the nineteenth century and the first half of the twentieth century show the greatest socio-economic irresponsibility and neglect of the British government in India at

1. Bipan Chandra, Mridula Mukherjee and Aditya Mukherjee, ***India After Independence,*** Penguin Books, N. Delhi, p. 341.
2. Bipan Chandra, **'The Colonial Legacy'** in Bimal Jalan (Ed.) ***The Indian Economy: Problems and Prospects***, Penguin Books, N. Delhi, Revised Edition, 2004, p. 5.
3. B.R. Tomlinson, ***The Economy of Modern India 1860–1970,*** Cambridge University Press, Cambridge, 1993, p. 7.
4. Angus Maddison, ***The World Economy: A Millennial Perspective,*** OECD, Paris, 2001, p. 116.
5. A. Vaidyanathan, 'The Indian Economy Since Independence (1947–90)' in Dharma Kumar (ed.), ***The Cambridge Economic History of India,*** Vol.II, Cambridge University Press, Cambridge, England, Expanded Edition, 2005, p. 947.
6. Angus Maddison, **The World Economy** p. 116.
7. The respective data of Digby and Atkinson have been quoted by Sumit Sarkar, ***Modern India 1885–1947,*** Macmillan, N. Delhi, 1983, p. 42.

one hand and the wretchedness of the masses at the other.[8]

The political leaders and the industrialists both were very much aware and conscious about the economic inheritance once India became independent. Somehow, these dominant lot of people who were going to lay down the foundation stones of the independent Indian economy were almost having consensual[9] view, even before the independence, on many major strategic issues:

(i) State/governments should be given a direct responsibility for development.
(ii) An ambitious and vital role to be assigned to the public sector.
(iii) Necessity for the development of heavy industries.
(iv) Discouragement to foreign investment.
(v) The need for economic planning.

Once India became independent, it was a real challenge for the government of the time to go for a systematic organisation of the economy. This was a task full of every kind of challenges and hurdles as the economy had hardly anything optimistic. The need of delivering growth and development was in huge demand in front of the political leadership as the country was riding on the promises and vibes of the nationalist fervour. It was not a simple task.

Now the decisions which were to be taken by the political leadership of the time were going to shape the very future of India. Many important and strategic decisions were taken only by 1956 which shaped Indian economic journey till date—undoubtedly they heavily dominated the pre-reform period, but the post-reform period is also not completely free of their impact. To understand the nature and scope of the Indian economy in current times it is not only useful but essential to go through the facts, reasons and the delicacies which made the economy evolve and unfold the way it evolved and unfolded. A brief overview follows.

PRIME MOVING FORCE—AGRICULTURE VS. INDUSTRY

A topical issue of the debate regarding India has been the choice for the sector which will lead the process of development. The government of the time opted for industry to be India's prime moving force of the economy. Whether India should have gone for agriculture as its prime moving force for better prospects of development, is a highly debatable issue even today among experts.

Every economy has to go for its development through exploitation of its natural and human resources. There are priorities of objectives set by the economy which is attempted to be realised in a proper time frame. The availability and the non-availability of resources (natural as well as human) are not the only issues which make an economy decide to declare whether it opts for agriculture or industry as its prime moving force. There are many more socio-political compulsions and objectives which play their roles in such decision making.

The political leadership selected industry as the leading force of the economy after Independence—this was already decided by the dominant group of the nationalist leaders way back in the mid-1930s when they felt the need for economic planning in India before setting up the National Planning

8. Recounted vividly by *Mike Davis* in his ***Late Victorian Holocaust: El Nino Famines and the Making of the Third World,*** (Verso, London & New York, 2001, p. 162) where he links the monsoon failures in India to El Nino - Southern Oscillation (ENSO) climate fluctuations in the western Pacific—the monsoon failure leading to drought and hunger one year and then to a severe malaria epidemic the next when the rains reappeared and a burst of mosquito abundance afflicted a weakened population.
9. Bipan Chandra et. al., ***India's Struggle for Independence,*** p. 15.

Committee (1938). Given the available resource base it seems an illogical decision as India lacked all those pre-requisites which could suggest the declaration of industry as its prime mover:

(i) Almost no presence of infrastructure sector, i.e., power, transportation and communication.

(ii) Negligible presence of the infrastructure industries, i.e., iron and steel, cement, coal, crude oil, oil refining and electricity.

(iii) Lack of investible capital—be the case of either the government or the private sector.

(iv) Absence of required technology to support the process of industrialisation and no research and development.

(v) Lack of skilled manpower.

(vi) Absence of entrepreneurship among the people.

(vii) Absence of the market for industrial goods.

(viii) Many other socio-psychological factors which acted as negative forces for the proper industrialisation of the economy.

The obvious choice for India would have been the agriculture sector as the moving force of the economy because:

(i) The country was having the natural resource of fertile land which was fit for cultivation.

(ii) Human capital did not require any kind of higher training.

By only organising our land ownership, irrigation and other inputs to agriculture, India could have gone for better prospects of development. Once there was no crises of food, shelter, basic healthcare, etc., to the masses, one goal of development could have been realised—a general welfare of the people. Once the masses were able to achieve a level of purchasing capacity, India could have gone for the expansion of industries. India was capable of generating as much surplus income for its masses as was required by the emerging industries for a market success. The People's Republic of China did the same in 1949—taking a realistic evaluation of its resources, it declared agriculture as its prime moving force for the economy. The surplus generated out of agriculture was suitably invested to develop the pre-requisites for industrialisation and the country went for it in the 1970s.

The emergence of industrial China was so vibrant that its impact was felt in the so-called highly developed and industrialised economies of the world—the industrial homework of China catapulted it into a giant.

Was the political leadership of Independent India not able to analyse the realities as we did above and conclude that agriculture should have been the moving force of the economy in place of industry? Is it possible that Pandit Nehru in command could have missed the rational analysis of the Indian realities, a giant among the Asian visionaries of the time (Mao was still to emerge on the international scene)? How India could have not opted for agriculture as its prime moving force whose leadership had fought the nationalist movement on the Gandhian fervour of villages, agriculture and rural development. Even if Gandhi was not in the government there were many devout Gandhians in it and no one should doubt that the main internal force which vibrated throughout the governmental decisions were nothing but 'Gandhian Socialism'. There were many decisions which were taken under the influence of the main political force of the times, still some very vital ones were influenced by the visionary hunches of the political leadership mainly being J. L. Nehru. This is why the economic thinking of independent India is considered and said to be nurtured by the Nehruvian Economics still today. If we go through the major literatures on the Indian economic history, views of the critiques of the time and the

contemporary experts, we may be able to feel the answer as to why India went for industry as its prime moving force in place of an obvious and logical choice of agriculture (we should not be happy to know that even today this is a highly debatable issue among experts):

(i) Looking at the resources available, agriculture would have been the obvious choice as the prime moving force (PMF) of the economy (i.e., cultivable land and the manpower). But as Indian agriculture was using the traditional tools and technology its modernisation as well as future mechanisation (latter to some extent) would have been blocked due to the lack of indigenous industrial support. If we had gone for import this would have required enough foreign reserves and a natural dependence on foreign countries. By choosing industry as the PMF we were going to industrialise the economy as well as modernise our traditional mode of farming.

(ii) The dominant ideology around the world as well as in the WB and the IMF was in favour of industrialisation as a means to faster growth which could be translated into faster development. These international bodies were supporting the member countries from every point of view to industrialise. Same was the case with the developed economies. It was possible not only to industrialise faster on these supports but a hope for emerging as an industrial exporter was also there. Such kind of supports were not being offered by them to an economy going to opt for agriculture as its PMF. Basically, going for the agriculture sector was considered a symbol of 'backwardness' at that time also. The political leadership wanted to carry India ahead, and not in the backward direction. It was only in the 1990s that the world and the WB/IMF changed its opinion regarding the agriculture sector—and emphasis on this sector by an economy was no more considered a sign of backwardness.

(iii) The Second World War has proved the supremacy of defence power. For defence a country needs not only the support of science and technology but also an industrial base. India also required a powerful defence base for herself as a deterrent force. By opting for industries as her PMF the economy tried to solve many challenges simultaneously—first, industry will give faster growth, second, agriculture will be modernised in time and third the economy will be able to develop its own defence force. Since the economy had also opted for scientific and technological preparedness, its achievements were to sustain the pace of modernising world out there (this seems taking place in India to a great extent.).

(iv) Even before Independence, there was a socio-economic consensus among social scientists along with the nationalist leaders, that India needed a boost towards social change as the country lagged behind in the areas of modernisation. A break from the traditional and outmoded way of life and cultivation of a scientific outlook was a must for the country. Such feelings also made the political leadership of the time go in favour of wholehearted industrialisation.

(v) By the time India got her independence the might of industrialisation was already proven and there were no doubts regarding its efficacy.

Given above are some of the important reasons that worked to make Indian political leadership

go in favour of industry as the economy's prime moving force. Probably, the resource-related and temperamental realities of India got marginalised in hopes and wishes of a future industrialised and developed India. It is yet impossible to conclude whether the economy has completely failed to do so. Experts have divided opinions on this issue.

The last decade of the 20th century (i.e., the decade of the 1990s) saw major changes taking place in the world economic idea about the agriculture sector. It was no more a symbol of backwardness for an economy if it had started emphasising its agriculture sector as the engine of growth and development. China had proved to the world that how agriculture could be made the prime moving force of an economy and generate internal as well as external strength to emerge as an industrial economy. In the wake of ongoing reform process India was introspecting almost all economic policies it followed since Independence. It was time for the agriculture sector to have the prime attention. A major shift[10] took place in the Indian economic thinking when the government announced in 2002 that from now onwards, in place of industry, **agriculture will be the prime moving force (PMF)** of the economy. This was a policy shift of historic importance which was announced by the highest economic think tank of the country—the Planning Commission—as the economy commenced the Tenth Plan (2002–07). As per the Planning Commission[11] such a policy shift will solve the three major challenges faced by the economy:

(i) Economy will be able to achieve food security with the increase in agricultural production. Besides, the agricultural surplus will generate exports in the globalising world economy benefiting out of the WTO regime.

(ii) The challenge of poverty alleviation will be solved to a great extent as the emphasis will make agriculture a higher income-generating occupation and induce growth in the rural economy by generating more gainful employment.

(iii) The situation of India as an example of 'market failure' will cease.[12]

Though the world outlook towards agriculture sector had changed by the early 1990s, the Government of India announced the policy shift more than one decade later. There is now a consensus among experts, policymakers and the governments alike that for development to take place in India it is necessary to strengthen the sector on which the masses depend for their income and livelihood. More than 65 per cent of the Indian population depends on agriculture and allied activities, while only 18.5 per cent of the gross domestic product (GDP) comes from the sector.[13] It means that above 65 per cent of Indian population shares just 18.5 per cent of the gross

10. The Government of India had shown such an intention in two regular Union Budgets (i.e., the fiscals 2000–01 and 2001–02) but has not announced the shift officially.
11. Planning Commission, **Tenth Five Year Plan (2002–07),** GoI, N. Delhi, 2002.
12. It has been argued by economists time and again that India is a typical example of 'market failure'. Market failure is a situation when there are goods and services in an economy and its requirement too but due to lack of purchasing power the requirements of the people are not translated into demand. Whatever industrial goods and services India had been able to produce they had stagnated or stunted sales in the market as the largest section of the consumers earned their livelihood from the agriculture sector which is unable to create a purchasing power to the levels required by the market. As agricultural activities will become more gainful and profitable, the masses depending on it will have the level of purchasing capacity to purchase the industrial goods and services from the market. Thus, the Indian market won't fail. The view has been articulated by *Amartya Sen* and *Jean Dreze* in their monograph titled ***India: Economic Development and Social Opportunity,*** United Nations University, 1996.
13. **Central Statistical Organisation,** GoI, N. Delhi, Feb. 2007.

income generated by the economy. The rest of the population that does not depend on agriculture (i.e., below 35 per cent) share 81.5 per cent the gross income generated by the economy. The gap of income shows the lower purchasing power of the people involved in agricultural activities—which is more than two-third of the total population. How market can succeed in such a situation and what to ask of the market economy. As the economy was more in favour of a market economy, the situation of market failure needed to be arrested The income of the population dependent on the agriculture sector needed strengthening. Though the effects of the policy shift are not clearly visible yet, we may glance at the major policies which are intended towards strengthening of the agriculture sector:

(i) **New Agriculture Policy, 2000:** The policy mainly intends to convert agriculture into the category of industry so that the population dependent on it could earn income and profit out of agricultural activities with the same pace and mode as the industry has enabled the population dependent on industrial activities.

(ii) **National Agricultural Insurance Scheme, 1999–00:** The new insurance scheme launched for agriculture intends to provide insurance coverage to all agricultural activities right from seeds, sowing, harvesting to marketing risks—a necessary support to which the industry had access but agriculture had no reach.

(iii) **Exim Policy, 2002–07:** The Export Import Policy, 2002–07 for the first time accepted at the policy level the long-standing opinion of the experts—that a one per cent increase of the agricultural products in India's exports supplies additional Rs. 8,500 crores to the agricultural sector. Many policy initiatives were taken to increase the share of agriculture in the total export of the economy.

(iv) **Second Green Revolution:** A major programme to boost agricultural production with the sustainable approach was launched in 2004 with an initial corpus of Rs. 50,000 crore.

(v) **Bharat Nirman:** A major programme to focus on the agricultural and rural infrastructure (totalling six items) was launched by the government in 2005 with the ultimate intention of strengthening rural economy.

(vi) **Others:** Similarly, many time-bound programmes and schemes have been launched since 2002 which focus on the agriculture sector and the rural areas from different angles—education, electricity, wage, as well as self-employment, healthcare, communication, etc.

Looking at the size of the population dependent upon the agriculture sector, comparatively longer government apathy to the agricultural realities and the late start of the reform process in it make things very tough to effect visible changes in the sector in a short time span. It also requires comparatively longer period of time. We will then be able to see the visible results of the policy shift as well as the results of the economic reforms in the agriculture sector provided there remains a continued political commitment to the cause. One positive development of the last decade has been that India has been able to reach a silent political consensus on some of the very important aspects of development (for example—on the process of economic reforms, foreign investment, deregulation, social justice, emphasis on agricuture, priority to the social sector, etc.), which gives us hope that the economy will be able

to take care of the agriculture sector in due course and more accelerated growth and development can be achieved.

PLANNED AND MIXED ECONOMY

Independent India was declared to be a planned and a mixed economy. India needed national planning, it was decided by the political leadership almost a decade before Independence.[14] India was not only facing regional disparities at the level of resources but inter-regional disparities were also prevalent, since centuries. Mass poverty could only be remedied once the government started the process of economic planning. Economic planning was thus considered an established tool of doing away with such disparities.

Basically, it was the abject poverty of the masses which made the government go for planning so that it could play an active role in the allocation of resources and mobilise them for an equitable growth and development. Though India was constitutionally declared a federation of states, in the process of planning, the authority of regulation, directing and undertaking economic activities got more and more centralised in the Union government.[15]

India's decision for a planned economy was also moulded by some contemporary experiences in the world.[16] *Firstly,* the Great Depression of 1929 and the reconstruction challenges after the Second World War had made experts to conclude in favour of a state intervention in the economy (opposite to the contemporary idea of 'non-interference' as proposed by Adam Smith). *Secondly,* it was the same time that the command economies (i.e., state economies) of the Soviet Union and the East European countries started making news about their faster economic growth. In the 1950s and 1960s, the dominant view among the policymakers around the world was in favour of an active role of the state in the economy. *Thirdly,* a dominant role for the state in the economy to neutralise market failure situations (as happened during the period of the Great Depression when demand fell down to the lowest levels) was gaining ground around the world. For many newly independent developing nations, economic planning was therefore an obvious choice. Economic planning was considered to help states to mobilise resources to realise the prioritised objectives in a well-defined time frame.

Once the political leadership had decided in favour of a planned economy for India and a major role for the state in the economy, they needed to clarify about the organisational nature of the economy—whether it was to be a state economy or a mixed economy—because planning was not possible in a free market economy (i.e., capitalistic economy). The idea of planning in India was inspired from the Soviet planning which was a command economy and did not suit the requirements of democratic India which was till now a privately owned economy.[17] The dominant force behind planning in India, at least after Independence, was Nehru himself who had strong socialist leanings. He thought it very urgent to define the role of the state in the economy, which was going to be at times similar to the state in the Soviet Union and at times completely dissimilar to it. Though there was an example of a capitalistic-democratic system going for planning, France by that time (1947), it had little experience to offer the Indian policymakers (France had gone

14. **National Planning Committee,** GoI, N. Delhi, 1949.
15. Bimal Jalan, ***India's Economic Policy,*** Penguin Books, N. Delhi, 1993, p. 2.
16. C. Rangarajan, ***Perspectives on Indian Economy,*** UBSPD, N. Delhi, 2004, p. 96.
17. Rakesh Mohan, 'Industrial Policy and Control' in Bimal Jalan (Ed.) ***The Indian Economy: Problems and Prospects,*** p. 101.

for a mixed economy by 1944–45). With the basic urge to accelerate the process of economic growth, the planners went to define the respective roles of the state and the market, in the very first Plan itself. The following lines look refreshingly ahead of the times and crystal-clear about the scope of the government's role in the economy vis-á-vis the private sector.

"This brings us to the problem of the techniques of planning. A possible approach to the problem is, as mentioned earlier, through a more or less complete nationalisation of the means of production and extensive system of government controls on the allocation of resources and on the distribution of the national product. Judged purely as a technique of planning, this may appear a promising line of action. But, viewed against the background of the objectives outlined above, and in the light of practical considerations, such an expansion of the public sector is, at the present stage, neither necessary nor desirable. Planning in a democratic set-up implies the minimum use of compulsion or coercion for bringing about a realignment of productive forces. The resources available to the public sector have, at this stage, to be utilised for investment along new lines rather than in acquisition of existing productive capacity. Public ownership of the means of production may be necessary in certain cases; public regulation and control in certain others. The private sector has, however, to continue to play an important part in production as well as in distribution. Planning under recent conditions thus means, in practice, an economy guided and directed by the state and operated partly through direct state action and partly through private initiative and effort."[18] The above-quoted lines are imaginatively ahead of the times. It will be suitable to note here that as 1950s and 1960s made the world experts favour state intervention in the economy, the ***East Asian Miracle (WB)***[19] of the coming three decades was going to define the very limits of such an intervention. The East Asian economies were able to sustain a high growth rate over three decades and had revived again the discussions regarding the respective roles of the state and the market as well as the nature of the state's role in the economy. The kind of conclusions drawn were very similar to the view presented in India's First Plan itself which was presented by the World Bank in 1993.

The real nature of the Indian brand of mixed economy, though beautifully outlined in 1951 itself, went through a process of detailed evolution in the decade of the 1950s.[20] By the end of the 1950s, the concept of the mixed economy was almost buried and rose from hibernation only by mid-1980s and finally early in 1990s, in the wake of the process of economic reforms.

The state–market mix (i.e., the public sector and private sector) defined for India though, clearly delineated the nature of mixed economy, the vision was obviously blurred in the coming decades as part of economic mismanagement. The imagined mixed economy of India will become more clear in the next sub-topic.

EMPHASIS ON THE PUBLIC SECTOR

The state was to be given an active and dominant role in the economy, it was very much decided by the time India became independent. There were no doubts about it in the minds of the people who formed the dominant political force at the time. Naturally, there was going to be a giant structure of the government-controlled enterprises to be known as the public sector undertakings (PSUs). Criticism aside, there were at that time, a strong logic behind the glorification of PSUs. Some of the reasons for heavy investments in the PSUs were

18. Planning Commission, ***The First Five Year Plan: A Draft Outline,*** GoI, N. Delhi, 1951.
19. ***The East Asian Miracle,*** World Bank, Washington D.C, 1993.
20. We see the process of evolution specially in the industrial policies, India pursued since 1948 to 1956.

purely natural while others were consequential in nature. There were certain highly commendable objectives set for them, some other goals would go on to serve the very soul of the mixed economy. We must go for an impartial and rational analysis of the matter, in the midst of all the criticism of PSUs and the contemporary moves of privatising them, to understand their roles in the Indian economy. We may understand the reasons behind the ambitious expansion of the PSUs in the face of the following major requirements.

1. Infrastructural Needs

Every economy whether it is agrarian, industrial or post-industrial, needs suitable levels of infrastructure such as—power, transportation and communication. Without their healthy presence and expansion, no economy can grow, and develop.

At the eve of Independence, India was having almost no presence of these three basic requirements. There was just a beginning in the area of railways, and post and telegraph. Power was restricted to selective homes of government and the princely states. [It means, even if India had opted for agriculture as its prime moving force (PMF), it had to develop the infrastructure sector.]

These sectors require too much capital investment as well as heavy enginering and technological support for their development. Expansion of the infrastructure sector was considered not possible by the private sector of the time as they could possibly not manage the following components:

(i) heavy investment (in domestic as well as foreign currencies),
(ii) technology,
(iii) skilled manpower, and
(iv) entrepreneurship

Even if these inputs were available to the private sector it was not feasible for them as there was no market for such infrastructure. These infrastructures were essential for the economy, but they needed either subsidised or almost free supply as the masses lacked the market-determined purchasing capacity. Under these typical condition, it was only the government which could have shouldered the responsibility. The government could have managed not only the inputs required for the development of the sector but could also supply and distribute them to the needy areas and the consumers for the proper growth of the economy. There were no alternatives and that is why the infrastructure sector in India has such a dominant state presence that many areas have obvious government monopolies—as in power, railways, aviation, telecommnication, etc.

2. Industrial Needs

India had opted for the industrial sector as its prime moving force, as we saw in the earlier pages. Now there were some areas of industries which the government had to invest in, due to several compulsive reasons. For industrialisation and its success, every economy needs the healthy presence of some 'basic industries', which are also known as the 'infrastructure industries'.[21] There are six basic industries which every industrialising economy requires, namely—

(i) Iron and Steel
(ii) Cement
(iii) Coal
(iv) Crude oil
(v) Oil refining and
(vi) Electricity

[***Note:*** At present, there are eight ***Core Industries*** in India (with the Base: 2004–05=100), six existing *'basic/infrastructure industries'* with two

21. 'Infrastructure sector' and 'infrastructure industries' are quite different things.

new additions, i.e., *Natural Gas* and *Fertilizer*. Core industries together have a combined weight of 37.90 per cent in the Index of Industrial Production (IIP). Individual percentages of them are: Coal (weight: 4.38 per cent); Crude Oil (weight: 5.22 per cent); Natural Gas (weight: 1.71 per cent); Petroleum refinery (weight: 5.94 per cent); Fertilizer (weight: 1.25 per cent); Steel (weight: 6.68 per cent); Cement (weight: 2.41 per cent); and Electricity (weight: 10.32 per cent).]

Similar to the infrastructure sector, these basic industries also require high level of capital, technology, skilled manpower and articulation in entrepreneurship which was again considered not feasible for the private sector of the time to manage. Even if the private sector supplied goods from the 'basic industries', they might not be able to sell their products in the market due to the lower purchasing power of the consumers. Perhaps, that is why again the responsibility of developing the basic industries was taken up by the government.

Out of the six basic industries the cement sector was having some strength in the private and in iron and steel sector a lone private company was present. The coal sector was controlled by the private sector and crude oil and refining was just a beginning by them. The level of demands of an industrialising India was never to be met by the existing strength of the basic industries. Neither the required level of expansion in them was possible by the existing number of private players. With no choice left, the government decided to play the main role in them. In many of them we as a result, see a natural monopoly for the PSUs, again.

3. Employment Generation

The PSUs were also seen as an important part of the employment generation strategy. A government in a democratic set up cannot think only economics, but it has to realise the socio-political dimensions of the nation too. The country was faced with the serious problem of poverty and the workforce was increasing at a fast rate. Giving employment to the poor people is time-tested tool of poverty alleviation. The PSUs were thought to create enough jobs for the employable workforce of the economy.

There was also felt an immediacy for a social change in the country. The poverty of a greater section of the country was somehow connected to the age-old caste system which propitiated the stronghold of the upper castes on the ownership of land which was the only means of income and livelihood for almost above 80 per cent of the population. Along with the ambitious policy of land reforms, the government had decided to provide reservations to the weaker sections of the society in government jobs. The upcoming PSUs were supposed to put such jobs at the disposal of the goverment which could have been distributed along the decided reservation policy—such reservations were considered an economic tool for social change.

In the highly capital-intensive sectors in which the government companies were going to enter, managing investible funds to set them up was not going to be an easy task. The government did manage the funds with sources like taxation, internal and external borrowing and even taking last refuge in the printing of fresh currencies. The government went to justify the high taxation and heavy public indebtness in supplying employment to the Indian employable population.

The PSUs were considered by the government as the focus of the 'trickle-down effect'. The government did everything to set up and run the PSUs as the benefits were supposed to percolate to the masses, finally reinforcing growth and development in the country. Employment in the PSUs was seen as the effort of the trickle down theory, simply said. At a point of time, Nehru even mentioned the PSUs as the 'temples of modern India'. The government went to commit even a

job in every household via the PSUs—without calculating the dimensions of the future labour force in the country and the required resources to create jobs at such a high scale. But the government went on creating new PSUs without analysing the fiscal repercussions—moreover believing them to be the real engine of equitable growth. The employment generation responsibility of the PSUs was extended to such an extent by the government that most of them had over-supply of the labour force which started draining its profits on account of the salaries, wages, pensions and provident funds (the latter two had late financial impact).

4. Profit and Development of the Social Sector

The investment to be made by the government in PSUs was in the nature of asset creation and these entities were to be involved in production activities. It was natural for the government to gain control over the profits and dividends accruing from them. The goods and services the PSUs were to produce and sell were going to provide disposable income to the government. The government had a conscious policy of spending the income generated by the PSUs. They were to be used in the supply of the 'social goods' or what is called the 'public goods'. And thus, India was to have a developed social sector. By social goods the government meant the universal supply of certain goods and services to the Indian people. These included education, healthcare, nutrition, drinking water, social security, etc., in India. It means that the PSUs were also visioned as the revenue generators for the development of the social sector. Due to many reasons the PSUs would not be able to generate as much profit as was required for the healthy development of the social sector. This eventually hampered the availability of public goods in the country. In place of giving profits back to the government, a large number of the PSUs started incurring huge losses and required budgetary supports as a regular phenomenon.

5. Rise of the Private Sector

As the PSUs will take the responsibility of supplying the infrastructure and the basic industries to the economy, a base for the rise of private sector industries will be built. With the rise of the private sector industries in the country, the process of industrialisation will be completed. Out of the many roles the PSUs were supposed to play this was the most far-sighted. Whatever happened to the different roles the PSUs were assigned is a totally different matter to which we will return while discussing the industrial scenario in the country. Here we have analysed why the government in India after Independence went for such an ambitious plan of expansion of the public sector.

Besides, the PSUs were aimed at many other connected areas of developmental concerns, such as, self-sufficiency in production, balanced regional development, spread of small and ancillary industries, low and stable prices, and long-term equilibrium in balance of payment. Over time the PSUs have played a critical role in promoting the growth and development of the country.[22]

22. Sumit Bose and Sharat Kumar, 'Public-sector Enterprises', in Kaushik Basu and Annemie Maertens (Eds.) ***The New Oxford Companion to Economics in India,*** Vol. II, Oxford University Press, New Delhi, 2012, p. 578–583.

CHAPTER

4

ECONOMIC PLANNING

- Introduction
- Definition
- Origin and Expansion of Planning
- Types of Planning

*The idea of planning and a planned society is accepted now in varying degrees by almost everyone. But planning by itself has little meaning and need not necessarily lead to good results. Everything depends on the objectives of the plan and on the controlling authority, as well as, of course, the government behind it.**

* *As Jawaharlal Nehru writes in **The Discovery of India**, Oxford University Press, 6th Impression (1st Edition 1946, Oxford, London), N. Delhi, 1994, p. 501.*

INTRODUCTION

In order not to limit the discussion on economic planning to just an academic exercise, we need to discuss it taking real life examples from different economies. Without a historical background to planning, we would not be able to understand the meaning and role of planning in India. This small chapter intends to brief the reader on all the ***whats, hows*** and ***whys*** of the concept of economic planning with due recourse to the experiments by different countries from time to time, including India. It could also be considered a theoretical backgrounder for the next chapter, *Planning in India.*

DEFINITION

A number of definitions have been forwarded by different economists from time to time since the term 'planning' entered the domain of economics. To make us develop a clear understanding of planning, we need to see only a few of them which will enable us to draw out a working definition that fits contemporary time.

A large number of economists and experts have agreed that perhaps the best definition is given by H. D. Dickinson, according to whom, economic planning is, "the making of major economic decisions—what and how much is to be produced and to whom it is to be allocated by the conscious decision of a determinate authority, on the basis of a comprehensive survey of the economic system as a whole."

It was the National Planning Committee, set up in 1938 by the Indian National Congress which, for the first time, tried to define planning (in 1940, though, its final report was published in 1949) in India. It could be considered the broadest possible definition of planning: "Planning, under a democratic system, may be defined as the technical coordination, by disinterested experts of consumption, production, investment, trade, and income distribution, in accordance with social objectives set by bodies representative of the nation. Such planning is not only to be considered from the point of view of economics, and raising of the standard of living, but must include cultural and spiritual values, and the human side of life."[1]

By the late 1930s, there was an almost political consensus that independent India will be a planned economy. As India commenced economic planning by the early 1950s, the Planning Commission of India also went on to define planning. According to the Planning Commission, "Planning involves the acceptance of a clearly defined system of objectives in terms of which to frame overall policies. It also involves the formation of a strategy for promoting the realisation of ends defined. Planning is essentially an attempt at working out a rational solution of problems, an attempt to coordinate means and ends; it is thus different from the traditional hit-and-miss methods by which reforms and reconstruction are often undertaken".[2]

In the post-War period, a large number of the newly independent countries were attracted towards planning. Many new forces of change kept refining the very idea of planning due to the compulsive necessities of industrialisation or the issue of sustainability of the development process. But to carry forward our discussion, we need a working as well as a contemporary definition of planning. We may define it as *a process of realising well-defined goals by optimum utilisation of the available resources.*[3] While doing economic planning the government sets developmental objectives and attempts to deliberately coordinate

1. S.R. Maheshwari, ***A Dictionary of Public Administration,*** Orient Longman, N. Delhi, 2002, p. 371.
2. Planning Commission, ***First Five Year Plan (1951-56),*** Government of India, N. Delhi, 1991, p. 7.
3. After the emergence of the concept of **Sustainable Development** (1987) experts across the world started using the term 'optimum' in place of the hitherto used term 'maximum'.

the economic decision making over a longer period to influence, direct and in some cases even to control the level and growth of a nation's main economic variables (i.e., income, consumption, employment, saving, investment, exports, imports, etc.).[4]

An economic plan is simply a set of specific economic targets to be achieved in a given period of time with a stated strategy. Economic plans may be either comprehensive or partial. A ***comprehensive plan*** sets targets to cover all major aspects of the economy while a ***partial plan*** may go for setting such targets for a part of the economy (i.e., agriculture, industry, public sector, etc.). Taken broadly, the planning process itself can be described as an exercise in which a government first chooses social objectives, then sets various targets (i.e., economic targets), and finally organises a framework for implementing, coordinating, and monitoring a development plan.[5]

One very important thing which should be clear to all is that the idea of planning first emerged in its applied form and after studying and surveying the experiences of different countries who followed it, experts started theorising about planning. Thus, in the case of planning, the direction has been from practice to theory. This is why the form and the nature of planning kept changing from country to country and from time to time. As we will see in the following pages, the types of planning itself evolved through time as different countries experimented with it.

As per our working definition, we may say the following things about planning:

(i) ***Planning is a process***. It means planning is a process of doing something. Till we have some goals and objectives left regarding our lives, the process might continue. With the changing nature of our needs, the nature and scope of the planning process might undergo several changes. Planning is not an end in itself. As processes accelerate and decelerate, change direction and course, so also does planning.

(ii) ***Planning must have well-defined goals***. After the Second World War, several countries went for development planning. As these nations had enormous socio-economic hurdles, they first set some goals and objectives and then started their process of realising them via planning. In due course of time, there emerged a consensus that planning must have some goals and those goals should be well-defined (not vaguely defined)—so that the government's discretionary intervention in the economic organisation could be democratically transparent and justified. Even in the non-democratic nations (i.e., erstwhile USSR, Poland, China, etc.) the goals of planning were clearly defined.[6]

(iii) ***Optimum utilisation of the available resources***. Here we see two catch concepts. *First,* is the way of utilising the resources. Till the idea of sustainability emerged (1987) experts tried to 'maximise' the resource exploitation. But once experts around the world introspected the untenability of such a method of resource utilisation, the sustainable approach was included into planning and here in entered the idea of utilising resources at its 'possible best', so that environmental degradation could be at its minimum and

4. Michael P. Todaro, ***Development Planning: Models and Methods.*** Oxford University Press, Nairobi, 1971.
5. United Nations Department of Economic Affairs, ***Measures for Economic Development of Underdeveloped Countries,*** UNO, DEA, New York, 1951, p. 63.
6. ***First Five Year Plan (1928–33),*** The Gosplan, USSR, 1928.

the future generations could also be able to continue with their progress. *Second,* is the idea of the natural resources which are available. Resources (i.e., natural as well as human) could be of indigenous origin or exogenous. Most of the countries doing planning tried to utilise their indigenous resources, yet some others tried to tap the exogenous resources too, taking leverage of their diplomatic acumen. For example, the first country going for national planning, i.e., Soviet Union, leveraged resources available in the East European countries. India also used exogenous resources for her development planning wherever it was necessary and possible to tap.[7]

By 1950s, planning had emerged as a method or tool of utilising resources to achieve any kind of goals for policymakers, around the world:

(i) Trying to achieve a particular size of family for different countries came to be known as ***family planning***.

(ii) The process of providing suitable physical and social infrastructure for the erstwhile or the upcoming urban areas came to be known as ***town/urban planning***.

(iii) A country trying to optimise the use of its revenues for different categories of expenditures came to be known as ***financial planning***. Financial planning is more popularly known as ***budgeting***. Every budget, be it of the government or of the private sector is nothing but excercises in the area of financial planning.

(iv) Similarly, at the macro and micro levels, there might be any number of planning processes—agricultural planning, industrial planning, irrigation planning, road planning, house planning, etc.

Simply said, the art of achieving any kind of goal by the use of the resources we have is the process of planning. We may cite a very general example—students of a class are able to join the class at the right time coming from different places of their stay. How they are able to do so? All of them must be planning their time in such a way that they are able to join the class at the same time though their places of residence are not at an equal distance from the class. All might be having their own way of time planning—some might be having bed-tea, some might not, some might be having breakfast at their place, yet some others might think to take their breakfast in the college canteen, etc.

It means that even if we are not consciously planning or have not announced it as yet, we are always planning our days. Same is correct in the case of countries also. Many countries announced that they will be planned economies yet some others didn't go for any such policy announcements. The Soviet Union, Poland, China, France, India are examples of the former category while the USA, Canada, Mexico fall in the latter category.[8] But here we are concerned with the conscious process of planning. There will be some methods, some tools and types of planning emerging through time as different countries will start their processes of planning.

ORIGIN AND EXPANSION OF PLANNING

Planning as a method of achieving faster economic progress has been tried by different countries at different times and at different levels. We may see them as under:

7. Many of the PSUs in the 1950s and the early 1960s were not only set up with natural resources (capital as well as machines) from USSR, Germany, etc. but even the human resource was also tapped from there for few years.
8. Though the USA was the first to go for planning, but at the regional level (Tennessee Valley Authority, 1916)—it never announced its any intention of national planning.

1. REGIONAL PLANNING

It was at the regional level that planning was used as a part of development policy by any country for the *first time*. It was the USA which started the first regional planning after the Tennessee Valley Authority (TVA) was set up in 1916—for a large-scale rehabilitation in south-eastern USA covering parts of seven states. With the primary aim of flood control, soil conservation and providing electricity, the TVA/the regional plan was also involved in many related activities such as industrial development, forestry, wildlife conservation, town planning, construction of road and rail, encouraging sound agricultural practices and malaria control in the defined region.[9] The US experience of regional planning became such a success in realising its well-defined goals that it emerged as a role model and an object of inspiration for many countries around the world in the coming decades—the Damodar Valley Corporation (DVC) in India (1948), the Volta River Project in Ghana (1966), etc.

2. NATIONAL PLANNING

The official experiment in the area of national planning is rooted in the Bolshevik Revolution of Russia (1917)—the Soviet Union. Dissatisfied with the pace of industrialisation, it was in 1928 that Joseph Stalin announced its policy of central planning for the Soviet Union. The collectivisation of agriculture and forced-draft industrialisation were other radical new policy initiatives announced by Stalin besides economic planning in 1928.[10] The Soviet Union went for its first five year plan for the period 1928–33 and the world was to have its *first* experience of *national planning*. The famous Soviet slogan "great leap forward" was initiated for rapid industrialisation through the introduction of economic planning at the national level. The nature and scope of Soviet planning (called ***the Gosplan***) will have its direct or indirect bearings on all those countries who went for economic planning, be state economies or capitalist or mixed economies. India was to have direct bearings of Soviet planning on its planning process. In the first Soviet Plan, heavy industry was to be favoured over light industry, and consumer goods were to be the residual sector after all the other priorities had been met. We see the same emphasis in the Indian planning process.[11] The Soviet model of economic planning spread to the East European countries, especially after World War II and found its purest form of such planning in the People's Republic of China (1949). During the early 1940s, the concept of national planning was borrowed by France and the world saw national planning being initiated by a hitherto capitalist economy as well as by a non-centralised political system (i.e., democratic system). France started economic planning at the national level after announcing itself a mixed economy.

TYPES OF PLANNING

After the first national planning was started by the Soviet Union, many more countries followed it, but with variations in their methods and practices. Though there are many variants of planning the most important one is on the basis of the type of economic organisation (i.e., state economy, mixed economy). During the course of evolution, planning has been classified into two types, based

9. Leong, G.C. and Morgan, G.C., ***Human and Economic Geography***, Oxford University Press, Oxford, 1982., p. 145.
10. Alec Nove, ***An Economic History of the USSR***, 3rd ed., Penguin Books, Baltimore, USA, 1990, p. 139.
11. Rakesh Mohan 'Industrial Policy and Controls' in the Bimal Jalan (Eds), ***The Indian Economy: Problems and Prospects***, Penguin Books, N. Delhi, 2004., p. 101. Also see Bipan Chandra et. al., ***India After Independence***, Penguin Books, N. Delhi, 2000, pp. 341–342 as well as A. Vaidyanathan, **'The Indian Economy Since Independence (1947–70)'** in Dharma kumar (ed.), ***The Cambridge Economic History of India***, Vol. II, Cambridge University Press, Cambridge, 1983, pp. 949–50.

upon the type of economic system the economy has:

1. Imperative Planning

The planning process followed by the state economies (i.e., the socialist or communist) is known as the imperative planning. Such planning is also called as ***directive* or *target planning***. Such planning had two main variants. In the Socialist system, all economic decisions were centralised in the hands of the state with collective ownership of resources (except labour). In the Communist system (i.e., China of the past) all resources were to be owned and utilised by the state (including labour). Thus, communist China was the purest example of such planning. In the case of the Soviet Union a little bit of 'market' did exist—even after the collectivisation of agriculture was enacted by Stalin in 1928 only 94 per cent of Soviet peasants could be included in the process.[12] Basic features of such planning are as under:

(i) *Numerical (i.e., quantitative) targets* of growth and development are set by the plans. As for example, five lakh tonnes of steel, two lakh tonnes of cement, 10,000 kms of national highways, 5,000 primary schools, etc., will be produced/built in the coming 5 or 6 years.

(ii) As the *state* controls the ownership rights over the resources, it is very much possible to realise the above-cited planned targets.

(iii) Almost *no role for the market,* no price mechanism with all economic decisions to be taken in the centralised way by the state/government.

(iv) No private participation in the economy, only state played the economic role.

The ***Command Economies*** followed this kind of planning. That is why such economies are also known as the ***Centrally Planned Economies*** — the USSR, Poland, Hungary, Austria, Romania, etc., and finally China. Basically, it was the migration of some of the great economists from the Soviet Bloc countries to Britain and the USA that a proper study and discussion started on the very nature and purpose of planning in the command economies. Many of these economists went back to their countries of origin after the Second World War to serve and in some measure, suffer the revolution there.[13] It was their articulate and contemporary economic thinking which formed the basis for the idea of mixed economy in the post-War world. One among them was Oskar Lange, the famous Polish economist who after returning home to serve as the Chairman of the Polish State Economic Council (as India has the Planning Commission) suggested and coined the concept of *'market socialism'* in the 1950s. His ideas of market socialism were cancelled by not only Poland but also by other state economies of the time.[14]

The peak of this type of planning was reached in China after the Cultural Revolution (1966–69), which led to an economic slowdown in the country which had adopted a Soviet-style central planning system after 1949. Under Deng

12. Samuelson, P.A. and Nordhaus, W.D, ***Economics,*** McGraw-Hill Companies Inc., N. York, 2005., p. 591.
13. From Poland two great economists Oskar Lange (1904–65) and Michal Kalecki (1899–1970); from Hungary, William J. Fellner (1905–83), Nicholas Kaldor (1908–86), Thomas Balogh (1905–85) and Eric Roll (1907–95); from postwar Austria Ludwig von Mises (1880–1973), Friedrich A. von Hayek (1899–1992), Fritz Machlup (1902–83), Gottfried Haberler (1900–96) and Joseph A. Schumpeter (1883–1950) [J.K. Galbraith, ***A History of Economics,*** Penguin Books, London, 1987, pp. 187–190].
14. It was blasphemous to preach in favour of market in the socialist world at that time—he was not put behind the bars was a great mercy on him. Oskar Lange towards the end of his life told Paul M. Sweezy, the most noted American Marxist scholar, that during this period he did not retire for the night without speculating as to whether he might be arrested before the dawn (J.K. Galbraith, ***A History of Economics,*** Penguin Books, London, 1987, p. 189).

Xiaoping (1977–97), China decentralised a great deal of economic power with its announcement of the "open door policy" in 1985 to save the economy. The Chinese ***open door policy*** was an initiative in the direction of 'market socialism' under the communist political design itself (a popular student demand for political reform in favour of democracy was ruthlessly repressed in Tiananmen square in 1989). Similarly, the Soviet Union under the leadership of Mikhail Gorbachev began a process of political and economic reforms, called ***prestroika*** (i.e., restructuring) and ***glasnost*** (i.e., openness) in 1985 to save the failed economic experiments in the state economy. Other East European economies followed, similar economic reforms from 1989 onwards. Thus, the whole world of the state economies had moved towards market economy by the late 1980s. Since then none of the countries have followed imperative planning.

2. Indicative Planning

In the following two decades after the Soviet planning commenced, the idea of planning got attention from the democratic world. A time came when some such economies started national planning. As they were neither the state economies nor communist/socialist political systems, the nature of their planning was to be different from the command economies. Such planning has been called as indicative planning by economists and experts. Identifying features of indicative planning may be summed up as under:

(i) Every economy following the indicative planning were the mixed economies.

(ii) Unlike a centrally planned economy (countries following imperative planning) indicative planning works through the market (price system) rather than replaces it.[15]

(iii) Side by side setting numerical/quantitative targets (similar to the practice in the imperative planning) a set of economic policies of indicative nature is also announced by the economies to realise the plan targets.

(iv) The indicative nature of economic policies which are announced in such planning basically encourage or discourage the private sector in its process of economic decision making.

After converting to a mixed economy by the mid-1940s, France commenced its first six year plan in 1947, which got popularity as the ***Monnet Plan*** (he was the first chairman of the General Planning Commission and the then Cabinet Minister for Planning in France).[16] Later, Monnet Plan became synonymous with indicative planning. This plan is also sometimes described as the *basic sector planning* as the government had selected eight basic industries as the core of development in which the nature of planning was almost *imperative,* i.e., under state monopoly (these sectors were owned by the private sector till 1944 when France went for their nationalisation).[17] Other economic activities were open for private participation for which indicative kind of policy-planning was essential. France as well as Japan have followed indicative planning with great success. It was in 1965 that the UK commenced such a planning with the National Plan and abandoned in 1966 after being overtaken by events (a balance of payment crisis resulting in

15. ***Collins Internet-linked Dictionary of Economics***, Glasgow, 2006.

16. Steiner, ***Government's Role in Economic Life,*** McGraw-Hill, New York, 1993, p. 152.

17. India had a French influence on its development planning when it followed almost state monopoly in the six infrastructure industries also known as the ***core*** or the ***basic*** industries, i.e., cement, iron and steel, coal, crude oil, oil refinery and electricity.

a deflationary package of measures). Since then the UK never went for the Planning.[18]

Though the first use of economic planning as an instrument of economic progress was done by the USA (with the Tennessee Valley Authority in 1916 at the regional level), it never went for a *formal* national planning. In the 1940s, some economists had suggested in favour of the use of national planning. We may have a reflex of indicative planning in the USA if we look at the *Presidentail Reports* which come after regular intervals. These reports are just 'benchmarks' in the area of resource utilisation and governmental announcements of its objectives—basically trying to motivate the private sector towards the area of public objectives. The indicative planning as it is practised by the mixed economy, any growth target could only be achieved once the public and the private enterprises worked in tandem. This is why besides the plan targets, the governments need to announce some set of indicative policies to encourage and motivate the private sector to accelerate their economic activities in the direction of the plan targets.

After the Second World War, almost all the newly independent countries adopted the route of planned development. Though they followed an overall model of the indicative planning, many of them had serious inclination towards imperative planning. As in the case of India, the heavy bias towards imperative planning could only be reformed once the process of economic reforms was started in 1991.

Today, as there are mostly only mixed economies around the world, any country's development planning has to be only of the indicative type. After the revival of the role and the need of market in promoting growth and development via the Washington Consensus (1985), the Santiago/New Consensus (1998) and the World Trade Organization (1995), only indicative planning has remained possible with the state playing only a marginal role in the economy, especially in the areas of social importance (i.e., nutrition, healthcare, drinking water, education, social security, etc.).

There are still many other types of planning depending upon the point of view we are looking with. For example, from the territorial point of view, planning could be ***regional*** or ***national***. From the political point of view planning could be ***central, state*** or ***local***. Similarly, from the participatory point of view, planning has been categorised into ***centralised*** and ***decentralised***. Again, from the temporal point of view planning could be ***long-term*** or ***short-term*** (in relative sense). Finally, from the value point of view planning could be ***economic*** or ***developmental***.

A major classification of planning is done on the basis of societal emphasis. The type of planning which gives less emphasis upon the social and institutional dimensions is known as the ***systems planning***. In such planning, the planners just search for the best possible results in relation to the established goals giving less importance to issues like caste, creed, religion, region, language, marriage, family, etc. Opposed to it, the ***normative planning*** gives due importance to the socio-institutional factors. This is a planning from social-technical point of view, but only suitable for a country which has lesser degree of social diversities (naturally, not fit for the Indian conditions). But in the coming years there was a shift in the very thinking of policymakers. The *Economic Survey 2010–12* is probably the first document of the government of India which advocates the need for a ***normative approach*** to planning in India. It is believed that until a programme/scheme run by the governments are not able to connect with the customs, traditions and ethos of the population, their acceptability will not be of the desired levels among the target

18. Though the planning agencies the National Economic Development Council (NEDC) and the Economic Development Committees (EDCs) continued functioning, it was in 1992 that the NEDC was abolished (***Collins Dictionary of Economics, 2006***).

population. Establishing an empathic relationship between the programmes/schemes and target population is now considered an important aspect of planning and policymaking. Such a change in the thinking is based on the experiences of India and other countries of the world.

Economic planning is classified into more types—***sectoral*** and ***spatial***. In sectoral planning, the planners emphasise the specific sector of the economy, i.e., agriculture, industry or the services. In spatial planning development is seen in the spatial framework. The spatial dimensions of development might be defined by the pressure and requirements of national economic development. Indian planning has been essentially normative—single level economic planning with a greater reliance on the sectoral approach though the multi-level regional or spatial dimensions are being increasingly emphasised since the early 1990s.

CHAPTER

5

PLANNING IN INDIA

- ⇨ Introduction
- ⇨ Background
- ⇨ Major Objectives of Planning
- ⇨ Planning Commission
- ⇨ National Development Council
- ⇨ Central Planning
- ⇨ Multi-Level Planning
- ⇨ Way to Decentralised Planning
- ⇨ The Planning Commission & The Finance Commission
- ⇨ The Changing Nature and the Role of Planning
- ⇨ Monitorable Targets Set By The Twelfth Plan
- ⇨ A Critical Evaluation
- ⇨ Inclusive Growth
- ⇨ Investment Models
- ⇨ Central Sector Scheme and Centrally Sponsored Schemes
- ⇨ Composite Development Index of States
- ⇨ Independent Evaluation Office
- ⇨ Programme Evaluation Organisation
- ⇨ NITI AAYOG

*For the first eight Plans the emphasis was on a growing public sector with massive investments in basic and heavy industries, but since the launch of the Ninth Plan in 1997, the emphasis on the public sector has become less pronounced and the current thinking on planning in the country, in general, is that it should increasingly be of an indicative nature.**

** Montek S. Ahluwalia addressing the inaugurating of the Seminar on 'India's Economic Reforms' at Merton College, Oxford University, London, June 1993.*

INTRODUCTION

It was the Soviet Union which explored and adopted *national planning* for the first time in the world. After a prolonged period of debate and discussion, the First Soviet Plan commenced in 1928 for a period of five years. But the world outside was not fully known to the modus operandi of development planning till the 1930s. It was the exodus[1] of the east European economists to Britain and the United States in the 1920s and 1930s that made the world aware as to what economic/national planning was all about. The whole lot of colonial world and the democracies of the time were fascinated by the idea of planning as an instrument of economic progress. The nationalist leaders with socialistic inclination of the erstwhile British colonies were more influenced by the idea of economic planning. The whole decade of the 1930s is the period in the Indian history when we see nationalists, capitalists, socialists, democrats and academicians advocating for the need of economic planning in India at one point or another.[2]

Independent India was thus destined to be a planned economy. The economic history of India is nothing but the history of planning.[3] Even if the so-called economic reforms started in 1991–92, all the humble suggestions regarding the contours of reforms were very much outlined by the Planning Commission by then.[4] Once the reforms commenced, the think tank started outlining the major future direction for further plans.[5] Going through the history of planning in India is a highly educational trip in itself—for though the Planning Commission has been a political body, it never hesitated in pointing out good economics time and again. Let us therefore look into the unfolding of the planning process in India.

BACKGROUND

By the decade of the 1930s, the idea of planning had already entered the domain of intellectual and political discussion in India. Many fresh proposals suggesting immediacy of planning in India were put forward, though the erstwhile British government remained almost immune to them. But these humble proposals of planning served their purpose once independent India decided to adopt a planned economic pattern for India of which a list is given below:

THE VISVESVARAYA PLAN

The credit of proposing the first blueprint of Indian planning is given to the popular civil engineer and the ex-Dewan of Mysore state M. Visvesvaraya—in his book *The Planned Economy of India*, published in 1934.[6] His ideas of state planning were an exercise in democratic capitalism (similar to the USA) with emphasis on industrialisation—a shift of labour from the agrarian set up to the industries targeting to double national income in one decade. Though there was no follow up by the British government on this plan, it aroused an urge for national planning among the educated citizens of the country.

1. J.K. Galbraith, ***A History of Economics,*** Penguin Books, London, 1991, p. 187.
2. Bipan Chandra, ***'The Colonial Legacy'*** in Bimal Jalan ds, ***The Indian Economy: Problems and Prospects,*** p. 30.
3. Arjun Sengupta, ***'The Planning Regime since 1951'*** in N.N. Vohra and Sabyasachi Bhattacharya edited ***Looking Back: India in the Twentieth Century,*** NBT, N. Delhi, 2001, p. 121.
4. Planning Commission, ***Seventh Five Year Plan (1985–90),*** GoI, 1985.
5. Planning Commission, ***The 8th, 9th, 10th and 11th Plans,*** GoI, N. Delhi.
6. Sumit Sarkar, ***Modern India: 1855–1947,*** Macmillan, N. Delhi, 1983, pp. 360–361.

THE FICCI PROPOSAL

In 1934, a serious need of national planning was recommended by the Federation of Indian Chambers of Commerce and Industry (FICCI), the leading organisation of Indian capitalists. Its President N.R. Sarkar proclaimed that the days of undiluted laissez-faire were gone forever and for a backward country like India, a comprehensive plan for economic development covering the whole gamut of economic activities was a necessity. Voicing the views of the capitalist class he further called for a high powered 'National Planning Commission' to coordinate the whole process of planning so that the country could make a structural break with the past and achieve its full growth potential.[7]

By the late nineteenth century, the economic thinking of the nationalists (such as M.G. Ranade and Dadabhai Naroji) was in favour of a dominant role of state in the economy and doubted the prudence of the 'market mechanism'. This thinking was further reinforced by the Keynesian ideas in the wake of the Great Depression, the *New Deal* in the USA and the Soviet experiment in national planning. Thus, the Indian capitalist class were also influenced by these events which were voiced in the FICCI articulation for planning.

THE CONGRESS PLAN

Though the Gandhians and some of the business and propertied representatives were opposed to commit the party to centralised state planning (including Mahatma Gandhi),[8] it was on the initiative[9] of the INC president Subhash C. Bose that the National Planning Committee (NPC) was set up in October 1938 under the chairmanship of J.L. Nehru to work out concrete programmes for development encompassing all major areas of the economy. Basically, the NPC was set up in a conference of the Ministers of Industries of the Congress-ruled States (though other states were also invited to participate) where M. Visvesvaraya, J.R.D. Tata, G.D. Birla and Lala Sri Ram and many others including academicians, technocrats, provincial civil servants, trade unionists, socialists and communists, etc., were also invited. The 15-member NPC with 29 sub-committees and a total of 350 members produced 29 volumes of recommendations.[10] The work of the committee was interrupted when the Second World War broke out and in the wake of the Quit India Movement many of its members including the chairman were arrested, and between 1940 and 1945 the Committee had only a nominal existence. Though the final report of the NPC could only be published in 1949, many developments related to planning took place during the Interim Government upto 1946.

"A series of valuable reports were published which brought together the constructive thinking done by the committee and the sub-committees and the material collected in the course of their work. The importance of the NPC lies not so much in these reports as in the wide interest it created throughout the country for co-ordinated planning as the only means of bringing about a rapid increase in the standards of living and its emphasis on the need for bringing fundamental changes in the social and economic structure."[11]

Some of the important developments after the NPC was set up which prepared a foundation for coordinated planning in independent India are given below:

7. Bipan Chandra et.al, ***India After Independence, 1947–2000,*** Penguin Books, N. Delhi, 2000, p. 341.
8. A. Vaidyanathan. *'The Indian Economy Since Independence (1947–70)'* in Dharma Kumar Ed. ***The Cambridge Economic History of India, Vol.II***, Cambridge University Press, England, 1983, p. 949.
9. Sumit Sarkar, ***Modern India***, p. 360.
10. Publications Division, ***The Gazetteer of India, Vol.3,*** GoI, N. Delhi, 1975, p. 2.
11. ***Ibid.***, p. 2–3.

(i) ***Post War Reconstruction Committee:*** Early in June 1941, the Government of India formed (on popular demand) a Post-War Reconstruction Committee which was to consider various plans for the reconstruction of the economy.[12]

(ii) ***Consultative Committee of Economists:*** A consultative committee of economists under the chairmanship of Ramaswamy Mudaliar was set up in 1941 as a 'think tank' to advise the four Post-War Reconstruction Committees for executing national plan for the country.

Though the committee suggested many plans for different areas of the economy, but they had negligible practical significance as these suggestions were imbued with academic biases.

(iii) ***Planning and Development Department:*** After all possible delays, it was in 1944 that the government created a Planning and Development Department under a separate member of the Viceroy's Executive Council for organising planning work in the country and co-ordinating it. Ardeshir Dalal (the controller of the Bombay Plan) was appointed as one of its acting members. More than 20 panels of experts were set up. The central departments and the governments of Provinces and Indian states were invited to prepare detailed plans for industrialisation.[12] This Department was abolished in 1946.

(iv) ***Advisory Planning Board:*** In October 1946, the Government of India appointed a committee called the 'Advisory Planning Board'[13] to review the planning that had already been done by the British government, the work of the National Planning Committee, and other plans and proposals for planning and to make recommendations regarding the future machinery of planning and also in regard to objectives and priorities. The Board strongly recommended the creation of "a single, compact authoritative organisation ... responsible directly to the Cabinet ... which should devote its attention continuously to the whole field of development."[14] This was an emphatic advice for the creation of a National Planning Commission, similar to FICCI's view of 1934, which will have autonomy and authoritative say on the process of development planning, working in tandem with the Union cabinet and also influencing the developmental decisions of the states. This happened in 1950 with the setting up of the Planning Commission.

The Board, in its Report of January 1947, emphatically expressed the opinion that the "proper development of large-scale industries can only take place if political units, whether in the provinces or states, agree to work in accordance with a common plan."[15] This suggestion worked as a great influence on the planning process of independent India as it always tried to give unifying nature to development planning. But, this process also induced a serious tendency of centralisation in the Indian planning to which a number of states were to pose objections and straining the centre-state relations, time and again.[16] However,

12. There was a popular view in favour of rapid industrialisation among the important nationalists, economists and the business class of that time.
13. The Board was set up by the Interim Government formed in 1946 itself.
14. Dharma Kumar (Ed.), ***The Cambridge Economic History of India, Vol.II*** p. 950.
15. Kalikinkar Datta, ***An Advanced History of India,*** 4th Edition, Macmillan, N. Delhi, 2006, pp. 955–56.
16. S.N. Jha and P.C. Mathur (Eds), ***Decentralisation and Local Politics,*** Sage Publications, N. Delhi, 2002, pp. 28–33.

the political leadership right since 1920s was very conscious of the need for decentralised planning in the country.[17]

THE BOMBAY PLAN

Bombay Plan was the popular title of 'A Plan of Economic Development for India', which was prepared by a cross-section of India's leading capitalists. The eight capitalists involved in this plan were Purshotamdas Thakurdas, J.R.D. Tata, G.D. Birla, Lala Sri Ram, Kasturbhai Lalbhai, A.D. Shroff, Avdeshir Dalal and John Mathai.[18] The Plan was published in 1944–45. Out of these eight industrialists, Purshotamdas Thakurdas was one among the 15 members of the National Planning Committee (1938)[19] Rest three J.R.D. Tata, G.D. Birla and Lala Sri Ram, were the members of the sub-committees (29 in total) of the National Planning Committee.[20]

The popular sentiments regarding the need of planning and criss-cross of memberships between the NPC and the Bombay Plan club made possible some clear-cut agreements between these two major plans, which ultimately went to mould the very shape of the Indian economy after Independence. We may have a look at some of the very important agreements:[21]

(i) A basic agreement on the issue of the ***agrarian restructuring***—abolition of all intermediaries (i.e., zamindari abolition), minimum wages, guarantee of minimum or fair prices to agricultural producers, cooperatives, credit and marketing supports.

(ii) Agreement on ***rapid industrialisation*** for which both the plans agreed upon an emphasis on heavy capital goods and basic industries (the Bombay Plan had allocated 35 per cent of its total plan outlay on basic industries).

(iii) Taking clues from the Soviet Planning, the NPC and the Bombay Plan both were in favour of a simultaneous ***development of the essential consumer goods*** industries but as a low-key affair.

(iv) Both the plans agreed upon the importance of promoting the ***medium-scale, small-scale*** and ***cottage industries*** as they could provide greater employment and require lesser capital and lower order of plants and machineries.

(v) Both the plans wanted the ***state to play an active role*** in the economy through planning, controlling and overseeing the different areas of the economy, i.e., trade, industry, banking through state ownership (public sector) or through direct and extensive control over them.

(vi) Large-scale measures for ***social welfare*** were favoured by both the plans which suggested to be based on issues like, right to work and full employment, the guarantee of a minimum wage, greater state expenditure on housing, water and sanitation, free education, social insurance to cover unemployment and sickness and provision of utility services such as electricity and transportation at a low cost through state subsidies.

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17. A. H. Hanson, ***The Process of Planning: A Study of India's Five-Year Plans, 1950–1964,*** Oxford University Press, London, 1966, pp. 152–55.
18. Bipan Chandra, ***'The Colonial Legacy'***, in Bimal Jalan edited, ***Indian Economy Problems and Prospects,*** p. 23.
19. Partha Chatterjee, ***Development Planning and the Indian Planning,*** in Partha Chatterjee edited ***State and Politics in India,*** Oxford University Press, N. Delhi, 1997, p. 273.
20. Rakesh Mohan, ***'Industrial Policy and Controls'*** in Bimal Jalan (Ed.) ***Indian Economy: Problems and Prospects,*** 1992, p. 100.
21. Bipan Chandra **'The Colonial Legacy'** pp. 23–31.

(vii) Both the Plans agreed upon a planning which could do away with the gross ***inequalities.*** Through measures like progressive taxation and prevention of concentration of wealth. Inequality was considered undesirable as it tended to restrict the domestic market.

The Gandhian Plan

Espousing the spirit of the Gandhian economic thinking, Sriman Narayan Agarwal formulated this plan in 1944. This plan laid more emphasis on agriculture. Even if he referred to industrialisation, it was to the level of promoting cottage and village-level industries, unlike the NPC and the Bombay Plan which supported a leading role for the heavy and large industries. The plan articulated a 'decentralised economic structure' for India with 'self-contained villages'.

It needs to be noted here that the Gandhians did not agree with the views of the NPC or the Bombay Plan, particularly on issues like centralised planning, dominant role of the state in the economy and the emphasis on industrialisation being the major ones.[22] For Gandhi, the machinery, commercialisation and centralised state power were the curses of modern civilisation, thrust upon the Indian people by European colonialism. It was industrialism itself, Gandhi argued, rather than the inability to industrialise, which was the root cause of Indian poverty. This was until the 1940s that the Congress supported the above-given view of Gandhi to mobilise a mass movement against the colonial rule. But it was in the NPC that the Congress tried to articulate a different view on these issues, almost taking a break from Gandhi's ideas. The very first session of the NPC was brought to an impasse by J.C. Kumarappa (the lone Gandhian on the 15-member NPC) by questioning the authority of the NPC to discuss plans for industrialisation. He said on the occassion that the national priority as adopted by the Congress was to restrict and eliminate modern industrialism. The impasse was normalised after Nehru intervened and declared that most members of the NPC felt that large-scale industry ought to be promoted as long as it did not 'come into conflict with the cottage industries'.[23] This was a long-drawn ideological impasse which made it necessary to articulate the Gandhian view of planning via this plan.

The People's Plan

In 1945, yet another plan was formulated by the radical humanist leader M.N. Roy, chairman of the Post-War Reconstruction Committee of Indian Trade Union. The plan was based on Marxist socialism and advocated the need of providing the people with the 'basic necessities of life'.[24] Agricultural and industrial sectors, both were equally highlighted by the plan. Many economists have attributed the socialist leanings in Indian planning to this plan. The common minimum programmes of the United Front Government of the mid-nineties (20th century) and that of the United Progressive Alliance of 2004 may also be thought to have been inspired from the same plan. 'Economic reforms with the human face', the slogan with which the economic reforms started in early 1990s also has the resonance of the People's Plan.

The Sarvodaya Plan

After the reports of the NPC were published and the government was set to go for the five-year plans, a lone blueprint for the planned development of India was formulated by the famous socialist leader Jaiprakash Narayan—the Sarvodaya Plan published in January 1950. The plan drew its major inspirations from the

22. Dharma Kumar, 1983, op.cit, p. 949.
23. Partha Chatterjee, op.cit, p. 275.
24. S. K. Ray, ***Indian Economy,*** Prentice-Hall, N. Delhi, 1987, p. 369.

Gandhian techniques of constructive works by the community and trusteeship as well as the Sarvodaya concept of Acharya Vinoba Bave, the eminent Gandhian constructive worker. Major ideas of the plan were highly similar to the Gandhian Plan like emphasis on agriculture, agri-based small and cottage industries, self-reliance and almost no dependence on foreign capital and technology, land reforms, self-dependent villages and decentralised participatory form of planning and economic progress, to name the major ones.[25] Some of the acceptable ideas of the plan got their due importance when the Government of India promoted five year plans.

By the early 1960s, Jayprakash Narayan had become highly critical of the Indian planning process especially of its increasing centralising nature and dilution of people's participation in it. Basically, the very idea of democratic decentralisation was disliked by the established power structure, namely, the MLAs/MPs, the bureaucracy and the state-level politicians.[26] This led the Jayprakash Narayan Committee (1961) to observe against the centralising nature of Indian planning. The committee pointed out that after having accepted Panchayati Raj as the agency responsible for planning and execution of plans, there is "no longer any valid reason for continuing the individual allocations subjectwise even to serve as a guide."[27]

Disregarding the humble advice of the committee, central schemes like small farmers development agency (SFDA), drought-prone area programme (DPAP), intensive tribal development programme (ITDP), intensive agricultural district programme (IADP), etc., were introduced by the governments and were put totally outside the purview of Panchayats.

It was only after the 73rd and 74th Amendments effected to the Constitution (1992) that the role of local bodies and their importance in the process of planned development was accepted and the views of Jayprakash got vindicated.

Some Area-wise Reports

The idea for the need of a planned development of India became more and more popular by the decade of the 1940s. It was under this popular pressure that the Government of India started taking some planned actions in this direction. In the 1940s, we see several area-specific reports being published:[28]

(i) Gadgil Report on Rural Credit
(ii) Kheragat Report on Agricultural Development
(iii) Krishnamachari Report on Agricultural Prices
(iv) Saraiya Report on Cooperatives
(v) A series of reports on Irrigation (ground water, canal, etc.)

All these reports, though prepared with great care and due scholarship, the government had hardly any zeal to implement plans on their findings. But independent India was greatly benefited when the planning started covering all these areas of concerns.

There is no doubt in drawing the conclusion that prior to Independence, there was thus a significant measure of agreement in India between the Government of India under the Secretary of State, the Indian National Congress, prominent

25. A.H. Hanson, 1966, op.cit, p. 175.
26. George Mathew, ***Power to the People*** in M.K. Santhanam edited, ***50 Years of Indian Republic,*** Publications Division, GoI, N. Delhi, 2000, p. 32.
27. L.C. Jain, et al., ***Grass Without Roots,*** Sage Publications, N. Delhi, 1985.
28. A. H. Hanson, 1966, op. cit, p. 180.

industrialists and the others on the following principles:[29]

(i) There should be central planning, in which the state should play an active part, for social and economic development to bring about a rapid rise in the standards of living;

(ii) There should be controls and licencing in order, among other things, to direct investments into the desired channels and ensure equitable distribution;

(iii) While there should be balanced development in all sectors of the economy, the establishment of basic industries was specially important. In this, state-owned and state-managed enterprises have an important role. There were, however, differences of approach with regard to the specific fields to be allocated to the public and private sectors.

It is highly interesting and important to note that all the above agreements and opinions were reached through an evolutionary manner in the last two-decades before Independence in the deliberations and excercises regarding the need for economic planning in the country.

"The plans prepared by the Governmnt of India, the Bombay Plan and other above-discussed plans (except the NPC and the Sarvodaya Plan) suffered from serious limitations. When they were prepared, it was known that transfer of power was to take place quite soon; but the exact form of the future government was not known, the plans consisted largely of proposals of experts which were not effectively co-ordinated. They had no social philosophy behind them. With the advent of Independence, they became inadequate, though the thinking that had taken place on planning generally and its techniques proved useful for the future."[30]

MAJOR OBJECTIVES OF PLANNING

Planning for India was an instrument to realise the aspirations and dreams of the future. We know that the foundations of future India were not laid in one day. The cherished dream about future India had evolved through a long-drawn process of the entire period of the freedom struggle. These aspirations and goals got their proper places and due importance in the reports of the National Planning Committee (NPC), in the deliberations of the Constituent Assembly and finally in the Constitution of India. From the margins of the ripening nationalist movement as well as taking clues from the Soviet and the French styles of planning, the NPC articulated the objectives of planning in India. The process of planning in India tried to include all the aspirations of the nationalist movement as well as of the future generations. But this will be a highly general comment upon the objectives of planning in India. We need to delve into the specific and objective goals of planning in India to further our discussions. Some of the historic deliberations regarding planning will serve our purpose:

(i) Reviewing the entire situation, in the light of the social philosophy evolved over decades, the Constituent Assembly came to the conclusion that to guide this 'revolution of rising expectations' into constructive channels, India should make determined efforts through carefully planned large-scale social and economic development and the application of modern scientific and technological improvements, to bring about a rapid and appreciable rise in the standard of living of the people, with the maximum measure

29. ***Gazetteer of India, Vol.3,*** op.cit, p. 5.
30. ***Gazetteer of India, Vol.3,*** op.cit, p. 5.

of social justice attainable. On the whole it was a call for India becoming a welfare state.[31] This important deliberation does not only call for the necessity of planning for the country but it also outlines the broader objectives of planning, too.

(ii) There are three important features included in the constitutional provisions, which pertain to the objectives of planning in the country:[32]

(a) 'Economic and social planning' is a concurrent subject. Also, while framing the 'Union', 'State' and 'Concurrent' lists, allocating subjects and other provisions, the Constitution vests power in the Union to ensure co-ordinated development in essential fields of activity while preserving the initiative and authority of the states in the spheres allotted to them.

(b) The Constitution includes provisions for promoting cooperation on a voluntary basis between the Union and the states and among states and groups of states in investigation of matters of common interest, in legislative procedures and in administration, thus avoiding the rigidities inherent in federal constitutions (Articles 249, 252, 257, 258, 258-A, and 312). In other words, the objective is cooperative federalism.

(c) The Constitution also sets out in broad outline the pattern of the welfare state envisaged and the fundamental principles on which it should rest.

These are the major cornerstones of planning and its objectives enshrined in the Constitution that will breed enough Union–State tussle in coming decades and make it compulsive for the government to resort to 'reforms with a human face' rhetoric. We can see the methodology of planning taking a U-turn in the era of the economic reforms since the early 1990s.

(iii) The government, resolution announcing the setting up of the Planning Commission (March 1950) started with a reference to the constitutional provisions bearing on the socio-economic objectives of the Constitution. The Fundamental Rights and the Directive Principles of the Constitution assure every citizen, among other things, adequate means of livelihood, opportunities for employment and a socio-economic order based on justice and equality. Thus, the basic objectives[33] of planning were already given in the provisions of the Constitution of India. These were emphatically stated in the First Five Year Plan (1951–56) itself, in the following words:

"The urge to economic and social change under present conditions comes from the facts of poverty and of inequalities in income, wealth and opportunity. The elimination of poverty cannot obviously, be achieved merely by redistributing existing wealth. Nor can a programme aiming only at raising production remove existing inequalities. These two have to be considered together...."

(iv) The above objectives of planning were emphasised in one form or the other in the coming times also. As the Second Five Year Plan (1956–61) said:

"The Plan has to carry forward the process initiated in the First Plan period. It must

31. ***Gazetter of India, Vol.3,*** op.cit, p. 5.
32. ***Gazetter of India, Vol.3,*** op.cit, pp. 7–10
33. ***Gazetteer of India, Vol.3,*** op.cit, pp. 7–10.

provide for a larger increase in production, in investment and in employment. Simultaneously, it must accelerate the institutional changes needed to make the economy more dynamic and more progressive in terms no less of social than of economic ends."

(v) The same objectives were repeated by the Sixth Five Year Plan (1980–85) in the following words:

"The basic task of economic planning in India is to bring about a structural transformation of the economy so as to achieve a high and sustained rate of growth, a progressive improvement in the standard of living of the masses leading to eradication of poverty and unemployment and providing a material base for a self-reliant economy."

(vi) It will be highly needful to enquire about the objectives of planning in the era of the economic reforms initiated in the fiscal 1991–92 as this new economic policy (NEP) made the experts and economists to conclude many questionable things about the objectives of planning in the country:

(a) The need to shift dependence from wage to self-employment.

(b) The state is rolling back and the economy is becoming pro-private and sector-wise the social purpose of the planning will be lacking.

(c) The objectives of planning nearly outlined hitherto have been blurred.

(d) The promotion of foreign investment will induce the economy into the perils of neo-imperialism, etc.

But all the above-given doubts were cleared by the forthcoming plans in straightforward words. We may quote from the following Plans:

- "For the future economic development, the economy will be more dependent upon private participation and the nature of planning will become more indicative with the major objectives of planning remaining the same". This was announced by the government while launching the economic reforms (July 23, 1991) and commencing the Eighth Five Year Plan (1992–97). "There was no change in the basic objectives of planning even though there was change in instruments of policy"—this was announced by the government while announcing the new economic policy (1991).
- While the Ninth Plan (1997–2002) was being launched it was announced: "The goals of planning in India, which were set by Panditji have not changed. The Ninth Plan does not attempt to reinvent the wheel. At the same time, the goals and targets this Plan attempts to achieve are based on the lessons of experience including the Eighth Plan. They address today's problems and challenges and try to prepare the nation for tomorrow as well."[34]

Finally, a broad consensus looks evolving through the process of planning and crystallising on the six major objectives of planning[35] in India which are as follows:

34. Deputy Chairman, Planning Commission, May 1999. It is interesting to note here that the composition of the polity in Centre was dominated by the BJP while the Deputy Chairman, Planning Commission was K.C. Pant (an old congress man) – continuity in the basic ideas and objectives of planning being maintained.

35. ***India,*** various years taken together, Publications Division, GoI, N. Delhi.

(i) **Economic Growth:** Sustained increase in the levels of production in the economy is among the foremost objectives of planning in India, which continues till date and will be so in future, without any iota of doubt in it.

(ii) **Poverty Alleviation:** Poverty alleviation was the most important issue which polarised the members of the NPC as well as the Constituent Assembly that a highly emphatic decision in favour of a planned economy evolved even before Independence. Several programmes have been launched in India directing the cause of poverty alleviation by all the governments till date and the process continues even today with more seriousness (we see the National Rural Employment Guarantee Programme—NREGP—being launched by the UPA Government in 2006 by passing an Act in the Parliament—the matter has started attracting such high political concern).

(iii) **Employment Generation:** Providing employment to the poor has been the best tool of economics to alleviate poverty. Thus, this objective of planning in India comes naturally once it commits itself to alleviate poverty. Employment generation in India has been, therefore, part and parcel of the objective of poverty alleviation in India. General programmes and schemes have been launched by the governments from time to time in this direction, some based on the wage employments still, others based on self-employment.

(iv) **Controlling Economic Inequality:** There were visible economic inequalities in India at the inter-personal as well as at the intra-personal levels. Economic planning as a tool of checking all kinds of economic disparities and inequalities was an accepted idea by the time India started planning.[36] To fulfil this objective of planning the governments have enacted highly innovative economic policies at times even inviting a tussle with regard to the Fundamental Rights enshinned in the Constitution.

Though Indian Planning has socio-economic objectives to fulfil, only economic planning was made a part of the planning process (technically speaking) and social planning (better called social engineering) was left to the political process. That is why reservation in government jobs and admissions in premier academic institutions, land reforms, promoting inter-caste marriages, etc., do not fall under the purview of the Planning Commission.

(v) **Self-reliance:** During the 1930s and 1940s, there was an ardent desire among the nationalists, capitalists and the NPC for making the economy self-reliant in all economic sphere. Self-reliance was defined not as autarchy but as an effort to strike against a subordinate position in the world economy. As Jawaharlal Nehru asserted: self-reliance, "does not exclude international trade, which should be encouraged but with a view to avoid economic imperialism."[37] India still

36. Duely discussed by the NPC as well as the Constituent Assembly.

37. ***National Planning Committee Report;*** Also Nehru in ***The Discovery of India.***

strives for self-reliance in every field of the economy as well as serving the realities of higher interdependence in the globalising world post-World Trade Organisation (WTO).

(vi) **Modernisation:** Modernising the traditional economy was set as a foremost objective of planning. Specially, the agriculture sector of the economy needed an immediate inclusion of modern methods and techniques of farming dairying, etc. Similarly, in education too, India needs to go for inclusion of modern education system.

India did not miss the chance of accepting the importance of modern science and technology. As the economy had selected industry as its prime moving force (PMF), it was essential to adopt the changing dimensions of science and technology.

The major objectives of planning in India are not only broad but open-ended. That is why it hardly needs any change and modification in them with the changing times. It means, after the completion of one plan the objectives for the new plan are automatically set. Coming to the composition of the objectives, we may confidently conclude that all the aspirations of the Preamble,[38] the Directive Principles of the State Policy,[39] the Fundamental Duties and the Fundamental Rights have got their due place and weightage. All the aspirations of the nationalists and the freedom fighters look resonating in the very soul of the Indian planning system.

The objective of planning in India was so broad a term that gradually it encompassed the entire sphere of administration excluding only defence and foreign affairs. The objectives of planning tremendously evolved and got cemented together once the functions of the Planning Commission were announced by the government in 1950 itself and further expanded in 2002 (*which we will see in the next sub-title*).

PLANNING COMMISSION

Once the National Planning Committee published its Report (1949) and there was a firm inclusion of the need for 'Economic and Social Planning'[40] in the Constitution, the stage was set for the formal launching of planning in the country. Though the economy was run on the principles of planning very much after the Independence itself[41] it was in a piecemeal manner only. For formal planning to begin, for the whole economy at the national level, there was a need for a permanent expert body which could take over the responsibility of the whole gamut of planning, i.e., plan formation, resource aspects, implementation and review—as planning is a technical[42] matter. Thus, in March

38. The Preamble was declared by the Supreme Court as an ***integral part of the Constitution*** and any amendments amounting to a change in its meaning and spirit amounted to the violation of the 'basic feature' of the Constitution (Keshvanand Barti, 1973 and S.R. Bommai, 1994 cases). This further magnified the objectives and role of Planning in India.
39. As the different Articles of the Directive Principles got interpreted being complementary parts of the Fundamental Rights, their enforcement became obligatory for the Governments in coming times-still broadening the objectives of planning in the country.
40. Distribution of Legislative Power, List-III, Entry 20.
41. Though formal planning commenced in the fiscal 1951–52, the planning has already commenced with the Industrial Policy Resolution, 1948. More so, the Prime Minister of India who headed the NPC had already taken firm decision that India would be a planned economy by August 1937 (Congress Working Committee, Wardha) itself. Thus, the economy takes its first wink in the planned era!
42. Alan W. Evans, ***Economics and Planning,*** in Jean Forbes (ed.) ***Studies in Social Science and Planning,*** Scottish Academy Press, Edinburgh, 1972, p. 121.

1950[43] the Planning Commission (PC) was set up by the government by Cabinet Resolution (without resorting to legislation). Important details regarding the composition, legal status, etc., of the PC are as under:

(i) An ***extra-constitutional*** (i.e., non-constitutional) and ***non-statutory*** body (though planning originates from the Constitution there is no reference to the PC in it).

(ii) An ***advisory body*** to the Government of India on an array of issues of economic development.

(iii) A 'think tank' on economic development with the Prime Minister as its ex-officio Chairman and with the provision or a Deputy Chairman.[44] The main function of the Deputy Chairman is to ***co-ordinate*** the work of the Commission.[45]

(iv) Has an open provision for the number of its membership (as many area experts are required by the particular proposed period of planning) other than six Union Cabinet Ministers as its ***ex-officio members***[46] and a Member Secretary. The Minister of Planning is already an ex-officio member of the PC.[47]

(v) An ***autonomous body*** entitled to form its own views on important issues and place them before the governments. It works closely with the Union and State cabinets and has full knowledge of their policies.

(vi) Is invariably ***consulted*** on changes proposed in social and economic policies. To ensure free and full exchange of ideas, the PC has established a ***convention*** that it will not give publicity to differences of views between the Commission and the Union and State governments.

(vii) ***Linked*** with the Union Cabinet at the secretariat level. The PC is part of the Cabinet organisation and the 'demand for grants' for it is included in the budget demand for the Cabinet Secretariat.

(viii) Seated at the 'Yojana Bhavan', the Commission has a staff of secretaries and advisers and also a research organisation.[48]

(ix) The PC is a ***technical body*** with experts and professionals coming from an array of specific areas as per the need of planning of the concerned period (see footmote 42).

(x) The Commission has ***executive powers.***[49]

43. ***Gazetteer of India, Vol.3,*** p.10, op. cit. The confusion regarding the time of setting up the PC needs to be settled. According to Bipon Chandra et al. (***India After Independence, p. 343, op. cit.***) the PC was set up in January 1950. Kalikinkar Datta (***An Advanced History of India, p. 956, op. cit.***) and S.R. Maheshwari (***Indian Administration, Orient Longman, N. Delhi, 2002, p.121***) support the ***Gazetteer of India*** view. While A. Vaidya nathan (Dharma Kumar edited, ***The Cambridge Economic History of India, p. 949, op. cit.***) considers the PC to be set up in January 1950.

44. He was later given a Cabinet rank in the Union Council of Minister.

45. ***Gazetteer of India, Vol.3,*** p.11, op. cit.

46. ***India 2008,*** Publications Division, Ministry of Information and Broadcasting, GoI, N. Delhi, p. 676.

47. There was a provision of only *three* Cabinet Ministers as its ***ex-officio*** members namely the Finance, Human Resource Development and Defence upto July 2004 when the United Progressive Alliance Government increased it to include the other *three* Cabinet Ministers-the Railways, Agriculture and Information Technology. It has been only once in the history of the PC that it had *six* Cabinet Ministers as its ex-officio members i.e. in the final years of the Rajiv Gandhi regime (***The Economic Times, 16 July 2004, N. Delhi Edition***).

48. ***Gazetteer of India, Vol.3,*** p.11, op.cit.

49. Prima facie a body should be either constitutional or statutory to wield the executive powers but as a number of Cabinet Ministers as well as the PM himself are directly involved with the PC it wields execudive powers for all practical purposes.

FUNCTIONS OF THE PC

Though the PC was set up with a definite purpose of planning, nobody knew that it would extend its functions over the entire spectrum of administration in the country. It was described as the 'economic Cabinet of the country as a whole' even encroaching upon the constitutional body like the finance commission[50] and not being accountable to the Parliament.[51] Through time it built up a heavy bureaucratic organisation[52] which led even Nehru himself to observe—"The Commission which was a small body of serious thinkers has turned into a government department complete with a crowd of secretaries, directors and of course a big building."[53]

Though the functions of the PC were extended to include timely changes in the planning needs (in the reforms era), its functions were announced by the same government order which did set up the Planning Commission, itself. The order[54] says:

"The Planning Commission will—

(i) Make an assessment of the material, capital and human resources of the country, including technical personnel, and investigate the possibilities of augmenting such of those resources as are found to be deficient in relation to the nation's requirements;

(ii) Formulate a plan for the most effective and balanced utilisation of the country's resources;

(iii) On a determination of priorities, define the stages in which the plan should be carried out and propose the allocation of resources for the due completion of each stage;

(iv) Indicate the factors which are tending to retard economic development, and determine the conditions which, in view of the current social and political situation, should be established for the successful execution of the plan;

(v) Determine the nature of the machinery which will be necessary for securing the successful implementation of each stage of the plan in all its aspects;

(vi) Appraise from time to time the progress achieved in the execution of each stage of the Plan and recommend the adjustments of policy and measures that such appraisal may show to be necessary; and

(vii) Make such interim or ancillary recommendations as appear to be appropriate either for facilitating the discharge of the duties assigned to it; or on a consideration of the prevailing economic conditions, current policies, measures and development programmes; or on an examination of such specific problems as may be referred to it for advice by Central or State governments."

50. ***Report of the Fourth Finance Commission*** (with P.J. Rajamannar as its Chairman), GoI, N. Delhi, 1965, pp. 88–90.
51. By 1950s it was a general criticism of the PC which looked highly logical. But through the entire period of planning the Governments never did think to convert the PC into a constitutional body. Practically enough, the Union cabinet and the whole Government is accountable to the Parliament for the functions of the PC as it has complete mandate and support of the Governments of the time.
52. Appleby, ***Public Administration in India: Report of A Survey,*** Ford Foundation, 1953, p. 22.
53. As quoted in D.D. Basu, ***An Introduction to the Constitution of India,*** Wadhwa & Company, N. Delhi, 1999, p. 330.
54. ***Gazetteer of India, Vol.3,*** pp. 10–11, op.cit.

With the commencement of the Tenth Plan (2002–07), the government handed over ***two new functions*** to the Planning Commission in 2002, namely:

(i) To monitor the plan implementation with special reference to the process of 'economic reforms' with the help of the steering committees.

It should be noted here that once the process of economic reforms was initiated in the country (early 1990s) there was a diminishing role proposed for the state in the economy in some areas and increased role for the state in some other areas. The re-definition of the state's role in the economy (though it was the contemporary thinking world wide) made most of the experts and the business community to conclude as if there will be no role for planning in the economy. The New Economic Policy (NEP) of 1991–92 was a prima-facie proposal for the expansion of the market economy in the country. But it was not the case altogether. Planning has not become irrelevant though it needed to search for a new orientation. And it was highly essential that the process of planning keeps its relevance to the bigger and the broader process of economic reforms. This particular new function of the PC must be seen in this light.

(ii) To monitor the progress of various Central Ministries. It should be noted here that for the first time, the PC went to set the 'monitorable targets' for 10 areas indicating development. The Central Ministries have been linked to these monitorable targets. The timely performances of the Ministries are now monitored by the PC as per its new fuction.

With the inclusion of the above-mentioned two functions in the existing functions (which were already very broad), the PC has emerged as a real 'supercabinet'. Since it is basically the Deputy-Chairman who officiates the general meetings of the Commission, he has a high-level say[55] in articulating the direction and the nature of the economic policies. Through the first new function it articulates, the future dimensions of the economic reforms and through the second new function, it influences the works of the various ministries—ultimately it seems as if the PC has been able to emerge as the real think-tank of development in the country.[56]

The PC has also been able to influence the states economic policies since 2002 in a great way. Though the PC today does not make the state plans[57] it is able to influence the overall economic policies of the states. It has been possible due to the setting of 'monitorable targets' for states for the same development indicators/areas as has been set for the Centre.[58] The

55. It is not uselessly that the Government decides to call in Montek Singh Ahluwalia, an economist of international repute to officiate as the Deputy chairman of the PC. Every idea and opinion of Mr. Ahluwalia is today understood by the coalition partners of the Central Government as a thing the Government is necessarily going to implement in future. One can imagine the increased role of the office and the PC, both, by this. There is always a hue and cry every time the Deputy Chairman articulates an idea or opinion. Though the PC is chaired by the PM, it seems that the Deputy Chairman has started availing enough autonomy to speak his mind.

56. Ibid.

57. As per the original mandate the PC was supposed to formulate the state plans also. By 1960s, with the decision to follow the multi-level planning (MLP) in the country the states started having their own state planning boards (SPBs).

58. In setting these targets the concerned states were consulted approach of planning was followed.

states are liable for being monitored by the PC concerning their performances regarding these monitorable targets. This way the Central Government has started having its say over the state governments via the new functions of the PC.

We may conclude that the PC has been able to unify not only the various economic policies of the Centre, but also those of the states with the help of these two new functions given to it. Earlier, there had always been a lack of congruence among the policies of the various central ministries and the ideas articulated by the PC.

An Epitaph to the PC

On January 1, 2015, the government formally abolished the PC by replacing it with the newly created body—the NITI Aayog. With this there ended an era in the economic history of independent India. Whether it was better to revive the PC or abolish it has been a matter of much debate among the discipline experts, politicians and the media. The debate, at times, had emotional tones, too. But the government has its own wisdom behind the action (a detailed discussion on it has been included as the last ***sub-topic*** of this *Chapter* titled **'NITI Aayog'**).

As an 'epitaph' to the PC (may be an 'ode'), it will be quite relevant to have an eye on the report of the Independent Evaluation Office (IEO) on the former which was submitted to the Prime Minister Office by late June 2014. As per it, the PC was created in response to the unique challenges faced by a nascent democracy and a fledgling economy—it conceived a 'top-down approach' to planning that envisaged a dynamic Central government building up the economic and social order of weak states. The report called the **PC** in its current form and function a hindrance and not a help to India's development. It further added that it is not easy to reform such a large *ossified body* and it would be better to replace it with a new body that is needed to assist states in ideas, to provide long-term thinking and to help cross-cutting reforms. Some of the **major** advices of IEO on the PC are as follows:

(i) The PC be scrapped and replaced with the *Reform and Solutions Commission (RSC)*, which should be staffed with experts with domain knowledge and kept free from a ministerial administrative structure. The new body should have full-time representation of major trade and industry organisations, civil society representatives, academics, etc., so as to capture their concerns and benefit from their expertise in formulating long—term strategy.

(ii) The RSC will perform ***three*** main functions:

  (a) Serve as a solutions exchange and repository for ideas that have been successful in different aspects of development in various states and districts and in other parts of the world;

  (b) Provide ideas for integrated systems reform; and

  (c) Identify new and emerging challenges and provide solutions to preempt them.

(iii) The current functions of the PC be taken over by other bodies 'which are better designed to perform those functions'.

(iv) Since the state governments have better information about local requirements and resources than the central government and central institutions, they should be allowed to identify priorities and implement reforms at the state level, independent of mandatory diktats from central institutions.

(v) The task of long-term economic thinking and coordination can be performed by a new body established to act solely as a 'think tank' within the government.

(vi) The Finance Commission be made a *permanent body* responsible for the allocation of centrally collected revenue to the states and the finance ministry be tasked with the division of funds among the various central ministries.

The advices of the IEO (a brainchild of the PC itself) on the PC were quite surprising, even shocking to few. Whether the new body replacing the PC will be a betterment over the latter and will be able to carve out its desired aims is a matter to be evaluated and analysed in future. Meanwhile, we can visibly find some of the advices of the IEO resonating in the newly created body, the NITI Aayog, the replacement for the PC.

[**Note:** While a detailed literature has been included on the 'NITI Aayog' in this edition (as the last *sub-topic*), the literature on the PC has been left unchanged for the ease of understanding and comparative purpose.]

NATIONAL DEVELOPMENT COUNCIL

The National Development Council (NDC) was set up on August 6, 1952 by a Resolution[59] issued from the cabinet secretariat. The first Plan recommended its formation with a very concise and suitable observation:[60]

"In a country of the size of India where the states have under the constitution full autonomy within their own sphere of duties, it is necessary to have a forum such as a National Development Council at which, from time to time, the Prime Minister of India and the Chief Ministers of the states can review the working of the plan and of its various aspects."

There were some strong reasons why the NDC was set up which may be seen as follows:

(i) The Central Plans were to be launched in the states and the UTs with the participation of the state–level personnel. The Planning Commission was not provided with its own implementation staff (though the PC was given the responsibility of plan implementation) for this purpose. Therefore, the consent and co-operation of these federal units was a must.

(ii) Economic planning as a concept had its origin in the centralised system (i.e., Soviet Union). For India, to democratise/decentralise the very process of planning was not a lesser task/challenge than promoting development itself. Indian planning is rightly said to be a process of trial and error in striking a balance between liberty and progress, central control and private initiative and national planning with local authority.[61]

The setting up of the NDC can be considered as the step in India towards decentralised planning.

(iii) In the constitutional design of the federal rigidities it was necessary to provide the whole planning process a unified outlook. The NDC serves the purpose of diluting the autonomous and rigid federal units of the Union of India.[62]

59. ***Resolution No. 62/CF/50*** (06.08.1952), Cabinet Secretariat, GoI, N. Delhi.
60. ***First Five Year Plan: A Draft Outline,*** PC, GoI, N. Delhi, July 1951, p. 253.
61. ***Gazetteer of India, Vol.3,*** p. 10 op.cit.
62. The Advisory Planning Board (1946) set up by the Interim Government had suggested for such a consultative body with the representatives from the provinces, the princely states and some other interests to advise the Planning Commission for the success of planning in India.

The NDC initially comprised the Prime Minister of India (de facto Chairman), the Chief Ministers of all States and the Members of the Planning Commission. In the first meeting of the NDC held on 8–9 November 1952, J.L. Nehru stated that NDC is "essentially a forum for intimate cooperation between the State Governments and the Central Government for all the tasks of national development". In the *words* of J.L. Nehru, setting up of the NDC may be regarded as one of the most significant steps taken for promoting understanding and consultation between the Union and the State Governments on planning and common economic policies.

Considering the recommendations of the 'Administrative Reforms Commission', the NDC was reconstituted and its functions redefined by a Cabinet Resolution on October 7, 1967. The reconstituted NDC comprises the Prime Minister, all Union Cabinet Ministers, Chief Ministers of all States and Union Territories and the Members of the Planning Commission. Delhi Administration is represented in the Council by the Lt. Governor and the Chief Executive Councillor, and the remaining Union Territories by their respective Administrators. Other Union Ministers and State Ministers may also be invited to participate in the deliberations of the council. In the reconstituted Council, the Secretary of the Planning Commission acts as Secretary to the NDC and the Planning Commission is expected to furnish such administrative or other assistance for the work of the Council as may be needed. The baisc nature, origin and legal status of the Council are similar to the Planning Commission. The **revised functions**[63] of the NDC are:

(i) to consider the proposals formulated for Plans at all important stages and accept them;

(ii) to review the working of the Plans from time to time;

(iii) to consider the important questions of social and economic policy affecting national development; and

(iv) to recommend measures for the achievement of the aims and targets set out in the national plan, including measures to secure the ***active participation*** and co-operation of the people, improve the efficiency of the administrative services, ensure the fullest development of the less advanced regions and backward sections of the community and through sacrifices borne equally by all citizens, build up resources for national development.[64]

Though the first Plan of India was launched before the arrival of the NDC, the body had many meetings before the terminal year of the plan and useful deliberations (almost all) after due consideration were included by the government into the planning process. But after the death of J.L. Nehru—the greatest champion of democratic decentralisation in the country[65] the NDC had become a small gathering of only those who had the same vested interests with only the Congress CMs participating in its meetings. The CMs belonging to other political parties usually did not come to its meetings; the government hardly gave any importance to their advice. A phase of tussle between the Centre and the states started worsening from here onward with a degradation

63. Other than the ***Cabinet Resolution,*** it is also quoted is the ***Gazetteer of India, Vol. 3,*** p. 15, op.cit.

64. The ***italicised*** words are here highlighting the level of the Government's consciousness about the concerned issues of decentralised planning, regional and individual inequalities to which the planning was to be specially attentive.

65. George Mathew, undoubtedly among the legendary commentator on the Panchayat Raj/democratic decentralisation calls J.L. Nehru as "its most eminent champion at the national level" (***Power to the People*** in M.K. Santhanam edited ***50 Years of Indian Republic,*** Pub. Div., GoI, 2000, p. 31). Similarly, the reputed historians Bipan Chandra et al. call Nehru as "the greatest champion of planned economic development"– for Nehru the process of planning is the country was to be democratic about which seems very clear, as his writings support (***India After Independence,*** Bipan Chandra et.al., p. 341, op.cit.).

in principles of the ***co*-operative federalism,** with every five-year plans which followed. It was only by the mid-1990s that we see the revival of the lost glory of NDC as well as that of the spirit of decentralised planning. This has been possible due to three major reasons:

(i) In the era of economic reforms, with greater dependence on the private capital made it necessary to allow states greater autonomy in economic matters. Once the WTO regime started it became an economic compulsion.

(ii) The enactment of the Constitutional Amendments 73rd and the 74th had made local level planning a constitutional compulsion.

(iii) And lastly it was the compulsion of coalition politics in the formation of the Union Government which made the Centre to favour the states.

As per the major experts on the issue of decentralised planning, the last of the above given three reasons has played the most important role. After a long-long time, two plans (*the Tenth and the Eleventh*) were passed by the NDC with complete support coming from the CMs.

It is believed that as the local-level planning (i.e., the gram panchayat and the urban municipalities and corporations) allows more and more scope of planning by the states, the NDC will be able to function on its more original principles. The contemporary concerns of the governments give enough hope to think like this, at least it seems so.

CENTRAL PLANNING

The Plans which are formulated by the Central Government and financed by it for the implementation at the national level are known as Central Plans. Over the years, the Centre has launched three such plans and the governments have maintained continuity in their implementation. The three central plans are:

A. Five-Year Plans,
B. Twenty-Point Programme, and
C. Member of Parliament Local Area Development Scheme.

An introductory description of these plans is given as follows:

A. THE FIVE-YEAR PLANS

This is the most important among the central plans and is being continuously implemented one after the other since planning commenced in India. As planning has been a purely political excercise in India, the five-year plans of the country have seen many unstable and critical moments till date. Several new developments related to planning also took place during the years. Given below is a concise summary of the plans as we see their different periods of implementation:

FIRST PLAN

The period for this plan was 1951–56. As the economy was facing the problem of large-scale foodgrains import (1951) and the pressure of price rise, the plan accorded the highest priority to agriculture including irrigation and power projects. About 44.6 per cent of the plan outlay went in favour of the public sector undertakings (PSUs).

The Plan was launched with all the lofty ideas of socio-economic development, which had frustrating outcomes in the following years.

SECOND PLAN

The plan period was 1956–61. The strategy of growth laid emphasis on rapid industrialisation with a focus on heavy industries and capital goods.[66] The plan was developed by Professor

66. Sukhomoy Chakravarti, ***Development Planning: The Indian Experience,*** Oxford University Press, New York, 1989, pp. 9–11.

Mahalanobis. Due to the assumption of a closed economy, shortages of food and capital were felt during this Plan.

THIRD PLAN

The Plan period was 1961–65. The Plan specifically incorporated the development of agriculture[67] as one of the objectives of planning in India besides, for the first times, considering the aim of balanced, regional development.

Enough misfortunes awaited this plan—two wars, one with China in 1961–62 and the other with Pakistan in 1965–66 along the Gujarat border and a severe drought-led famine in 1965–66 had to be faced. Due to heavy drain and diversion of funds, this plan utterly failed to meet its targets.

THREE ANNUAL PLANS

The period of the three consecutive Annual Plans was 1966–69. Though the Fourth Plan was ready for its implementation in 1966, the weak financial situation as well as the low morale after the defeat by China, the government decided to go for an Anuual Plan for 1966–67. Due to the same reasons the government went for another two such plans in the forthcoming years. The broader objectives of these Annual Plans were inside the design of the Fourth Plan which would have been implemented for the period 1966–71 had the financial conditions not worsened by then.

Some economists as well as the opposition in the Parliament called this period as a discontinuity in the planning process, as the Plans were supposed to be for a period of five years. They named it a period of "Plan Holiday", i.e., the planning was on a holiday.[68]

FOURTH PLAN

The Plan period was 1969–74. The Plan was based on the Gadgil strategy with special focus to the ideas of growth with stability and progress towards self-reliance. Droughts and the Indo-Pak War of 1971–72 led the economy to capital diversions creating financial crunch for the Plan.

The politicisation of planning started from this plan which took serious 'populist' design in the coming plans. Frequent double-digit inflations, unreigned increase in the fiscal deficits, subsidy-induced higher non-plan expenditures and the first move in the direction of 'nationalisation' and greater control and regulation of the economy were some of the salient features of this plan, which continued unchanged till the early 1990s. The search for political stability at the Centre converted planning into a tool of real politics with greater and greater 'centralisation' ensuing plan after plan.

FIFTH PLAN

The Plan (1974–79) has its focus on poverty alleviation and self-reliance.[69] The popular rhetoric of poverty alleviation was sensationalised by the government to the extent of launching a fresh plan, i.e., the Twenty-point Programme (1975) with a marginal importance being given to the objective of 'growth with stability' (one of the major objectives of the Fourth Plan).

The planning process got more politicised. The havocs of hyper-inflation led the government to hand over a new function to the Reserve Bank of India to stabilise the inflation (the function which the RBI carries forward even today). A judicious price wage policy was started to check the menace

67. C. Rangarajan, ***Indian Economy: Essays on Money and Finance, UBSPD,*** N. Delhi, 1998, p. 272.
68. It should be noted here that as per the official version of the Government of India, the planning has been a *continuous process* in the country and there is no term like the 'Plan Holiday' in Its official documents. The term was given by the critics and popularised by the contemporary media.
69. Experts believe this Plan to be somewhat based on the ideas of D.P. Dhar, the Minister for Planning at that time.

of inflation on the wage-earners. This Plan saw an increase in the socio-economic and regional disparities despite the many institutional, financial and other measures which were initiated by the government to attend them. The nationalisation policy continued. There was an overall decay in the quality of 'governance'. A nexus of the 'criminal-politician-bureaucrat' seems to emerge for the first time to hijack the political system.[70]

The plan period was badly disturbed by the draconian emergency and a change of the government at the Centre. The Janata Party came to power with a thumping victory in 1977. As the government of the time had then complete say in the central planning in India how could the new government continue with the Fifth Plan of the last government which had still more than one year to reach its completion. The dramatic events related to Indian planning may be seen objectively as given below:

(i) The Janata Government did cut-short the Fifth Plan one year ahead of its terminal year, i.e., by the fiscal 1977–78, in place of the decided 1978–79.

(ii) A fresh Plan, the Sixth Plan for the period 1978–83 was launched by the new government which called it the **'Rolling Plan'.**[71]

(iii) In 1980, there was again a change of government at the Centre with the return of the Congress which abandoned the Sixth Plan of the Janata Government in the year 1980 itself.

(iv) The new government launched a fresh new **Sixth Plan** for the period 1980–85. But by that time, two financial years of the Janata Government's Sixth Plan had already been completed. These two years of the Plan were adjusted by the Congress Government in a highly interesting way:

 (a) The first year, i.e., 1978–79 was added to the fifth plan which was cut-short by the Janata Government to four years. And thus the Fifth Plan officially became of 5 years again (1974–79).

 (b) Now what to do with the second year, i.e., 1979–80. The Congress Government announced this year to be a year of one Annual Plan. This Annual Plan (1979–80) may be considered the lone independent remnant of the 'Rolling Plan' of the Janata Government.

The Sixth Plan (1978–83) which could not become an official plan of India had emphasis on some of the highly new economic ideas and ideals with almost a complete no to foreign investment; new thrust on price control; rejuvenation of the Public Distribution System (PDS); emphasis on small-scale and cottage industries; new lease of life to the Panchayati Raj Institutions (i.e., the 2nd Phase of the revival of the PRIs); agriculture and the subject of rural development getting the due; etc., being the major ones.

70. As N.N. Vohra remarks.

71. It should be noted here that there is nothing like the 'Rolling Plan' in the official documents of planning in India. Basically, the origin of the concept of the 'Rolling Plan' goes back to the period when India went for the Annual Plans (1966–69) for the first time and the critics noted it as a ***discontinuity*** in the planning process calling it a period of the 'plan holiday'. The basic trait of the 'Rolling Plan' was its ***continuity*** while the congress commenced its Sixth Plan (1980–85) the idea of the 'Rolling Plan' was cancelled as for the new Government the element of 'rolling' (continuity) was already in the Indian Planning – India was following the approach of the 'perspective planning'. A separate Division of Perspective Planning was already functioning in the Yojana Bhavan since the mid-1970s. The two elements which make a plan a 'perspective plan' are – firstly, the 'continuity' and secondly, 'evaluation - based' planning. For the Congress Government, logically, the planning in India was not only 'rolling' but more than that – evaluation-based, too.

SIXTH PLAN

This Plan (1980–85) was launched with the slogan of '*Garibi Hatao*' (alleviate poverty).[72] Already, a programme (the TPP) was tested and tried by the same government in the Fifth Plan which tried to improve the standard of living of the poor masses with the 'direct approach' (the idea of poverty alleviation, but such a slogan of '*Garibi Hatao*' was not given to the programme).

Some of the major issues addressed by the Plan were—emphasis on socio-economic infrastructure in rural areas; eliminating rural poverty and reducing regional disparities through the IRDP (1979); 'target group'[73] approach initiated; a number of national level programmes and schemes were launched during the plan, which tried to attend to the specific areas and the specific concerns of socio-economic development (this is 'target group' approach):[74]

(i) National Rural Employment Programme (NREP)—1980
(ii) Restructured Twenty-Point Programme–1982
(iii) Biogas Programme—1982
(iv) Development of Women and Children in Rural Areas (DWERA)—1983
(v) Rural Landless Employment Guarantee Programme (RLEGP)—1983
(vi) Self-Employment to Educated Unemployed Youth Programme (SEEUP)—1983
(vii) Dairy Development Programme (DDP)—1983
(viii) Village and Small Industries Development Programme (VSIDP)—1983
(ix) Tribal Development Agency (TDA)—1983
(x) Village and Small Industries Development Programme (VSIDP)—1983.
(xi) National Seeds Programme (NSP)—1983.
(xii) Intensive Pulses Development Programme (IPDP)—1983.
(xiii) Intensive Cotton Development Programme (ICDP)—1983.
(xiv) Khadi and Village Industries Programme (KVIP)—1983
(xv) Programme for Depressed Areas (PDA)—1983.
(xvi) Special Programme for Women and Children (SPWC)—1983

SEVENTH PLAN

The Plan (1985–90) emphasised on rapid foodgrain production, increased employment creation and productivity in general. The basic tenets of planning, i.e., ***growth, modernisation, self-reliance*** and ***social justice*** remained as the guiding principles.[75] The *Jawahar Rojgar Yojana* (JRY) was launched in 1989 with the motive to create wage-employment for the rural poors. Some of the already existing programmes such as the IRDP, CADP, DPAP and the DDP were re-oriented.

Till date, the government has been evaluating the achievements of all the developmental

72. Some experts see this Plan as a symbol of the planning being converted to a complete politics – with utter populism entering into the planning process of India. The circle of the politicisation of planning gets completed with this Plan
73. 'Target group' approach of planning is selecting the group of people where a particular problem is and attacking the problem directly – the TPP was the first such programme in India.
74. ***India 1980–1983,*** Pub. Div., GoI, N. Delhi.
75. ***Seventh Five Year Plan*** (1980-85), PC, GoI, N. Delhi, 1980.

programmes, courtesy the youngest PM of India. Somehow, democracy and development got connected with a major change in the thinking of the political elite which decided to go in for democratic decentralisation to promote development. It laid strong foundations for itself as the constitutional amendments—the 73rd and 74th were possible by the early 1990s.

Though the economy had better growth rates throughout the 1980s, specially in the latter half, yet it was at the cost of bitter fiscal imbalances. By the end of the Plan, India had a highly unfavourable balance of payments situation. Heavy foreign loans on which the governmental expenditures depended heavily during the period, the economy failed to service.[76] The Plan was not laid with a strong financial strategy which put the economy into a crisis of unsustainable balance of payments and fiscal deficits.[77] India basically tried to attend its growth prospects by commercial and other external borrowings on hard terms which the economy failed to sustain. In the process of liberalisation, an expansion of internal demand for the home market was permitted without generating equitable levels of exports and ultimately Indian imports were financed by the costly external borrowings. Such an 'inward looking' fiscal policy proved to be a mistake when the external aid environment for the economy was deteriorating.[78]

TWO ANNUAL PLANS

The Eighth Plan (whose term would have been 1990–95) could not take off due to the 'fast-changing political situation at the Centre'.[79] The pathbreaking and restructuring-oriented suggestions of the Eighth Plan, the sweeping economic reforms ensuing around the world as well as the fiscal imbalances of the late 1980s were the other important reasons for the delay in the launch of the Eighth Plan. The new government, which assumed power at the centre in June 1991, decided to commence the Eighth Plan for the period 1992–97 and that the fiscals 1990–91 and 1991–92 should be treated as two separate Annual Plans. The two consecutive Annual Plans (1990–92) were formulated within the framework of the approach to the Eighth Plan (1990–95) with the basic thrust on maximisation of employment and social transformation.

EIGHTH PLAN

The Eighth Plan (1992–97) was launched in a typically new economic environment. The economic reforms were already started (in July 1991) with the initiation of the structural adjustment and macro-stabilisation policies necessitated by the worsening balance of payments, higher fiscal deficit and unsustainable rate of inflation.

This was the first plan which went on for an introspection of the macro-economic policies which the country had been pursuing for many decades. The major concerns and pathbreaking suggestions[80] which this Plan articulated may be summarised as follows:

76. Similar financial strategy to promote growth and development had led the Soviet Union to economic collapse via the balance of payment crisis during Gorbachev's regime by 1991, as is pointed out by Jeffrey Sachs in ***The End of Poverty*** (Penguin Books, London, 2005, pp. 131–134).
77. C. Rangarajan, 1998, p. 274, op.cit.
78. ***Bimal Jalan*** in Bimal Jalan (ed.), 1992, pp. 190–191, op.cit.
79. This is official version for the delay (***India 2007,*** Pub. Div., GoI, 2007, p. 680).
80. It should be noted here that the kind of economic reforms India started in 1991–92 were ***almost ditto suggested*** by the Eighth Plan. The suggestions were based on India's own experience and the experiences of the world economies after the Second World War. The Sixth and the Seventh Plans had suggested almost on the similar lines which made the Governments of the time go for the so-called 'liberalisation' moves in the mid-1980s.

(i) an immediate re-definition of the state's role in the economy was suggested;
(ii) 'market-based' development advised in the areas which could afford it, i.e., a greater role for the private sector in the economy;[81]
(iii) more investment in the infrastructure sector, especially in the laggard states as the ongoing emphasis on greater private sector investment could not be attracted towards these states;
(iv) rising non-plan expenditure and fiscal deficits need to be checked;
(v) subsidies need restructuring and refocussing;
(vi) planning immediately needs to be 'decentralised';
(vii) special emphasis on 'co-operative federalism' suggested;
(viii) greater focus on 'agriculture' and other 'rural activities' was suggested for which the Plan cited empirical evidences as they encourage the economy to achieve enhanced standard of living for its people and to promote the cause of balanced growth, a shift in the mindset of planning.

As the economy moved towards liberalisation, criticism came from every quarter against the move. The process of planning was also criticised on the following counts:

(i) As economy moves towards the market economy, the planning becomes 'irrelevant';
(ii) When the state is 'rolling back', planning makes no sense;
(iii) The planning process should be 're-structured' in the era of liberalisation; and
(iv) There should be increased thrust on the 'social sector' (i.e., education, healthcare, etc.)

NINTH PLAN

The Ninth Plan (1997–2002) was launched when there was an all round 'slowdown' in the economy led by the South East Asian Financial Crisis (1996–97). Though the liberalisation process was still criticised, the economy was very much out of the fiscal imbroglio of the early 1990s. With a general nature of 'indicative planning' the Plan not only did target an ambitious high growth rate (7 per cent) but also tried to direct itself towards time-bound 'social' objectives. There was an emphasis on the seven identified Basic Minimum Services (BMS) with additional Central Assistance for these services with a view to obtaining complete coverage of the population in a time-bound manner. The BMS[82] included:

(i) Safe drinking water;
(ii) Primary health service;
(iii) Universalisation of primary education;
(iv) Public housing assistance to the shelter-less poor families;
(v) Nutritional support to children;
(vi) Connectivity of all villages and habitations; and
(vii) Streamlining of the public distribution system.

The issue of fiscal consolidation became a top priority for the governments starting from this Plan, for the first time which had its focus on the following[83] related issues:

81. C. Rangarajan, 1998, pp. 275–276, op.cit.
82. ***India 2007,*** Pub. Div., pp. 682–83, op.cit.
83. ***Economic Surveys*** (1998–2002), Ministry of Finance, GoI, N. Delhi & ***India 2007,*** p. 683, op.cit.

(i) Sharp reduction in the revenue deficit of the government, including centre, states and the PSUs through a combination of improved revenue collections and control of inessential expenditures;
(ii) Cutting down subsidies, collection of user charges on economic services (i.e., electricity, transportation, etc.), cutting down interest, wages, pension, PF, etc;
(iii) Decentralisation of planning and implementation through greater reliance on states and the Panchayat Raj Institutions (PRIs).

TENTH PLAN

The Plan (2002–07) commenced with the objectives of greater participation of the NDC in their formulation. Some highly important steps were taken during the plan, which undoubtedly points out a change in the planning policy mindset of the government, major ones being:[84]

(i) Doubling per capita income in 10 years;
(ii) Accepting that the higher growth rates are not the only objective—it should be translated into improving the quality of life of the people;
(iii) For the first time the Plan went to set the 'monitorable tragets' for eleven select indicators of development for the centre as well as for the states;
(iv) 'Governance' was considered a factor of development;
(v) States' role in planning to be increased with the greater involvement of the PRIs;
(vi) Policy and institutional reforms in each sector, i.e., reforms in the PSUs, legal reforms, administrative reforms, labour reforms, etc;
(vii) Agriculture sector declared as the prime moving force (PMF) of the economy;
(viii) Increased emphasis on the social sector (i.e., education, health, etc.);
(ix) Relevance between the processes of economic reforms and planning emphasised; etc.

The Mid-term Appraisal of the Plan was approved by the NDC in June 2005. The assessment gives a mixed picture regarding its performance. As per the appraisal, the country performed well in many areas and these gains needed to be consolidated, but there were some important weaknesses also, which, if not corrected can undermine even the current performance level.[85]

ELEVENTH PLAN

The Plan targets a growth rate of 10 per cent and emphasises the idea of 'inclusive growth'. In the approach paper, the Planning Commission shows its concerns regarding realising the growth targets on account of the compulsions towards the Fiscal Responsibility and Budget Management Act. In recent times some aberrations in the economy have started to increase the government's concerns in meeting the Plan target of 10 per cent growth. The major concerns are:

(i) A higher inflation (above 6 per cent) led to the tightening of the credit policy forcing lower investment in the economy (which will lower the production);
(ii) A stronger rupee is making export earnings shrink fast;
(iii) Costlier foodgrains and other primary articles playing havoc for the poor masses;

84. ***Tenth Five Year Plan (2002–07),*** P.C, GoI, N. Delhi.
85. ***Mid-Term Appraisal of the Tenth Plan,*** P.C, GoI, N. Delhi.

(iv) Costlier oil prices becoming a burden for the national exchequer; etc.

Not only the government but the Confederation of Indian Industry (CII) as well as the World Bank expressed doubts in the Eleventh Plan realising the ambitious 10 per cent growth.

Eleventh Plan: Performance

The Planning Commission (PC) had attempted the mid-term appraisal of the Plan, which was considered and approved by the National Development Council in July 2010. The appraisal document reviewed the developments and provided a comprehensive assessment of the performance of the economy during the Eleventh Plan period so far, in different sectors, together with suggested mid-course corrections. It has drawn attention to the problems in some selected areas and identified constraints that would be of relevance for the balance period of the Eleventh Plan and also for the Twelfth Plan. These include inter-alia:

(i) Restoring dynamism in agriculture,

(ii) Managing India's water resources,

(iii) Problems in achieving power generation targets,

(iv) Issues pertaining to urbanisation, and

(v) Special problems of tribal development.

In respect of *agriculture,* the mid-term appraisal notes that though performance of agriculture and the rate of growth in the Eleventh Plan is likely to be better than that in the Tenth Plan, it may, however, not reach the target of 4 per cent per year. The need to focus on agriculture and other critical issues mentioned above would require *concerted action* by the Centre and the states.

The Review by the PC regarding the **Poverty Estimates** is also important when the issue has become a matter of debate in the country. The Planning Commission is the nodal agency for estimating poverty in the country, both at the national level and across the states. The estimates the poverty on the basis of poverty line defined in terms of monthly per capita consumption expenditure. The Commission has been estimating poverty line and poverty ratio since 1997 on the basis of the methodology contained in the report of the Expert Group on 'Estimation of Number and Proportion of Poor' (known as *Lakdawala Committee Report*). The Head-count poverty ratio has been estimated by using the above mentioned poverty lines from a large size sample survey of household consumption expenditure carried out by the National Sample Survey Office (NSSO) with an interval of 5 years approximately.

The Planning Commission constituted an Expert Group in December 2005 under the chairmanship of Prof. Suresh D. Tendulkar to review the methodology for estimation of poverty. The Expert Group submitted its report in December 2009. While acknowledging the multi–dimensional nature of poverty, the Expert Group recommended moving away from anchoring the poverty lines to the calorie intake norm, adopting the Mixed Reference Period (MRP) based estimates of consumption expenditure as the basis for future poverty lines, adopting MRP equivalent of urban Poverty Line Basket (PLB) corresponding to 25.7 per cent urban headcount ratio as the new reference PLB for rural areas. On the basis of the above methodology, the all-India rural poverty headcount ratio for 2004–05 was estimated at 41.8 per cent, urban poverty headcount ratio at 25.7 per cent and all India level at 37.2 per cent. It may however be mentioned that the Tendulkar Committee's estimates are not strictly comparable to the present official poverty estimates because of different methodologies. As has been indicated in the Mid-Term Appraisal of the Eleventh Five Year Plan, the revised poverty lines and poverty ratios for 2004–05 as recommended by the Tendulkar Committee have been accepted by the Planning

Commission. The Tendulkar Committee has specifically pointed out that the upward revision in the percentage of rural poverty in 2004–05, resulting from the application of a new rural poverty line, should not be interpreted as implying that the extent of poverty has increased over time. These estimates, as reported by the Committee, clearly show that whether we use the old method or the new, the percentage of the population below poverty line has declined by about the same magnitude.

The performance on the **Fiscal Scenario**, according to the Planning Commission, the expansionary fiscal measures taken by the government in order to counter the effects of the global slowdown were continued in 2009–10, and this led to further increase in the key deficit indicators. The fiscal deficit of the Centre, which was 2.5 per cent in 2007–08 increased substantially to 6.0 per cent in 2008–09 and further to 6.4 per cent in 2009–10, but it declined to 5.1 per cent in 2010–11 (RE) and the Budget Estimates for 2011–12 put the fiscal deficit at 4.6 per cent of the GDP. Similarly, the revenue deficit of the Centre increased from 1.1 per cent in 2007–08 to 4.5 per cent in 2008–09 and further to 5.2 per cent in 2009–10 and declined to 3.4 per cent for 2010–11 (RE). As per 2011–12 (BE), the revenue deficit is projected at the same level of 3.4 per cent of the GDP. The increase in the deficit levels of the Centre owes to revenue foregone on account of reduction in indirect tax rates and enhanced public expenditure in order to boost demand in the economy amidst global meltdown.

The issue of **Price Stability** remained resonating for more than half of the Plan period. To ward off the crisis of rising prices, the government needed to announce several tax concessions at one hand, while it could not pass the burden of the costlier imported oil prices on the masses. That would have resulted in ultimately putting the exchequer in a fund-crunch mode, at the end, creating a short-supply of investible funds in government's hand, hence, causing the Eleventh Plan to perform at the levels below its target.

TWELFTH PLAN

The 'Draft Approach Paper' of the Twelfth Plan (2012–17) was prepared by the Planning Commission after widest consultation till date-recognising the fact that citizens are now better informed and also keen to engage. Over 950 civil society organisations across the country provided inputs; business associations, including those representing small enterprises have been consulted; modern electronic and 'social media' (Google Hangout) were used to enable citizens to give suggestions. All state governments, as well as local representative institutions and unions, have been consulted through five regional consultations. Though the Approach Paper for the Plan was approved by the NDC by mid-2011, the Plan Document was finalised much later after the launch of the plan (like the Tenth and Eleventh Plans).

The Draft Approach Paper lays down the major targets of the Plan, the key challenges in meeting them, and the broad approach that must be followed to achieve the stated objectives which are summed-up as follows:

(i) Growth rate of 9 per cent is targeted for the Plan. However, in view of the uncertainties in the global economy and the challenges in the domestic economy, the Approach Paper indicates that it could be achieved only if some **difficult decisions** are taken.

(ii) It emphasizes the need to intensify efforts to have 4 per cent average growth in **the agriculture** sector during the Plan period; with foodgrains growing at about 2 per cent per year and non-food grains (notably, horticulture, livestock, dairying,

poultry and fisheries) growing at 5 to 6 per cent.

(iii) The higher growth in agriculture would not only provide broad based income benefits to the rural population but also help restrain **inflationary pressure**, which could arise if high levels of growth are attempted without corresponding growth in domestic food production capabilities.

(iv) It proposes that the major **flagship programmes** which were instrumental for promoting inclusiveness in the Eleventh Plan should continue in the Twelfth Plan—there is a need to focus on issues of implementation and governance to improve their effectiveness.

(v) The Plan indicates that the **energy** needs of rapid growth will pose a major challenge since these requirements have to be met in an environment where domestic energy prices are constrained and world energy prices are high and likely to rise further.

(vi) For the GDP to grow at 9 per cent, commercial energy supplies will have to grow at a rate between 6.5 and 7 per cent per year. Since India's domestic energy supplies are limited, dependence upon imports will increase. Import dependence in the case of petroleum has always been high and is projected to be **80** per cent in the Twelfth Plan.

(vii) Even in the case of **coal**, import dependence is projected to increase as the growth of thermal generation will require coal supplies, which cannot be fully met from domestic mines.

(viii) It suggests the need to take steps to reduce energy intensity of production processes, increase domestic energy supply as quickly as possible and ensure rational energy pricing that will help achieve both objectives, viz., reduced energy intensity of production process and enhance domestic energy supply, even though it may seem difficult to attempt.

(ix) It draws attention to evolving a holistic **water** management policy aiming at more efficient conservation of water and also in water use efficiency particularly in the field of agriculture.

(x) It argues that a new legislation for **land acquisition** is necessary, which strikes an appropriate balance between the need for fair compensation to those whose land is acquired and whose livelihood is disrupted, and the need to ensure that land acquisition does not become an impossible impediment to meeting our needs for infrastructure development, industrial expansion and urbanisation.

(xi) It maintains that **health, education** and **skill development** will continue to be the focus areas in the Twelfth Plan and that there is a need to ensure adequate resources to these sectors – ***'universal healthcare'*** proposed by it, emphatically. Simultaneously, it also points to the need to ensure maximum efficiency in terms of outcomes for the resources allocated to these sectors. The need to harness ***private investment*** in these sectors has also been emphasised by the approach.

(xii) It takes cognizance of the fact that achieving 9 per cent growth will require large **investments** in infrastructure sector development—notes greater momentum to public investment and Public Private Partnerships (PPPs) in infrastructure sector needs to be imparted so that present infrastructure shortages can be addressed early.

(xiii) It has emphasised the importance of the process of **fiscal correction**. However, the paper cautions that fiscal consolidation would imply that total resources available for the Plan in the short run will be limited. Resource limitations imply the need to prioritise carefully and that some ***priority areas***, e.g., health, education and infrastructure will have to be funded more than others.

(xiv) It also emphasizes the need for focusing more on **efficient use** of available resources in view of the resource constraints. The Paper makes several suggestions in this regard, including giving implementing agencies greater amount of freedom, flexibility, promoting convergence between resources from different Plan schemes and the need for much greater attention to capacity building, monitoring and accountability.

B. TWENTY-POINT PROGRAMME

The Twenty Point Programme (TPP) is the second Central Plan which was launched in July 1975. The programme was conceived for coordinated and intensive monitoring of a number of schemes implemented by the Central and the state governments. The basic ***objective*** was of improving the quality of life of the people, especially of those living below the poverty line. Under this, a thrust was given to schemes relating to poverty alleviation, employment generation in rural areas, housing, education, family welfare and health, protection of environment and many other schemes having a bearing on the quality of life in rural areas.

The programme was restructured in 1982 and 1986. The programme, known as the ***'TPP-86'*** has 119 items grouped into 20 points which are related to the improvement in the quality of life in rural areas. Among the total items, 54 are monitored on the basis of evaluatory criteria, 65 against pre-set physical targets and rest of the 20 important items on monthly basis. The targets are fixed by the Ministries at the Centre in consultation with the states and the UTs. The allocation for the programme is done under the various Five-Year Plans.

The 'TPP-86' has been restructured and named 'TPP-2006' keeping in view the challenges of the 21st century with particular reference to the process of economic reforms. This is in harmony with the National Common Minimum Programme (NCMP) of the UPA Government.

Basically, the programme was targetted to the cause of poverty alleviation with the 'direct attack' approach. This experiment encouraged the government to go for a whole Five-Year Plan with the slogan 'Garibi Hatao' (i.e., the Sixth Plan, 1980–85). Over the years, the political changes at the Centre did not affect the programme and it has been continuously implented, more so due to its being of a high populist nature and known to the masses, as the experts believe.

C. MPLADS

The Member of Parliament Local Area Development Scheme (MPLADS) is the last of the Central Plans and latest to have been launched, too. The scheme was launched on December 23, 1993 with only Rs. 5 lakh given to each MPs which was increased to Rs. 1 crore in the year 1994–95. When the MPs did put a demand to increase the sum to Rs. 5 crore in 1997–98, finally the government enhanced it to Rs. 2 crore since 1998–99. In April 2011 the corpus was enhanced to Rs. 5 crore while announcing the new guidelines for the scheme.

Basically, in the early 1990s there came a demand from the MPs cutting across the party line for such a scheme so that the fruits of development could directly reach the masses via their representatives. The government of the

time decided to go in for such a scheme and the MPLADS came.

Under this scheme the Members of Parliament[86] recommend some works (i.e., creation of fixed community assets, based on locally felt developmental needs) to the concerned District Magistrate. The scheme is governed by a set of guidelines, which have been comprehensively revised and issued in November 2005. Its performance has improved due to pro-active policy initiatives, focus monitoring and review.[87]

In recent years, many criticisms of the scheme came to the public notice, which concerned either misappropriation of the funds or non-use of the funds, especially from the backward states. The people's representative at the PRI level have been demanding scrapping of the scheme as it infringes the idea of decentralised planning. In it's place, they want the funds to be given to the local bodies directly for the same kind of works specified by the MPLADS.[88]

The MOSPI (Ministry of Statistics and Programme Implementation) issued ***revised guidelines*** for the scheme in ***August 2012*** with the following salient features:

(i) Assistance to physically challenged persons upto maximum of Rs.10 lakh per year for purchase of *tri-cycles* and *artificial limbs* have been allowed,

(ii) Ambulances/hearse vans under the District Authority/CMO/Civil Surgeon of the district can now also be operated through private organisations,

(iii) MPs allowed to recommend eligible works upto Rs.10 lakh per year outside the constituency for Lok Sabha MPs and outside states for Rajya Sabha MPs.

(iv) Advances to government implementing agencies increased to the ratio of 75:25 (from 50:50).

(v) Contingency Funds of 0.5 per cent have been increased to 2 per cent of the annual entitlement as administrative expenses.

(vi) Works can also be implemented in areas affected by *man-made calamities* like chemical, biological and radiological hazards.

(vii) Mobile library for government educational institutions/public libraries now permissible.

(viii) Works from out of the shelf of MGNREGA. A project approved by the Zilla Panchayat for the year may also be recommended under the MPLAD Scheme. Similarly, ***convergence*** of MPLADS funds with Panchayat Yuva Krida aur Khel Abhiyan (PYKKA) and Urban Sports Infrastructure Scheme (USIS) for creation of durable sports assets from out of the shelf of PYKKA Projects has been allowed.

(ix) Funds can be used now for construction of Railway Halt Stations to facilitate the local community for boarding/deboarding the train.

(x) An MP has been entitled for setting up of MPLADS Facilitation Centre in the Nodal District for which MPLADS funds not exceeding Rs. 5 lakh being the

86. For development works the MP, Lower House (the Lok Sabha) may select one or more districts of his/her constituency; the MP, Upper House (the Rajya Sabha) may select any one or more districts from his/her constituency (i.e. a state or an UT); and the Nominated MPs may select any one or more district from their constituency (i.e. the whole country).

87. As the Government reports in the ***India 2007,*** pp. 711–712, op.cit.

88. We may especially quote the '21 Point Memorandum' handed over by the ***All India Panchayat Adhyakshas Meet,*** mid-2002, N. Delhi to the President and the Central Government of the time.

cost of equipments, furniture, etc., can be used. The space/room would be provided by DC/DM in the premises of the Collectorate/DRDA and the recurring running expenses will be booked under 2 per cent of the administrative charges, of which the Nodal District gets 0.8 per cent.

(xi) MPs may recommend purchase of ***books*** up to Rs. 22 lakh annually for schools/ colleges/public.

Besides, an annual competition ***'One MP – One Idea'*** was also introduced for selecting three best innovations in solving local problems to be held in each Lok Sabha Constituency.

MULTI-LEVEL PLANNING

It was by the late 1950s and early 1960s that the states demanded the right to plan at the state level. By the mid-1960s, the states were given the power to plan by the Centre advising them that they should promote planning at the lower levels of the administrative strata, too, i.e., the district level planning—via the municipalities and corporations in the urban areas and via block level through panchayats and the tribal boards. By the early 1980s, India was a country of multi-level planning (MLP) with the structure and strata of planning as follows:

First Strata: Centre Level Planning

At this level three types of Central Plans had evolved over the years—the Five Year Plans, the Twenty-Point Programme and the MPLADS.

Second Strata: State Level Planning

By 1960s, the states were planning at the state level with their respective planning bodies, the state Planning Boards with the respective CMs being their de-facto Chairman. The States Plans were for a term of five years and parallel to the concerned Five Year Plans of the Centre.

Third Strata: District Level Planning

By the late 1960s all the districts of the states were having their own plans with their respective District Planning Boards[89] with the respective District Magistrate being the de-facto chairman. The district level plans are implemented now via municipalities or corporations in the urban areas and the panchayats via the blocks in the rural areas.

Fourth Strata: Block Level Planning

As a part of the district level planning the Block Level Planning came up which had the District Planning Boards as their nodal body. Below the blocks, India developed the planning at the local level, too.

Fifth Strata: Local Level Planning

By the early 1980s, plans were being implemented at the local level via the blocks and had the District Planning Boards (DPBs) as the nodal agency. Due to socio-economic differentiations among the population, local level planning in India developed with its three variants,[90] namely:

(i) Village Level Planning
(ii) Hill Area Planning
(iii) Tribal Area Planning

89. After the implementation of the 74th Constitutional Amendments they have become the District Planning Committees (DPCs).
90. While people in some areas have socio-cultural similarities (as in the hill areas with no tribal population and the people living in the plains i.e villages) they lack economic similarities. Similarly, while people living in the tribal areas and the hill areas have economic similarities they lack socio-cultural similarities. That is why all these three habitations had three sets of planning patterns.

Basically, the MLP was started to promote the process of decentralised planning in the country. It was the Indian version of democratic planning which ultimately sought to guarantee the people's participation in the process of planning. But it failed to do so due to many reasons. The reasons have been discussed below:

(i) It could not promote people's participation in the formation of the various plans. The basic idea of the MLP model was that once the local level plans will be handed over to the blocks, the blocks will make their plans and once the blocks hand over their plans to the districts, the district level plans will be formulated. Similarly, the state plans and finally the Five-Year Plan if the Centre will formulate one. By doing so, every idea of planning will have the representation of everybody in the country at the time of plan formation—a special kind of plan empathy would have developed out of this process. But this was not the reality. Every strata made their own plans—lacking the empathy factor.

(ii) Only Central Plans were implemented as the states lacked the required level of finance to support the plans. They ultimately had to be satisfied by implementing the Central Plans which failed to include the states' empathy.

(iii) As the local bodies in India were not having any constitutional mandate, they just played the complementary roles to the state planning process. As they had no financial independence, their plans, even if they were formulated, remained on paper only.

(iv) The MLP, thus, failed to include the people's participation in planning, badly betraying the local aspirations.[91]

But at least the failure of MLP made the government to think in the direction of decentralised planning afresh leading to the enactment of the two important Constitutional Amendments—the 73rd and 74th.

WAY TO DECENTRALISED PLANNING

Economic planning was basically an element of the centralised kind of political system (i.e., the socialist and the communist). When India decided in favour of a planned economy it was to face double challenges:

(i) The first challenge was to realise the objectives of planning in a time-bound frame and

(ii) Making economic planning a suitable instrument of development in the democratic set up—to democratise and decentralise the process of planning itself.

The government tried to decentralise the planning process by setting up the NDC and promoting the MLP, but without being able to achieve the desired results. By the late 1980s, a direct link was established[92] between development and democracy. And it was established that the above-given challenges were basically complementary—without solving the second challenge (i.e., decentralisation) the first challenge (i.e., development) cannot be solved. Finally, once

91. G.V.K. Rao Committee (CAARD), 1985; L.M. Singhvi Committee (CCPPRI), 1986 and Sarkaria Commission, 1988 all discussed this inter-connection (***Legislative Status of Panchayat Raj in India,*** IIPA, N. Delhi, 1997).

92. Governments' failure in including the local aspirations in the process of planned development has been considered by the major experts as the foremost reason behind the success of the regional political parties, which has led to the governments of the 'compromises' i.e. coalition Governments, at the Centre and in the states via the 'hung parliaments' and the 'hung assemblies', respectively.

the PRIs were given the constitutional status first time planning became a constitutional excercise at any level, i.e., at the panchayat level.

Though the planning at the central and the state levels are still extra-constitutional activities, it has become constitutional at the level of local bodies. Kerala has shown some pathbreaking good works via local body planning.[93] But still there are many hurdles to be solved before the local bodies are really able to plan for their proper development. These hurdles as per the experts are as under:

(i) The financial status of the PRIs is still not stabilised.

(ii) Which taxes the PRIs can impose are still not clear.

(iii) The state assemblies have been procrastinating in delegating timely and needful powers to the PRIs.

(iv) Low level of awareness among the local people regarding their Right to Information and the right functioning of the PRIs

(v) Use of money and muscle power in the PRI elections in some states

By mid-2002, there took place an all India Panchayat Adhyaksha Sammelan in New Delhi. At the end of the meet, the Panchayat Adhyakshs handed over a '21 Point Memorandum' to the government which specially dealt with the financial status of the PRIs. In July 2002, while the then PM was addressing the annual meet of the District Rural Development Agency (DRDA), he announced that the PRIs will be given 'financial autonomy' very soon. He further added that once there is a political consensus, the government might go in for a further constitutional amendment. Unfortunately, the same coalition (i.e., the NDA) did not come to power in the forthcoming general elections. But the UPA Government does not look less serious on the issue of participatory development. By mid-2006, the Planning Commission wrote letters to every Chief Minister of each state that before the Eleventh Plan commences it wants that all the PRIs are duly delegated their functional powers of planning from the concerned states. Otherwise, the funds kept for local development would not flow to the states. This shows the seriousness of the Central Government.

Once there is right level of awareness among the local people and the PRIs are able to take their real shape, the planning process will get decentralised, we may be sure of that.

THE PLANNING COMMISSION & THE FINANCE COMMISSION

Federal political systems provide independent financial control to the central as well as the state governments so that they are able to perform their exclusive functions.[94] For the same objective, the Constitution of India has made elaborate provisions,[95] i.e., setting up of a Finance Commission to recommend to the President certain measures relating to the distribution of financial resources between the Union and the states. But the powers given to the Finance Commission by the Parliament limited its functions to the extent of finding out revenue gap of the states besides recommending for the 'grant-in-aids to the states from the Centre. The finance commission cannot determine the capital-related

93. Jose George, 'Panchayats and Participatory Planning in Kerala', ***The Indian Journal of Public Administration,*** Vol. XLIII, No.1, January–March, 1997.

94. As *K.C. Wheare* writes about the classical federal constitutions in ***Federal Government,*** Oxford University Press, 3rd Ed., 1956, p. 97.

95. Articles 270, 273, 275 and 280 of the ***Constitution of India.***

issues of the states (though the Constitution does not classify between the capital or revenue related roles of the commission while determining the Centre's assistance to the states).

In the meantime, to promote the process of planning, an extra-constitutional body, i.e., the Planning Commission was set up even before the First Finance Commission was set up. The Planning Commission plays a very vital role in the process of determining Central assistance to the states as all development plans, programmes and projects are within its purview. All grants or loans given by the centre to the states for developmental works are practically dependent on the recommendations of the Planning Commission. And that is why the role of the Planning Commission was said to 'confine'[96] the role of the Finance Commission, i.e., a non-constitutional body eclipsing a constitutional body. P.J. Rajamannar who headed the Finance Commission (1966–69) suggested to clearly define the relative scope and functions of the two commissions by amending the Constitution, and the Planning Commission was advised to be made a statutory body independent of the government. But no such follow ups came from the successive governments at the Centre. But one thing was important, most of the finance commissions devoluted some extra shares in the central taxes (i.e., the income tax and the central excise) and grants-in-aid.

Since the decade of the 1990s, certain events made the Central Government change its mindset regarding the role of the states in the process of development. Major events may be counted as under:

(i) The process of economic reforms started in 1991–92 required active economic participation from the states.

(ii) The constitutional requirement of 'participatory planning' mandated by the 73rd and 74th Constitutional Amendments was enacted in 1993.

(iii) The arrival of coalition era at the Centre when over a dozen political parties, having regional affiliations came together to form the government.

(iv) The recommendations of the Tenth Finance Commission followed by a constitutional Amendment making Alternative Method of Devolution a law in 1995.

(v) Various new needs of the time such as tax reforms, agricultural development, industrial expansion, etc.

The year 2002 could be considered a watershed in the area of promoting the states' need for financial resources in promoting their developmental requirements. In July 2002, while the government was setting up the Twelfth Finance Commission (2005–10) the then Minister of Finance announced that in future the Planning Commission will be *playing more or less a role of collaborator to the Finance Commission*. In the same announcement, the government made one member of the Planning Commission, a member of the Finance Commission too (a symbol of physical and ideological connection between the two bodies).[97] It was as if the government had accepted the suggestions of the Fourth Finance Commission to a great extent. Though the critics took it as an infringement of a constitutional body by a non-constitutional one, the government clarified by calling it a symbol for promoting the contemporary needs of the economy and fiscal federalism.

96. ***Report of the Fourth Finance Commission*** (chaired by P.J. Rajamannar), GoI, N. Delhi, 1965, p. 88.

97. In the 10th Plan, **Som Pal** was that common member in both the Commissions (who resigned from the PC once the UPA-I came to power). But this arrangement has been followed by the government in all new Commissions since then—with **B. K. Chaturvedi** and **Prof. Abhijit Sen** (Members, PC) being the *Additional Members* of the *13th* and *14th Finance Commissions*.

Another milestone was created in the enactment of the Fiscal Responsibility and Budget Management (FRBM) Act in 2003 which empowers the state governments to go for market borrowings to fulfil their plan expenditure without prior permission from the Central Government (provided they have enacted their respective Fiscal Responsibility Acts).[98] This has boosted the participatory planning in the country by guaranteeing greater autonomous plan participation from the states.

If we look at the tax reforms process, we see a general tendency of enabling the states to collect more and more taxes, the Value Added Tax (VAT) being a glaring example by which almost all states have been able to increase their gross tax revenue receipts. The cause will be served more once the economy goes for the proposed enactment of the Goods and Services Tax (GST).

Thus, we see an overall change in the mindset of the Central Government towards allocating more financial resources in favour of the states which has been also shown by the Tenth and Eleventh Plans.

THE CHANGING NATURE AND THE ROLE OF PLANNING

Led by various inter-connected and experience-based factors, a great many ***new elements*** have been included in the Indian planning process in recent years. Some of the new elements are too path breaking to reverse the very established thinking of planning in the country. Still some of them could be seen as the Government's attempt to address some of the long-standing and overdue criticisms of planning in India. The inclusion of the new ***methods*** and ***strategies*** of planning has gone to change the very ***nature***, ***role*** and the ***scope*** of planning in the country. It was the Tenth Plan which is credited of doing this. Many 'first time' initiatives were taken up by the Plan. Usually, the plan projections in India did talk about development in the recognised sectors, but here the Tenth Plan imaginatively forges ahead towards new goals—it was undoubtedly a historic moment. The new measures initiated by the Plan[99], which led to changes in planning may be seen as under:

1. THE ROLE OF THE STATE IN PLANNED DEVELOPMENT

It was for the first time that the Planning Commission not only went for a detailed talk on the states' concerns but also emphasised and recognised their role in the process of development planning (in Vol. III, Tenth Plan). The Plan accepts that unless the states achieve their targets, a nation cannot achieve its targets. This is an open acceptance of the state's role in planning and a clear pointer to the need for decentralised planning. The meeting of the Planning Commission which passed the Tenth Plan advised two important ideas in this regard:

(i) to make the Tenth Plan a ***'People's Plan'***, and

(ii) to make development a ***'People's Movement.'***

The Deputy Chairman, Planning Commission articulated on the ocassion that 'people's say in Plan is a must'. The Chairman, Planning Commission emphasised that only economic growth should not be our objective but improvement in the quality of life of the masses should be the real goal of planned development. He further added that

98. This should be considered a great fiscal freedom to the states (which even the constitution could not forsee) and also making them behave with more responsibility in fiscal matters. More than 20 states have passed their Fiscal Responsibility Acts (FRAs) by now and are borrowing from the market for their planned needs.

99. ***Tenth Five-Year Plan,*** Planning Commission, GoI, N. Delhi, 2002.

people's participation in the planning process is a must to make development a mass movement and helpful to all. This idea continued in the Eleventh Plan and proposes the Twelfth Plan (2012–17).

2. Agricultural Sector Accepted as the Driving Force of the Economy

There had been a bias against the agricultural sector around the world after the Second World War—emphasis on agrarian economy was considered a symbol of backwardness. This mindset, ultimately, changed by the early 1990s to which the World Bank also agreed. Though the Union Budgets of 2000–01 and 2001–02 clearly referred the proposition, it was the Tenth plan which clearly accepted the 'agriculture sector' as the Prime Moving Force (PMF) of the economy. The Nobel Laureate Amartya Sen has also suggested on the same lines.[100]

The Plan further adds that by prioritising agriculture (in place of industry) the economy will be able to solve three major problems which have been ailing the economy:

(i) With the increase in the agricultural production the economy will have food security,

(ii) Emphasis on agriculture will give a great thrust to employment generation (92 per cent of the employment is today generated by the unorganised sector with agriculture being the biggest), and

(iii) Purchasing power of the masses will increase which will reverse the long-standing situation of 'market failure' in the economy (that is why India sells lesser industrial goods and the industries lack the market for their products. It means by emphasising upon the agriculture sector, the economy will be able to boost its income from the industries).

Accepting agriculture as the 'core element' of the economy, the Plan suggested key reforms which are at their various stages of implementations:

(i) Elimination of inter-state barriers to trade and commerce;

(ii) Encouraging contract farming and permitting leasing in and leasing out of agriculture lands;

(iii) Need to amend the Essential Commodities Act;

(iv) Liberalising agri-industry, agri-trade and exports;

(v) Replacement of various Acts concerning food by one comprehensive 'Food Act';

(vi) Permitting 'future trading' in all commodities;

(vii) Removal of restrictions on financing of stocking and trading.

3. Governance Recognised the Most Important Factor of Development

It was for the first time that the economic think tank, the Planning Commission went to comment upon the issue of governance (which has been only of political concern till date and the Planning Commission never thought to ponder upon such issues). In its first comment upon it, the Planning Commission recognised governance among the most important factors to realise the planned goals (a full chapter devoted to it in Vol. I, Tenth Plan). The government also did set up an empowered committee on the matter which advised a list of reforms:

(i) Improved people's participation through PRIs;

(ii) Increased involvement of civil society and NGOs;

100. While he was in India to receive the 'Bharat Ratna' award in 2001.

(iii) Civil service reforms for improving transparency, accountability and efficiency; security of tenure for the civil servants with more equitable system of rewards and punishments;
(iv) Rightsizing both the size and role of government;
(v) Revenue and judicial reforms; and
(vi) Use of Information Technology for 'good governance'

After the World Bank report on 'Good Governance' in the mid-1990s, the government has been trying to sensitise the issue. Finally, it was the Tenth Plan which accepted the immediate need for good governance.

4. New Steps for Economic Reforms to be Taken by the State

In a major decision it was articulated that from now onwards all the new steps of economic reforms will be taken by the states with the Centre playing a supportive role. It was the time when the government initiated the Second Generation of Economic Reforms. Till date the states had been playing a secondary role in the process of economic reforms. That is why the economy had not been able to tap the expected benefits from it. Now the method and strategy from the reforms process have gone in for a change.

5. Monitorable Targets of Development Set for the First Time

There used to be planned targets in the past but this time an innovative way of setting these targets was initiated. The Plan did set, for the first time, a national level monitorable targets in 11 areas, showing development:

(i) Poverty reduction: 26 to 21 per cent by 2007 and to 15 per cent by 2012.
(ii) Population growth rate: 21.3 to 16.2 per cent by 2001–11.
(iii) Growth in gainful employment to, at least, keep pace with addition to the labour force over the Tenth Plan period.
(iv) Schooling: 100 per cent enrollment by 2003 and five years compulsory schooling by 2007 to be completed by 2012.
(v) Literacy: 65 to 75 per cent by 2007 and further increased to 80 per cent by 2012.
(vi) Infant Mortality Rate: to be reduced from 72 to 45 by 2007 and 28 by 2012 (per 1,000).
(vii) Maternal Mortality Rate: to be reduced from 40 to 20 by 2007 and 10 by 2012 (per 1,000).
(viii) Potable Water: to all villages by 2012.
(ix) Reducing Gender Gaps: in literacy and wage rates by 50 per cent by 2007.
(x) Forest Cover: to be increased to 19 per cent by 1999–2000, 25 per cent by 2007 and 33 per cent by 2012.
(xi) De-polluting the Waterbodies: major rivers by 2007 and other notified water stretches by 2012.

The monitorable targets have importance as the concerned central ministries are parties to its realisation. The ministries hand over an undertaking to the Planning Commission about their strategies of realising the targets, and performance reports are submitted by them which become the bases for monitoring by the Planning Commission.

6. Differential Development Strategy Adopted

The Tenth Plan accepts that national targets do not necessarily translate into balanced regional development. It further adds that the potential and constraints of each state differ vastly. That is why the Plan goes on to adopt a differential development strategy. Under this strategy, separate state-wise growth and other monitorable targets

were worked out by the Planning Commission for the states with their consultation so that the states can focus on their development plans. The states are getting central plan support according to their development requirement now as against the past pattern of plan allocations. The developmental funds to the states and the central loans to them now accrue subject to their performance concerning the monitorable targets set for the states (to which they agreed).

7. Monitoring the Progress of Various Central Ministries

With the Tenth Plan the government has started a process under which the progress of different central ministries is monitored by the Planning Commission This is how the policy initiatives of the various ministries and the Planning Commission's idea of development have been streamlined. The Planning Commission has really emerged as a 'super cabinet' in this way.

8. Relevance of Planning to Economic Reforms

After the two five-year plans (the eighth and the ninth) were already implemented, the government took up the cause of establishing a relevance between the process of planning and the broader process of economic reforms. Different steering committees have been set up which look after the plan implementation of the different sectors according to the decided idea of economic reforms. This step should be seen as the government's answer to the critics who opined that planning has become irrelevant in the era of economic reforms.

9. Reforming the Planning Process

The government called this Plan a 'reform plan' rather than a 'resource plan'. There has been a long-standing criticism about Indian plans that they are mere excercises in resource mobilisation. Probably, the Planning Commission has tried to do away with this criticism. The above given seven points visibly prove that the Tenth Plan was not merely a 'resource plan'. Basically, the Plan initiates many pathbreaking changes in the planning process—its methods, strategies and the ideas—all at the same time. Rightly, it has been called a 'reform plan' by the Planning Commission Second, this was the first plan in the era of economic reforms which accepts to go for establishing relevance to the process of economic reforms. From this perspective, too, this Plan is a 'reform plan'.

The inclusion of the above-given new elements into the Indian planning process has gone to really change the nature, role and scope of planning in the country. All these new elements are today carried forward by the Eleventh Plan with an emphasis wherever it is required. The planning process is more established today in India as the changes in the political arrangements at the Centre do not seem to be affecting it unlike the past.

MONITORABLE TARGETS SET BY THE TWELFTH PLAN

To focus the energies of the government and other stakeholders in development, it is desirable to identify monitorable indicators, which can be used to track the progress of our efforts. Given the complexity of the country and the development process, there are very large number of targets that can and should be used. However, there is a **core set of indicators** which could form the objectives towards which all development partners can work, which includes not only the Central and state governments, but also local governments, CSOs (Civil Society Organisations) and international agencies. The **Twelfth Plan (2012–17)** has set *twenty-five monitorable targets* in *seven broad areas*

reflecting its (India's) '*vision of rapid, sustainable* and more *inclusive growth*': [101]

ECONOMIC GROWTH

(i) Real GDP growth rate of 8 per cent.

(ii) Agriculture growth rate of 4.0 per cent.

(iii) Manufacturing growth rate of 10.0 per cent.

(iv) Every state must have an average growth rate in the Twelfth Plan preferably higher than that achieved in the Eleventh Plan.

POVERTY AND EMPLOYMENT

(v) Head-count ratio of consumption poverty to be reduced by 10 percentage points over the preceding estimates by the end of Twelfth Five Year Plan.

(vi) Generate 50 million new work opportunities in the non-farm sector and provide skill certification to equivalent numbers during the Twelfth Five Year Plan.

EDUCATION

(vii) Mean Years of Schooling to increase to seven years by the end of the Twelfth Five Year Plan.

(viii) Enhance access to higher education by creating two million additional seats for each age cohort aligned to the skill needs of the economy.

(ix) Eliminate gender and social gap in school enrolment (i.e., between girls and boys, and between SCs, STs, Muslims and the rest of the population) by the end of the Twelfth Five Year Plan.

HEALTH

(x) Reduce IMR to 25 and MMR to 1 per 1,000 live births, and improve Child Sex Ratio (0–6 years) to 950 by the end of the Twelfth Five Year Plan.

(xi) Reduce Total Fertility Rate to 2.1 by the end of the Twelfth Five Year Plan.

(xii) Reduce under-nutrition among children aged 0–3 years to half of the NFHS-3 levels by the end of the Twelfth Five Year Plan.

INFRASTRUCTURE, INCLUDING RURAL INFRASTRUCTURE

(xiii) Increase investment in infrastructure as a percentage of GDP to 9 per cent by the end of the Twelfth Five Year Plan.

(xiv) Increase the Gross Irrigated Area from 90 million hectare to 103 million hectare by the end of the Twelfth Five Year Plan.

(xv) Provide electricity to all villages and reduce AT&C losses to 20 per cent by the end of the Twelfth Five Year Plan.

(xvi) Connect all villages with all-weather roads by the end of the Twelfth Five Year Plan.

(xvii) Upgrade national and state highways to the minimum two-lane standard by the end of the Twelfth Five Year Plan.

(xviii) Complete Eastern and Western Dedicated Freight Corridors by the end of the Twelfth Five Year Plan.

(xix) Increase rural tele-density to 70 per cent by the end of the Twelfth Five Year Plan.

(xx) Ensure 50 per cent of rural population has access to 40 lpcd piped drinking water supply, and 50 per cent gram panchayats achieve Nirmal Gram Status by the end of the Twelfth Five Year Plan.

ENVIRONMENT AND SUSTAINABILITY

(xxi) Increase green cover (as measured by satellite imagery) by 1 million hectare

101. ***Twelfth Five Year Plan (2012–2017),*** 'Faster, More Inclusive and Sustainable Growth', Volume I, pp. 34-36, Planning Commission. GoI, N. Delhi. 2012.

every year during the Twelfth Five Year Plan.

(xxii) Add 30,000 MW of renewable energy capacity in the Twelfth Plan.

(xxiii) Reduce emission intensity of GDP in line with the target of 20 per cent to 25 per cent reduction over 2005 levels by 2020.

SERVICE DELIVERY

(xiv) Provide access to banking services to 90 per cent Indian households by the end of the Twelfth Five Year Plan.

(xxv) Major subsidies and welfare related beneficiary payments to be shifted to a direct cash transfer by the end of the Twelfth Plan, using the Aadhar platform with linked bank accounts.

States are encouraged to set ***state-specific targets*** corresponding to the above, taking account of what is the reasonable degree of progress given the initial position. Sector-wise monitorable growth targets set by the states have also been given by the Plan.

A CRITICAL EVALUATION

Planning has been subject to a number of criticisms right since its inception in the country. With the passage of time, not only the number of criticism increased, but more importantly the shortcomings of planning were pointed out. Although after considerable delay, the governments took note of the shortcomings besides taking some major steps. The criticisms stand even today but with one difference that the government is not only conscious of them but also trying to do away with them. We may briefly discuss the major criticisms of planning in India as well as the follow ups from the government to do away with them as under:

1. LACK OF 'PERSPECTIVE' IN PLANNING

According to experts, if a nation is going for economic planning it must have 'perspective' element in it. To have perspective in planning, two basic elements need to be fulfilled, namely—

(i) Planning should be evaluation-based, and

(ii) 'Long-term' goals should be followed up besides the 'short-term' goals.

In the Indian content, the succeeding plans have been always commenced without the full evaluation of the preceding Plan. This was mainly due to following reasons:

(a) Lack of a nodal body responsible for data collection at the national level;

(b) Federal nature of polity made data collection full of delays and also due to higher dependence on the states; and

(c) Speedier data delivery was not possible.

After the recommendations of the National Statistical Commission (Chaired by C. Rangarajan), 2000, the government discussed to set up a nodal body for data collection at the pan-India level, cutting across federal hurdles. Computerisation is already being done for speedier data delivery. For the time being the Plans are launched on the basis of projected data (provisional, latest, etc.), which is almost near the real data. But once the above discussed arrangements are in place, Indian planning will be based on evaluation, undoubtedly. In the meantime, the 'Quarterly Review' and the 'Performance Budgeting' of the Union Budgets have brought in the evaluation element to a greater degree.

The First Plan had set long-term goals (for the coming 20 years) besides the short-term goals (for five years). But over the time, falling confidence in mobilising required resources and political

uncertainties at the Centre made it a convention to set only short-term targets of planning. This shortcoming seems to be done away with after the commencement of the Tenth Plan. The Plan did not go for setting long-term goals only, but even did set monitorable targets for the Eleventh Plan, too.

Point should be noted here that the government had been conscious about the need for perspective planning as a separate division with the same name, which has been functioning in the Yojana Bhavan since the mid-1970s.

2. Failure in Promoting a Balanced Growth and Development

Indian planning is blamed for failing the objective of a regionally balanced growth and development. Though the Second Plan itself had noticed this fact, the measures taken were not sufficient or were short-sighted. Economic planning at the national level has proved to be a highly effective tool of promoting balanced growth. But in the Indian case it turned out to be the opposite.

To take care of the issue of balanced growth, the planning process has been using the right tools, i.e., allocating plan funds on a sectoral (primary, secondary and federal reasons) basis. But due to political reasons, enough discrepancies cropped up in the method of allocating funds to the states. At the theoretical level, the governments knew the remedies, but at the practical levels politics dominated the planning process. Democratic immaturity and politicisation of the planning process is to be blamed for this.

Now things have changed for the better. The government is following a two-pronged strategy to achieve the objective of a balanced growth and development in the country:

(i) Backward regions today are prioritised in directing the Central Government investment (very much the same since the 1950s), but a new beginning in the 'differential development strategy' has been made by the Centre with the Tenth Plan. Under this strategy, the development constraints of different states are to be tackled with a differentiation in the strategy. The more needy states get more funds and assistance from the Centre for their planned development, cutting across the political party lines (it is seen today as a symbol of political maturity on the issue of economic development, at least).

(ii) There is also a complementary strategy of the planning to address the matter of regional imbalance in the country. After the country started the process of economic reforms, the nature of planning was to incline more and more towards indicative planning. The economy was to be more and more dependent on private sector investment for its future development. And the private sector will be, naturally, more interested in investing in the regions, which have better infrastructure support. Since the developed regions have better infrastructure they will attract the highest level of private investment, which will again accelerate the process of imbalanced growth. To tackle this problem, the Centre is promoting the states with lower, infrastructure so that they can overcome the disadvantage. The process is slower the but at least the government is addressing the issue which is not less satisfying and there is no criticism to this strategy. Still balanced growth and development is going to be a great challenge for planning in India.

3. Highly Centralised Nature of Planning

Decentralising the process of planning has been a major goal of the governments since the 1950s. But after Nehru, with every Plan we see greater tendency of centralisation in the planning process. Setting up of the NDC and promoting multi-level planning (MLP) did not serve much purpose in this direction. It has been among the criticised areas of planning in India as the National Planning Committee as well as the First Plan itself had called for 'democratic planning' in the country.

By the mid-1980s, the mindset of the Centre went for a change and the need for decentralised planning got proper attention. Finally, by early 1990s two constitutional amendments (i.e., the 73rd and the 74th) promoted the cause of decentralised planning by delegating constitutional powers to the local bodies. With this, a new era of planning began, but still the planning of local bodies is in nascent stage due to lack of proper financial provisions for them. Once the financial provisions for them are evolved to the adequate level or the local bodies are given financial autonomy, the process of decentralised planning will surely get a new direction and meaning, as the experts believe.

In the meantime, the Tenth Plan emphasised greater role for the states in the planning process. The Plan started a concerted effort to include the states' participation in the national planning process. The Centre is today more concerned about the developments constraints of the states and is trying to adequately support the State Plans to the extent possible. In return, the centre wants greater and transparent fiscal compliance from the states. This approach continued during the Eleventh Plan and so has been committed for the Twelfth Plan, too. After some time we may hope that this criticism of Indian planning will lose it's ground.

It is high time now that the planning process of the nation tries including the mass participation. The ***Economic Survey 2011–12*** rightly devotes a section to dwell into contracts and how the **civil society** and citizens play a key role in fostering economic growth. *"Honesty, punctuality, the propensity to keep promises, the attitude towards corruption are matters shaped in great part by norms and social beliefs and the behaviour patterns can become habitual. Moreover, in a democracy like India, what can be done by government depends in great measure on how ordinary people think and what people believe in,"* it says. The Survey further adds that the **civil society** has been campaigning to put in place new institutions, such as the Lokpal Act, to ensure the quality of service and bring about transparency through steps such as auction of natural resources while the government has either been slow or resisted several changes.[102]

4. Lop-sided Employment Strategy

Planning in India has been tilted heavily in favour of 'capital intensive' industries, especially from the Second Plan onwards. Such industries in the public sector could not generate enough employment. In place of it India should have gone in for 'labour-intensive' industries. In the era of economic reforms, the attitude changed and the planning process is promoting the agriculture sector with an emphasis on agri-industries and agro-exports to create more gainful and quality employment opportunities. The earlier emphasis on 'wage-employment' has shifted towards 'self-employment' to do away with the lop-sided employment strategy of the past.

102. ***Economic Survey 2011-12,*** MoF, GoI, N. Delhi, p.30.

5. Excessive Emphasis on PSUs

Indian planning emphasised on public sector undertakings (PSUs) for the right reasons, but in the wrong way and for a considerably longer period of time. The state's monopolies in certain areas continued over such a long period that too in losses that there came a demand-supply gap in the major goods and services produced by the PSUs. Though very conducive policy changes were effected after the country started the reform processes, the hangover of the past is still looming large. Several reforms in the PSUs as well as a more liberal approach towards the private sector with market reforms are needed to phase out the discrepancies created by the over emphasis on PSUs.

6. Agriculture Overshadowed by the Industry

Promoting the cause of faster industrialisation over time became so dear to the planning process that the agriculture sector got badly overshadowed. Though the Plans were highlighting or prioritising agriculture, the industrial sector and the PSUs were glorified in such a way that time and resources both were scarce for the agriculture sector. Such a policy always created a situation of food insecurity (even today) for the country and the masses who depended upon agriculture for their livelihood and income (still it is 58.2 per cent)[103] could never increase their purchasing power to a level that the economy could reverse the situation of 'market failure'. In India, even today, industrial growth is badly dependent on agricultural growth.

The Tenth Plan recognises agriculture as the 'core element' of development. This is a welcome ideological change in the strategy of planning. Now the industries can sustain themselves, but the laggard agriculture sector needs some special care and promotion from the government, so that the masses who earn their livelihood from agriculture can benefit out of the WTO-promoted globalisation. The agriculture sector is in emergent need of attention, otherwise, the process of globalisation is going to be ineffective in benefitting the masses.

7. Faulty Industrial Location Policy

There are time-tested theories of 'industrial location' considering the nearness of raw materials, market, cheaper labour, better transportation and communication, etc. But the Plans always prioritised setting up of new industrial units (i.e., the PSUs) in the backward regions of the country, which falsify the theories of industrial location. The government needs to develop all industrial infrastructures besides setting up certain PSUs. As the PSUs require skilled labour force, the regions failed to gain any employment from the PSUs too. The government still continues with the same policy of setting up industries, but now the new PSUs are hardly set up in traditional areas.

8. Wrong Financial Strategy

Mobilising resources to support the highly capital-intensive Plans (courtsey the PSUs) has always been a challenge for the government. To support the Plans, no stones were left unturned namely, going for a highly complex and liberal tax structure, nationalising the banks, etc. Ultimately, tax evasion, the menace of parallel economy and lesser and lesser capital for the private sector were the bane of India. Expansion of subsidies, salaries and the interest burden every year gave an upward push to the non-plan expenditure leading to scarcity of funds to support the plan expenditure (i.e., the developmental expenses).

In the era of reforms, the governments started giving attention to financial strategy of supporting

103. ***Economic Servey* 2012-13**, MoF, GoI, N.Delhi, p.173.

the plans in the right way. Besides, tax reforms, the financial reforms, as well as fiscal consolidation have been given proper care in recent years.

9. Politicisation of the Planning Process

In a democratic political system, almost every issue of socio-political importance is influenced by politics. It is more correct in the case of lesser matured democracies. The same stands true for the process of planning in our country. Greater and greater politicisation of the planning process culminated in such a design that at times economic planning served the opposite purpose. For example, we know that planning is a tool for promoting regionally balanced growth but in India in the process of serving vested political interests of the Centre, it resulted into promoting an imbalanced growth.

In the recent years governments have tried to address the major criticism of planning in India. More such constructive steps with better results are expected in future. More aware and better informed citizens will lead to better and better planning in future.

There has been a general anger among the sections of society regarding coalition politics, scams, etc., in recent years. The ***Economic Survey 2014–15*** rightly *blames coalition politics* and the *federal structure* for tardy decision making in several areas—from oil subsidy to tax reforms, FDI in retail and free movement of foodgrains. Almost everyone outside the government blamed it for *policy paralysis*. The Survey notes it as an area of concern. The Survey notes that ***politicians*** and ***policymakers*** can set the ball rolling by acting as ***role models,*** but it also cited the poor record on enforcement of contract to argue that people's attitude needs to change. *"In these everyday situations (such as hiring a cab or a painter) it is cumbersome to bring in the state and the law courts. Here the main guarantor has to be people's personal integrity and trustworthiness"*, it says. The statement comes from a government that has been battling a spate of *corruption scandals*—ranging from those in the telecom sector to Commonwealth Games and criticism over poor governance standards and inability to push through critical decisions.[104]

The ***Economic Survey 2012–13*** suggested a new objective for the Planning Commission – the global economic and financial crisis which has persisted for the last five years has not only exposed the vulnerability of almost all the countries over the globe to external shocks, but also has lessons for the ***planning process***—countries need to have inbuilt social safety nets for facing such eventualities, which affect the weak and vulnerable the most, and wipe out the fruits of growth for years. India with its focus on inclusive development and timely interventions has, however, been able to weather the crisis better than many other countries.[105]

INCLUSIVE GROWTH

Inclusive growth is a growth process which yields broad-based benefits and ensures equality of opportunity for all (*UNDP* and the *11th Plan*). Fundamentally, the ideas of growth and development already include the element of 'inclusiveness' in them, but at times, due to certain reasons, the processes might occur in non-inclusive manner.

It was in 2000-01 that the Government of India (GoI) came to think clearly about 'inclusiveness' in the economy while reviewing the performance of the economic reforms. It was found that the reform process enabled economy towards faster and higher 'wealth creation' but all could

104. ***Economic Survey 2011-12,*** MoF, GoI, N. Delhi, p. 30.
105. ***Economic Servey 2012-13***, Mof, GoI, N.Delhi, p.269.

not be part of it. Only the people with resources (physical or human) were able to get benefits out of the reforming economy. It was assessed that the fruits of reforms could not percolate to the ***disadvantaged*** and ***marginalised*** sections of the society. It means, the growth process during reforms was not able to include a big segment of Indian population. In this backdrop, we see the government adopting a conscious policy towards 'inclusive growth'. Even before reforms commenced in the country this element was lacking. But during reforms it became more glaring due to the higher pace of growth which the economy attained during this period. Though government started attending this issue since 2000-01 itself, it was given real attention in the *11th Plan* (2007-12) where we see a clear policy evolving towards the idea of inclusive growth in the country – 'including the disadvantaged and marginalised sections of the society, specially, SCs, STs, OBCs, Minorities and Women' in the processes of growth and development. By *12th Plan* (2012-17), the focus increased when we see the issue of inclusiveness entering into the very slogan of the Plan- 'Faster, Sustainable and More Inclusive Growth'. During the course of time, we see the government evolving a clear *short-term* and *long-term* policy towards the cause of inclusive growth:

Short-term policy: This policy is aimed at supplying those goods and services to the disadvantaged and marginalised sections of society which are bare minimum and of essential nature. Several Central Sector Schemes and Centrally Sponsored Schemes are run by the governments for this purpose. This policy touches the areas like:

- Food and nutirition (Annapurna, Antodaya, Mid-Day Meal, and the last being National Food Security Act, etc.);
- Healthcare and sanitation (National Health Mission, Total Sanitation Campaign, ASHA, Mission Indradhanush, and the last being Swachh Bharat Abhiyan, etc.);
- Housing (Indira Aawas Yojana, Rajiv Aawas Yojana, etc.);
- Drinking water (National Rural Drinking Water Programme, etc.);
- Education (Sarva Shiksha Abhiyan, Rashtriya Madhyamik Shiksha Abhiyan, Model School Scheme, etc.).

The short-term policy has two drawbacks- *firstly*, the schemes in it are subsidy-based which incurr heavy drain on the national exchequer (it means it will not be fiscally sustainable in the long run) and *secondly*, they fail to make the target population self-dependent. This is why the government has also evolved a long-term policy in this regard.

Long-term policy: This policy is aimed at bringing in self-dependence in the target population. This policy contains in itself the sustainabilty element, too. The attempts by the governments may be classified as given below –

- All the schemes which aim at poverty alleviation and employment generation;
- All the programmes which promote education at any level;
- Vocationalisation of education (one such old idea has been the Industrial Training Institutes); and
- Skill Development (a recent idea).

In recent time, we see increased emphasis on imparting right 'skill' among the population. Towards this, the government decided in 2008-09 to launch a skill development programme in the country- through the National Skill Development Corporation (a joint venture non-profit company under Ministry of Finance 49% owned by GoI and 51% by private sector- a PPP). There is overall target of skilling/upskilling 500 million people in

India by 2022, mainly by fostering private sector initiatives in skill development programmes and providing funding. The new Government at Centre has also given the same call in the *'Skill India'*.

This way, we can see a full-proof policy towards inclusive growth getting evolved by the GoI which is sustainable, too. Planning Commission *(11th Plan)* says that inclusive growth can only be ensured if there is a degree of empowerment that creates a true feeling of participation so necessary in a democratic polity. Empowerment of disadvantaged and hitherto marginalized groups is therefore an essential part of any vision of inclusive growth. India's democratic polity, with the establishment of the third layer of democracy at the Panchayati Raj Institutions (PRIs) level, provides opportunities for empowerment and participation of all groups with reservations for SCs, STs, and women. These institutions should be made more effective through greater delegation of power and responsibility.

The strategy for inclusive growth in the *11th* and *12th Plans* is not just a conventional strategy for growth to which some elements aimed at inclusion have been added. On the contrary, it is a strategy which aims at achieving a particular type of growth process which will meet the objectives of *inclusiveness* and *sustainability*. A key feature of the inclusive growth strategy is that growth of "GDP should not be treated as an end in itself, but only as a means to an end". This is best done by adopting *monitorable targets* which would reflect the multi-dimensional **economic** and **social** objectives of inclusive growth. Furthermore, to ensure efficient and timely implementation of the accompanying projects and programmes, these targets need to be disaggregated at the level of the States which implement many of the programmes.

RESOURCE MOBILISATION

Resource mobilisation is a broad term which includes raising and directing the resources (physical and human) of the economy to realise the desired socio-economic objectives. It involves all the economic policies activated by the governments – per se, we can percieve it to be the very essence and the end result of the 'fiscal policies' of both the governments – Centre and the States.

So that the Indian economy moves on the path of desired growth and development the Government of India (GoI) needs to take care of the issue of resource mobilisation for various agents in the economy, namely –

1. GoI,
2. State governments,
3. Private Sector, and
4. General Public

In India, the responsibility of mobilising resources for the *planned* development of India was given to the Planning Commission (PC)- under this, it used to take care of the fund requirements of the GoI and the state governments. Practically, it was the PC which has to put in place the means by which the required funds for the *planned targets* of the economy were moblised. These plan targets are set by the GoI through the PC itself. The plan targets set by the States are also duly taken care of the PC in due course of this process. Though the effective responsibilities to moblise resources ultimately rests with the Central Ministry of Finance – in which the various departments and divisions of the ministry play their diverse and highly focused roles.

1. **GoI:** To the extent GoI is concerned it needs funds to realise two categories of the **planned targets**, namely:

(i) *Infrastructural targets* (which chiefly includes power, transportation and communication- in coming years so many other sectors got attached with it, for example, technology parks, urban infrastructure, etc.); and

(ii) *Social Sector targets* (which includes education, health, social security, etc.—known as the Human Development related targets since 2010–11). These funds get mobilised through the *Plan Finance-II Division* of the Ministry of Finance.

2. **State Governments:** Other than the fund requirements of GoI, the states also need funds for their developmental requirements (similar as the GoI)—they get the funds mobilised through three sources: *firstly,* through their own sources of income and market borrowings (after the recommendations of the 13th Finance Commission states are allowed to finance 25 per cent of their Plan Expenditure through market borrowing for which they do not need any permission from the GoI, provided they have effected their Fiscal Responsibility Acts); *secondly,* through the loans they get from the GoI on the advice of the PC (Ministry of Finance, GoI, shows these expenditures in the *Plan Finance-I Division*); and *thirdly,* through the GoI Central Sector Schemes, Centrally Sponsored Schemes and Additional Central Allocations (this includes the fund transfer to the states under 'Special Category States').

3. **Private Sector:** Other than the governments, a large amount of fund is required by the private sector to meet their short-term (working capital) and long-term (capital market) requirements. The GoI needs to take care of this issue also—the financial system is managed in such a way that other than the governments the private sector is also able to mobilise resources for its various requirements. This becomes even more important in a mixed economy which is reforming and favours increased participation in the economy from the private sector.

   This needs a directed reform in the financial system as it was structured to channelise more funds and resources towards government needs before reforms commenced. The main idea here is to prevent the governments from 'crowding out' the funds and let it flow smoothly towards the private sector—the process of reforms in financial sector, tax structure, fiscal policies of the Centre and states, etc., come under it.

4. **General Public:** Other than the government and the private sector, common people of an economy also need funds for their *general spending* and *investment*. The government needs to put in place such a fiscal policy which enables them (too) to have their access to funds. The savings common people do is used as investment provided they are able to save. Other than savings people must get incentive and enough funds which they might directly invest in the primary or secondary security markets or in financial instruments (shares, bonds, mutual funds, pension funds, insurance, etc.). Common people are the main drivers of 'demand' in an economy. In the periods of reforms GoI sets *twin targets*—at one hand promoting private sector so that 'supply' can be optimised in the economy (through *'structural reforms'*) and at the other it tries to create adequate 'demand' in the economy (by the process of *'macro-economic stabilisation'*).

GoI has used different 'means' to mobilise resources since Independence in order to realise the desired and required kind of developmental goals. A part of resources are mobilised for investment purposes (i.e., the creation of productive assets) for which different *'investment models'* have been tried by now.

INVESTMENT MODELS

Investment is a process of putting money in productive activities to earn income. It can be done *directly* (in different activities in primary, secondary or tertiary sectors), and *indirectly* (as in financial securities, such as shares, debentures, bonds, mutual funds, etc.). In case of India, 'Investment Models' are the *means and tools* by which the GoI has tried to mobilise required funds (resources) to promote the different goals of planned development. Since India started the planning process (1951), we see differing ***models*** being tried by the governments to mobilise resources—it has been a kind of 'evolutionary' process. We may understand them in the following 'phases':

PHASE-I (1951–69)

This was the phase of 'State-led' development in which we see the GoI utilising every internal and external means to mobilise required resources. The main areas of resource allocations were for infrastructure and social sector. The famous Mahalanobis Plan gets implemented during this period. In this period, we see the whole financial system, tax system and fiscal policy of the country getting regulated to drive in maximum funds for the GoI requirements to meet its planning related financial responsibilities.

This phase was marred by visible mismatches between the need and availability of investible fund – there always prevailed a lag between the requirement of funds and their mobilisation. Thus investment targets of the government got derailed many times (war with China and a limited war with Pakistan also eroded and diverted the resource allocation mechanism). But overall, the government was able to start the process of industrialisation almost from nothing by mobilising heavy funds in favour of infrastructure sector and infrastructure industries (the core sector)—education, health care also got funds but in a subdued manner as the GoI remained greatly preoccupied with 'glorification of the public sector'. This was the age when GoI used to consider the PSUs as the 'temples of modern India'.

PHASE-II (1970–73)

With the enactment of the Industrial Policy of 1970 we see GoI moving towards including the 'private capital' in the process of planned development— but not in a big and open way. The idea of 'Joint Sector' comes under which a combination of partners—Centre, State and Private Sector—could enter the industrial sector. This was done basically, to make private sector come up in the areas which were open for them but due to certain technical and financial reasons they were not able to take part. In due course of time the government did quit such ventures and such industrial settlements came under complete private control.

This is for the first time we see the government inclining on private funding for planned development, but we do not see any private entry in the GoI's monopoly areas of industrial activities (which takes place only after the reform process begins in 1991).

PHASE-III (1974–90)

With the enactment of the FERA in 1974 we see GoI, for the first time, proposing to take in the help of 'foreign capital' in the process of planned development—but not via cash foreign investment—only through the 'technology transfer' route that too up to only 26 per cent of the

total project value proposed by the private sector. Basically, under FERA government tightened the flow of foreign currency to Indian private sector, which started hampering the technological upgradation process and initiation of the state-of-the-art technologies from the world—the technology transfer route was put in place to fill this gap. It means that even if GoI tried to include foreign investment in the developmental process its entry remained restricted in two ways:

(i) It was not either 'direct' (as we see FDI during the reform process) or 'indirect' (as the PIS), but via technology transfer.

(ii) Foreign entities could enter only those industrial areas which were open for the Indian private sector (under the Schedule B of the Industrial Policy Resolution, 1956). The 'monopoly' industries under GoI (some of the most attractive industries for the private sector) remained closed for entry.

It means, that India failed to articulate an *investment model* which could tap the better elements of the foreign capital—state-of-the-art technologies, better work culture and most importantly the scarce investible capital. Experts believe it as a missed opprtunity for India. By 1965–66, the South East Asian economies like Malaysia, Indonesia, Thailand and South Korea had opened up their economies for both forms of foreign investments—direct as well as indirect—and the governments there 'decontrolled' the industrial sectors which were fully under government controls (it should be noted here that these economies had started exactly the same way as India started after Independence). This gave those economies a chance to tap not only scarce investible fund into their economies, but the state-of-the-art technologies from the world and world class work culture and entrepreneurship, too. Soon these economies came to be known as the Asian Tigers.

The period after 1985 saw dynamism in the area of resource moblisation – two consecutive Planning Commissions suggested for opening up of the economy and inclusion of the Indian and foreign private capital in the industrial areas which were hitherto reserved for the GoI. It suggested the GoI to withdraw from the areas where the private sector was capable and fit to function (for example, infrastructure sector) and concentrate on the areas where private sector would not be interested to operate (for example, the social sector). In a sense, during this time, we see an ideological shift in the government towards giving an 'active' or 'central' role to the private sector in the process of economic development. This was an advice for a completely different kind of *investment model*. But due to lack of political will the governments of the time could not go in for the same. Though, we find the govenrment going for a kind of limited degree of economic reforms through the Industrial Policies of 1985 and 86 (this should not be taken as Economic Reforms in India which officially starts in 1991 only).

As a **summary** of the investment models up to 1990, we can highlight the following points:

(i) Government remains the main investor in the economy and experts believe that India did undue delay in putting in place an *investment model* by which the potential of the private sector could be channelised into the process of developmental investment.

(ii) Emphasis on the public sector continued together with nationalisation drives also by late 1960s and early 1980s (the PSUs, to a large extent, were privatised by the South East Asian economies by now, making these socially-oriented and loss-making units to catapult into hubs of profit and real drivers of growth and development).

(iii) Tax system was structured to raise maximum tax revenue (which led to tax

evasion and excessive tax burdens on the citizens).

(iv) GoI continued cutting its non-plan expenditures so that resources could be allocated for the purpose of planned development (which led to expenditure cuts even on the essential areas like education, health care, etc.).

(v) Excessive government dependence on the financial system continued 'crowding out' funds, and as a result, the private sector could not mobilise suitable levels of funds for their requirements.

(vi) Technological upgradation and initiation of new technologies into the economy got hampered due to non-availability of foreign currency to the private sector (GoI, by late 1970, started facing the difficulty of paying its external liabilities, which were mainly created due to the expansion of the PSUs).

(vii) Main sources of fund in this Model were, government's tax revenue, internal borrowings, external borrowings and the freshly printed of currencies.

There always prevailed a lag between the requirement of funds and their mobilisation resulting into government investment targets getting derailed most of the times. In the meanwhile, the biggest crisis was building-up in the areas of infrastructure shortcomings. By early 1960s itself the Indian private sector was eager to enter this sector so that adequate levels of infrastructure could be developed. But due to several reasons we see the GoI continuing as the monopoliser in these sectors.

PHASE-IV (1991 ONWARD)

Due to prolonged follow-up of weak fundamentals of economics and immediated after Gulf War-I, India headed for a severe Balance of Payment crisis by late 1980s which made India go to the IMF for financial help. It comes up but at some 'conditions'—the design of the 'conditions' made India to go for a 'restructuring' of the economy under the process of economic reforms commencing in 1991.

Reform era shifted India towards including the 'private sector' (domestic as well as foreign) for the future development of the economy—and here comes a different *investment model.* Main elements of this investment model are as given below:

1. The hitherto monopoly sectors of the industry were opened up for private investment—barring Nuclear Research, Nuclear power and Railways (latter two areas are partially opened)—in all of them direct foreign investments have also been allowed (between 26 to 100 per cent). We see the 'investment model' for *'infrastructure sector'* shifting from 'government-led' to 'private-led'.
2. In coming times, GoI articulated the idea of the Public Private Partnership (PPP) model of investment for this sector, to provide confidence and space to the private sector to enter the sectors (as the private sector was not much interested to participate due to some inter-related problems in the sector, for example lack of 'market reforms'). By the 10th Plan we see private sector putting in around 21 per cent of funds required for the infrastructure projects in the PPP mode which increased up to 32 per cent by the 11th Plan. On the basis of past two plans the PC projected that private sector will put in around 50 per cent (48 per cent, to be precise) of the funds required for infrastructure development during the 12th Plan (which could not come in due to several internal and external reasons till 2015). Here, one point should not be missed that in future the infrastructure sector is to be fully handled by the private

sector—as per the idea of the reform process.

3. In 2002, the government, articulated the idea of PPP (Public-Private-People-Partnership) through the 10th Plan (2002–07). The idea has its use at the local level where the resources are to be mobilised for the creation of physical and social infrastructure. It was launched in the watershed management successfully. Gujarat state had shown highly successful model of this investment in its 'Pani Panchayat'.
4. To support the private sector to mobilise their share of fund in the infrastructure PPP, the government has set up the Infrastructure Development Fund, which also has provisioned for the Viability Gap Funding (VGF).
5. Inside the general idea of PPP, government has also put in place some other options of investment models, such as BOT (Build-Opetare-Transfer); BOO (Build-Own-Operate); BOOT (Build-Own-Operate-Transfer); BLT (Build-Lease-Transfer); BOLT (Build-Operate-Lease-Transfer); DBFO (Design-Build-Finance-Operate); DBOT (Design-Build-Operate-Transfer); DCMF (Design-Construct-Manage-Finance); etc.
6. In the area of mobilising resources for the expansion of the **Social Sector**, we see an increased focus coming from the governments (general government expenditure increasing from the levels of around 1.37 per cent of GDP in 1991 to 6.7 per cent of GDP by 2014–15, as per the *Economic Survey 2014–15*). But the government still thinks inadequacy of funds for the proper and timely development of the sector. Thus, by 2012, the GoI proposed plans to include the participation of private sector in the sector, mainly, education and health care through the PPP mode, which is still to be formally launched. Meanwhile, the provision regarding corporate social responsibilty (CSR) via the Companies Act, 2013, some additional funds have started flowing to the fund-starved social sector. By early 2015, the government has asked the PSUs to flow their part of the CSR expenditures to the GoI for the newly launched sanitation drive, the Swachch Bharat Abhiyan.
7. So that the *corporate sector* is able to mobilise enough resources for its investment needs in the economy, the governments started to restructure the whole gamut of the tax structure, financial structure and its fiscal policy. Now, as the economy will depend more on private participation for its developmental requirements, the government avoids crowding out the fund from the economy—a process of fiscal consolidation starts in. An increased emphasis comes on the fronts of 'targeting' the subsidies, their better delivery, pension reforms, etc., so that the government could de-burden the financial system from its fund requirements and enough finance flows in the system for the private sector.
8. To take care of the spending and investment requirements of the *general public* the government is committed to put in place a cheap interest rate regime, right kind of financial environment, an stable inflation and exchange rate besides other instruments. Bringing in 'inclusiveness' in the growth process is now the declared policy stance of the government.
9. Once the new government came to power mid-2014, we find a renewed synergy in creating conducive environment for the private sector so that the economy could

be able to attract enough investible fund to further the process of development. The government looks committed to the cause of improving the *'ease of doing business'* in the country. Aimed to this we find government busy in putting in place the 'right' kind of land acquisition law, labour law, companies law, tax laws, digitalisation of government processes, etc.

Overall, the current investment model of the economy is **private-led** and for this the GoI proposes to put in place the right kind of financial system, legal framework, labour laws, etc. The main idea of this model is to 'unshackle' the hidden potential of the private sector. To the extent the role of the government is concerned, it will be limited to being a regulator with an increased tone of a "facilitator" and a caretaker of the well being of the disadvantaged and marginalised sections of the society, so that the face of the economic reform remains 'humane'. In wake of the financial crisis in the western economies, the challenge of mobilising resourecs has become tougher and it will be really good that the government is able to devise out a working investment model for today.

CENTRAL SECTOR SCHEME AND CENTRALLY SPONSORED SCHEMES

The exercise of planned development in India has evolved over the time two type of schemes—**Central Sector Scheme** and **Centrally Sponsored Scheme**—the names are derived from the pattern of funding and the modality for implementation.

The ***Central Sector Schemes*** are 100 per cent funded by the Union Government and implemented by the Central Government machinery. These schemes are mainly formulated on subjects from the *Union List*. In addition, the Central Ministries also implement some schemes directly in the states/UTs which are called Central Sector Schemes, but resources under these schemes are not generally transferred to states.

Under the ***Centrally Sponsored Schemes (CSSs)*** a certain percentage of the funding is borne by the Centre and the states in the ratio of 50:50, 70:30, 75:25 or 90:10 and the implementation is done by the state governments. CSSs are formulated in subjects from the *State List* to encourage states to prioritise in areas that require more attention. Funds are routed either through the Consolidated Fund of states and or are transferred directly to state/district level autonomous bodies/implementing agencies. As per the *Baijal Committee Report* (1987), CSSs have been defined as the schemes which are funded directly by Central ministries/departments and implemented by the states or their agencies, irrespective of their pattern of financing, unless they fall under the Centre's sphere of responsibility, i.e., the Union List.

Conceptually, both CSS and Additional Central Assistance (ACA) schemes have been passed by the Central Government to the state governments. The difference between the two has arisen because of the *historical evolution* and the way these are being budgeted and controlled and release of funds takes place. In case of CSSs, the budgets are allocated under concerned ministries themselves which look after the entire process of the release of funds, too.

CENTRAL PLAN ASSISTANCE

Financial assistance provided by the Government of India to support State's Five Year Plans is called Central Plan Assistance (CPA) or Central Assistance (CA) which primarily comprises the following:

(i) **Normal Central Assistance (NCA)**: The distribution of the NCA is formula based (Gadgil-Mukherjee Formula) and is untied. Gadgil Formula of determining the Central Assistance to the State is being adopted from the Fourth Plan and

revised subsequently—allocation is made by the Planning Commission.

(ii) **Additional Central Assistance (ACA):** This is provided for implementation of externally aided projects (EAPs), and for which presently there is no ceiling. Unlike NCA, this is scheme based. The details of such schemes are given in the Statement 16 of the Expenditure Budget Vol. I. There can be one time ACA and advance ACA. **One time ACA** are assistance given by Planning Commission to particular states for undertaking important state specific programmes and schemes. These are one time assistance and thus not recurring. These assistances are discretionary in nature. **Advance ACA** are advances given to *Special Category States* in times of financial stress and recoverable in 10 years.

(iii) **Special Central Assistance (SCA):** This is provided for special projects and programmes, e.g., Western Ghats Development Programme, Border Areas Development Programme etc. (in exceptional situations, Advance Central Assistance, may also be provided). This special plan assistance is given only to *Special Category States* to bridge the gap between their Planning needs and resources. In other words, SPAs are ACA are for special category states.

CPA is provided, as per scheme of financing applicable for specific purposes, approved by the Planning Commission. It is released in the form of *grants* and/or *loans* in varying combinations, as per terms and conditions defined by the Ministry of Finance, Department of Expenditure. Central Assistance in the form of ACA is provided also for various Centrally Sponsored Schemes, viz., Accelerated Irrigation Benefits Programme, Rashtriya Krishi Vikas Yojana, etc., and SCA is extended to states and UTs as additive to Special Component Plan (renamed Scheduled Castes Sub Plan) and Tribal Sub Plan. Funds provided to the states under Member of Parliament Local Area Development Scheme (MPLADS), i.e., Rs.5 crore per annum per MP also count as CA.

Gadgil-Mukherjee Formula

Up to the Annual Plan period (1966–69) the Central Plan Assistance was schematic and no formula was used in allocation of the fund. During the Fourth and Fifth Plans (1969–74 and 1974–78) the *Gadgil Formula* was used which comprised four bases for CPA allocation:

(i) Population (60 per cent);
(ii) Per Capita Income (10 per cent);
(iii) Tax Effort (10 per cent);
(iv) On-going Irrigation & Power Projects (10 per cent); and
(v) Special Problems (10 per cent).

In coming years, since item (iv) was perceived as being weighted in favour of rich states, the formula was modified by raising the weightage of Per Capita Income (PCI) to 20 per cent. The National Development Council (NDC) approved the modified Gadgil formula in 1980. It formed the basis of allocation during the Sixth Plan (1980–85), Seventh Plan (1985–90) and Annual Plan 1990–91. Following suggestions from state governments, the modified Gadgil Formula was revised to Population (55 per cent), PCI (25 per cent—20 per cent by deviation method and 5 per cent by distance method), Fiscal Management (5 per cent) and Special Development Problems (15 per cent). However, it was used only during the Annual Plan 1991–92.

Due to reservations of state governments on the revision, a Committee under Pranab Mukherjee, (then Deputy Chairman, Planning Commission) was constituted to evolve a suitable formula. The suggestions made by the Committee

Gadgil-Mukherjee Formula

Criteria	Weight	Remarks
1. Population (1971)	60%	------------
Per Capita Income	25%	------------
(a) Deviation method	20%	Covering states with per capita State Domestic Product below national average
(b) Distance method	5%	For all states
2. Performance in Tax Effort, Fiscal Management and Progress in respect of National objectives	7.5%	Tax policy [2.5%], Fiscal Management [2.0%], National objectives [3%] comprising population control (1.0%), elimination of illiteracy (1.0%), timely completion of Externally Aided Projects (0.5%) and land reforms (0.5%)
3. Special problems	7.5%	------------

were considered by NDC in 1991, where following a consensus, the *Gadgil-Mukherjee Formula* was adopted. It was made the basis for allocation during the Eighth Plan (1992–97) and it has since been in use. After setting apart funds required for (a) Externally Aided Projects and (b) Special Area Programme, 30 per cent of the balance of Central Assistance for State Plans is provided to the Special Category States. The remaining amount is distributed among the non-Special Category States, as per the Gadgil-Mukherjee Formula.

CSSs Restructured

The existing 137 CSSs (Centrally Sponsored Schemes) and 18 ACA (Additional Central Assistance) Schemes have been restructured into 66 schemes in the *Twelfth Plan,* including 17 Flagship Programmes. This has been done for greater synergy—funds under these programmes are released by the GoI as *Central Assistance* to State Plans, thus giving states greater authority and responsibility. To suit the requirements of the states, the GoI has also approved that a scheme may have state specific guidelines which may be recommended by an Inter-Ministerial Committee constituted for this purpose. For each new CSS/ACA/Flagship scheme, at least 25 per cent of funds may be contributed by the General Category States and 10 per cent of funds by the Special Category States including J&K, Himachal Pradesh and Uttarakhand.

How much expenditures on these schemes should be shared by the states has been a matter of debate in recent years with the GoI having the view that states should shoulder increased financial responsibility in their implementation. The **Union Budget 2014–15** (Interim) says that states have the fiscal space to bear a reasonable proportion of the financial costs of implementing flagship programmes and must willingly do so, so that the Central Government can allocate more resources for subjects such as defence, railways,

national highways and telecommunication that are its exclusive responsibility.

The Finance Minister in his budget speech *(Union Budget (2013–14)* had stated that government is concerned about the proliferation of CSSs and ACA schemes and that each scheme would be reviewed and restructured. Earlier, the National Development Council (NDC), while approving the Twelfth plan in its meeting in December 2012 had also recommended building flexibility in the schemes to suit the requirements of the state governments.

The restructured schemes also include the following **17 Flagship Programmes**, running under various ministries and departments, during the twelfth Plan:

(i) Rashtriya Krishi Vikas Yojana (RKVY)—Department of Agriculture and Cooperation

(ii) Nirmal Bharat Abhiyan (NBA)—Ministry of Drinking Water and Sanitation

(iii) National Rural Drinking Water Programme (NRDWP)—Ministry of Drinking Water and Sanitation

(iv) National Health Mission (MHM)—Department of Health and Family Welfare

(v) Backward Region Grant Fund (BRGF)—Ministry of Panchayati Raj

(vi) Integrated Watershed Management Programme (IWMP)—Department of Land Resources

(vii) Rajiv Gandhi Panchayat Sashastrikaran Yohana (RGPSY)—Ministry of Panchayati Raj

(viii) Indira Awas Yojana (IAY)—Department of Rural Development

(ix) Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA)—Department of Rural Development

(x) National Social Assistance Programme (NSAP)—Department of Rural Development

(xi) Pradhan Mantri Gram Sadak Yojana (PMGSY)—Department of Rural Development

(xii) National Rural Livelihood Mission (NRLM) (SGSY restructured in 2010)—Department of Rural Development

(xiii) Mid Day Meal Programme (MDM)—Department of School Education and Literacy

(xiv) Sarva Shiksha Abhiyan (SSA)—Department of School Education and Literacy

(xv) Jawaharlal Nehru National Urban Renewal Mission (JNNURM)—Ministry of Urban Development and Ministry of HUPA

(xvi) Integrated Child Development Services (ICDS)—Ministry of Women and Child Development

(xvii) Accelerated Irrigation Benefit & Flood Management (AIBFM)—Ministry of Water Resources

Flagship programmes derive their origin from the term ***flagship*** which is the main or most important ship of a country's navy and is symbolic of the main thrust of the nation's developmental policy. Flagship schemes of the Government of India are those schemes which are declared so by the Union Cabinet or the Development Evaluation Advisory Committee (DEAC) of the Planning Commission—the list of these programmes can be modified by the DEAC or the government from time to time.

COMPOSITE DEVELOPMENT INDEX OF STATES

The development a state has been able to achieve is an outcome of a complex set of historical, cultural, and sociological factors. The Government of India has clear objective to have a more egalitarian society, coupled with balanced development of different regions. Despite taking a number of steps to reduce regional disparities, substantial differences in development still exist between states. In order to address this issue, the government in May 2013, decided to constitute an Expert Committee to consider backwardness of the states for evolving a '***Composite Development Index of States'*** under the Chairmanship of Raghuram G. Rajan, (the erstwhile Chief Economic Adviser, Ministry of Finance) which submitted its report in September 2013. The government is yet to take the final decision regarding the recommendations of the Committee for which there will be a need to revisit the existing Gadgil-Mukherjee Formula.

INDEPENDENT EVALUATION OFFICE

An Independent Evaluation Office (IEO) has been created by the GoI in February 2014, at an arm's distance from the government with the objective of strengthening public accountability of some of the important social sector programmes, which account huge resource mobilisation such as

Special Category States

The term Special Category States (SCS) has been in ***news*** for the past many years, specially since a new state of Jharkhand was carved out of the then Bihar—the new Bihar has been demanding such a status from the Centre—The present government in Bihar has always put this demand—before the General Elections of 2014, the government there put a condition on which it may think joining an Alliance forming the Central Government in the post-2014 times. Recently, the matter has been included by the GoI in the *Union Budget 2013–14* and the government has conveyed that it is 'considering such a status for Bihar'—whatever be the complusions/realities of the contemporary real politik, hereby, let us try to understand the idea of the ESCS.

The Special Category States (SCS) have some common characteristics like international boundary, hilly landscape, geographic and socio-economic backwardness with low capability to generate adequate income from available resources etc. Presently, 11 states come under this category- seven States of North-Eastern region, Sikkim, Jammu & Kashmir, Himachal Pradesh and Uttarakhand. Other states are referred as *General Category States (GCS)*. They are 'special' in the sense that they have special socio-economic, geographical problems, high cost of production with less availability of useful resources and hence low economic base for livelihood activities.

Fiscal Position of the SCS: The SCS are highly dependent on central grants from the Union Government for meeting their financial requirements. These states show a revenue surplus position because any 'expenditure that they make on creating assets out of grants from the Centre is not treated as revenue expenditure'. This is *contrary* to the existing accounting standards which treats all expenditure from grants as revenue expenditure.

Manipur, Nagaland, Sikkim and Uttarakhand have a fiscal deficit which is higher than 3 per cent but less than 6 per cent) of their GSDP and the *13th Finance Commission* has indicated that they have to make efforts to reduce the fiscal deficit to 3 per cent by ***2013–14***. Jammu and Kashmir and Mizoram have higher fiscal deficits and require concerted efforts at reducing their debt stock to achieve targets

set by the 13th Finance Commission. The other states Arunachal, Meghalaya, Assam, Tripura and Himachal pradesh have a fiscal deficit which is less than 3 per cent of GSDP and therefore need to maintain their position to achieve the targets set out by the 13th Finance Commission.

Although the 12th Finance Commission recommended that all states (including SCS) should be permitted to borrow from the open market at market rates, the special dispensation given to special category states continues for external loans. In the case of the externally aided projects to SCS, the Union Government treats 90 per cent of the amount borrowed as a grant and only the remaining 10 per cent is a loan. (For the general category states, externally aided projects are funded on a back-to-back basis).

More Central Assistance for SCS: Human Development Index (HDI) is considered as a better indicator of overall development of a state. Central grants are required to ensure/maintain better education and health standards in these states as they may not be able to generate own resources for this purpose due to their economic vulnerability. SCS require more central assistance as some of the SCS's Debt-GSDP ratio is higher than General Category States. High Debt GSDP ratio leads to fiscal vulnerability and poor sustainability of debt related obligations.

The *13th Finance Commission* has recommended a 'Performance Grant' of Rs. 1,500 crore to three SCS, namely Assam, Sikkim and Uttarakhand in recognition of the efforts made by these states to reduce their 'Non-Plan Revenue Deficit' *[Non Plan Revenue deficit = Non Plan Revenue receipts - Non Plan Revenue expenditure]*.

Planning Commission also publishes data regarding SCS central assistance as per 'Gadgil Formula', plan expenditure, fiscal status etc. The North Eastern States out of SCS have been provided special incentives by the Ministry of Development of North Eastern Region (DONER). Moreover, Ministry of Commerce and Industry had been formulated a separate policy named as *North East Industrial and Investment Promotion Policy (NEIIPP), 2007* [earlier known as the North East Industrial Policy (NEIP), 1997] providing incentives for all industrial units to expand industrialisation and development activities in North Eastern states. The Special Incentives packages for industrial development of the states like J&K, Himachal Pradesh and Uttarakhand are also implemented by the Ministry of Commerce and Industry.

the flagship programmes. Conceived on the lines of Independent Evaluation Office (IEO) of the IMF,[106] the body has been created on the basis of international experiences, in cooperation with the *World Bank* and the British *DFID* (Department for International Development)—it is modelled on the lines of Mexico's National Council for the Evaluation of Social Development Policy.

The IEO will be an independent office attached to the Planning Commission under a Governing Board chaired by the Deputy Chairman, Planning Commission—to be funded by the Planning Commission and will have, as its head, a full-time Director General (Ajay Chhibber) in the rank and status of Member of the Planning Commission / Union Minister of State. The DG has a tenure of 3

106. An Independent Evaluation Office (IEO) functions in International Monetary Fund (IMF) since 2001 which conducts independent and objective *evaluations* of Fund's policies and activities. Under its Terms of Reference, it is fully independent from the Management of the IMF and operates at arm's length from the Board of Executive Directors with the following *three* missions—(i) Enhancing the learning culture within the Fund, (ii) Strengthening the Fund's external credibility, and (iii) Supporting Institutional governance and oversight *(Source: Independent Evaluation Office, IMF, Washington DC, 2014).*

years extendable to 5 years. Its staff will be selected by the DG without any interference and will have its independent budget line.

It is felt that the government programmes can benefit enormously from concurrent independent evaluation. Presently concurrent evaluation is done by the concerned ministries as an on-going parallel process. Expert evaluation of programmes that have been in operation is done by the Programme Evaluation Organisation (PEO) of the Planning Commission—the IEO is expected to strengthen this evaluation process. **Main aims** of the office is:

(i) To help improve the effectiveness of government policies and programmes by assessing their impact and outcomes.

(ii) To set guidelines and methodology for all evaluations done by various departments, and agencies and encourage a culture of openness and learning in government systems.

(iii) To connect India to the best international evaluated evidence in development practice and knowledge to learn from others success and mistakes.

Main features about the functioning of the office may be summed-up as given below:

(i) It will conduct independent evaluations of plan programmes—especially flagship programmes—and assess their effectiveness, relevance and impact. Besides, it has the freedom to conduct independent evaluations on any programme which has access to public funding or implicit or explicit guarantees from the government.

(ii) The work programme of the IEO will be prepared through an open process of consultations, including feedback from **civil society** and will be made public.

(iii) The IEO will prepare the *Terms of Reference* for all independent evaluations, which will be conducted by selected institutes and researchers, selected on competitive basis.

(iv) IEO will provide guidance to any agency or department of the government to improve the quality of it's self evaluation and monitoring system. Such support is intended to bring all evaluations under a common internationally accepted methodology, help achieve better development outcomes and encourage a *culture of learning* in the government.

(v) Besides making available on it's web site and other public avenues, its reports will be submitted to the Parliament and the Prime Minister's Office.

(vi) It will also make internationally available findings from independently and professionally evaluated Indian programmes in the spirit of South-South learning and cooperation.

(vii) IEO will **represent** India as it's independent evaluation authority at international forums on development effectiveness and will endeavour to improve India's evaluation systems in line with international best practices.

The evaluations in areas such as the public distribution system and health issues were among the first to be undertaken by the IEO with MGNREGA and JNNURM to follow later.

Meanwhile, early September 2014, the DG of the IEO was relieved from his services by the government, leaving the institution in a state of limbo (with little clarity *as of yet* over its future role). The debate on the IEO has been going on in the PMO questioning the creation of the new institution in the light of a similar body called the *Programme Evaluation Organisation (PEO)*, which

already exists in the Planning Commission. The Committee of Secretaries set up for the purpose has decided to strengthen the PEO, leaving the option of either absorbing the IEO under the PEO or shutting down the institution.

PROGRAMME EVALUATION ORGANISATION

The Programme Evaluation Organisation (PEO) was established in October 1952, as an independent organisation, under the general guidance and direction of the Planning Commission (PC) with a specific task of evaluating the community development programmes and other Intensive Area Development Schemes. The evaluation set up was further strengthened by the development of methods and techniques of evaluation in the 1st Plan and setting up of evaluation machineries in the States during the 3rd Plan (1961–66) and 4th Plan (1969–74). Gradually, with the extension of the programmes/schemes in a variety of sectors, viz., agriculture cooperation, rural industries, fisheries, health, family welfare, rural development, rural electrification, public distribution, tribal development, social forestry, etc., the evaluation work undertaken by the PEO was extended to other important Centrally Sponsored Schemes.

The broad **functions** of the PEO include undertaking evaluation of selected programmes/ schemes under implementation, as per the requirement of the various Divisions of the PC, Central Ministries and Departments of the Government of India. The evaluation studies are designed to ***assess*** –

(i) the performance,

(ii) the process of implementation,

(iii) the effectiveness of the delivery systems, and

(iv) the impact of programmes.

The **objectives** of the PEO:

(i) Objective assessment of process and impact of the development programmes,

(ii) Identifying the areas of success and failures at different stages of administration and execution, analysis of reasons for success or failure,

(iii) Examining extension methods and people's reactions thereto and deriving lessons for future improvement in the formulation and implementation of the new programmes/schemes.

ORGANISATIONAL STRUCTURE

The PEO is primarily a *field level* organisation under the overall charge of the Deputy Chairman, PC. It has a **three-tier** structure:

First Tier: At the apex is the Headquarters at the PC which is responsible for evolving suitable methodologies including statistical designs for various type of evaluation studies, organizing execution and monitoring of sample surveys, data processing, statistical analysis and interpretation of qualitative and quantitative data generated by the field units and also for bringing out the Evaluation Reports. The Organisation is headed by the Adviser (Evaluation).

Second Tier: The middle link of the PEO represents Regional Evaluation Offices, which are 7 in number located at Chandigarh, Chennai, Hyderabad, Jaipur, Kolkata, Lucknow and Mumbai.

Tird Tier: The Field Units, known as Project Evaluation Offices constitute the third tier of PEO. These are located in the capital cities of 8 major states of the country, viz. at Guwahati, Bhubaneshwar, Shimla, Bangalore, Bhopal, Patna, Trivandrum and Ahmedabad.

EVALUATION AS PLAN SCHEME

The 10th Plan document pointed out that one of the most common reasons for the failure of programmes and schemes was the faulty and incomplete design of the programme/projects/ scheme. Care and attention must be taken to formulate programmes, projects and schemes in a more systematic and professional manner. It is essential to strengthen the existing mechanisms for *monitoring* and *evaluation*, in order to make sure that plans are being implemented as envisaged and the impact is also as planned. The strategy proposed above would definitely contribute to efficiency in resource use and improved performances of plan programmes. But evaluation capacity within and outside the government is limited. To make evaluation, an effective tool for this, capabilities of evaluation organisations will have to be enhanced. The *'Working Group for Strengthening Monitoring and Evaluation System'* set up (late 2012) by the PC recommended to enhance the evaluation capacity and incorporate evaluation in the Plan Scheme.

The PEO also encourages State Evaluation Organisations (SEOs) to send the evaluation reports to the PC so that these reports can also be put on the Internet (now, it may be sent to the **NITI Aayog**—a decision yet to be teken by the government). By late 2014, the government decided to strengthen the PEO—further actions in this direction is awaited.

NITI AAYOG

By mid-2014, India did show a quite strong mandate and a very stable government came at the Centre. We find the new government showing a renewed vigour and zeal in several areas. One such area has been its attempts at 'redefining' the federal polity of the country for the purpose of promoting growth and development. We see a pronounced policy shift in the direction of 'empowering and keeping state in front' by giving them more financial space and responsiblities.[107] Keeping its promises in the direction, the government abolished the Planning Commission (PC) and replaced it by a new body – the NITI Aayog. The acronym **NITI** stands for **National Institution for Transforming India**. We see the government aspiring for the emergence of the 'Team India' in the new body. It will be premature to be conclusive on this shift from "Planning to NITI" (as the government calls). Even an academic comparison between the old and the new bodies will also not serve enough purpose as it needs some time when the outcome of the change will be available. Judegemnts on this shift will be only good once it is done after some period of time. In the meantime, India remains a planned economy. The discussion given here is mainly based on the documents and releases which came out from the GoI before and after the NITI Aayog was set up (January 1, 2015). In these documents, the government has not only provided the reasons as why does India need to go in for a new body but charts out a very encouraging and out of tradition role/function for the new body. An attempt has been made to closely follow the 'government line' of thinking so that the 'spirit' of it is lost.

TRANSFORMING INDIA

The government aims at 'transforming the development agenda of India' with the help

107. Such a stance in the process of planning we find in the document of the 10th Plan (2002-07) for the first time when the government of the time (the NDA-led) the call – **'if states are developed, the nation is developed'**. We find a pronounced shift towards 'decentralised planning' (the Plan was nicknamed as the 'People's Plan). The new idea of 'monitorable targets' also commenced in this plan giving states more say and accountibility in the process of planned development (these targets were continued with in the forthcoming Plans). Several other steps were also taken in this Plan aimed at bringing the states in the mainstream of the development process – by giving them increased role and accountibility.

of the NITI Aayog and has given a slogan, "from planning to NITI". India has undergone a paradigm shift over the past six decades—politically, economically, socially, technologically as well as demographically. The role of the government in national development has seen a parallel evolution. Keeping with these changing times, the government decided to set up **NITI Aayog** as a means to better serve the needs and aspirations of the people of India. The government thinks the new institution to function as a catalyst to the developmental process; nurturing an overall enabling environment, through a *holistic approach* to development going beyond the limited sphere of the public sector and the GoI which will be built on the foundations of:

(i) An empowered role of states as equal partners in national development; operationalising the principle of *Cooperative Federalism*.

(ii) A knowledge hub of internal as well as external resources; serving as a repository of good governance best practices, and a *Think Tank* offering domain knowledge as well as strategic expertise to all levels of government.

(iii) A collaborative platform facilitating *Implementation*; by monitoring progress, plugging gaps and bringing together the various ministries at the Centre and in states, in the *joint pursuit* of developmental goals.

CHANGING CONTOURS OF INDIA

The government agrees that the Planning Commission has served India well. However, India has changed dramatically over the past 65 years at *multiple levels* and across *varied scales*. These transformatory forces have changed the very contours of India—highlighted by the government document in the five areas:

1. **Demographic shift:** India's population has increased over three-fold to reach 121 crores. This includes an addition of over 30 crore people to Urban India. As well as an increase of 55 crore youth (below the age of 35), which is more than one and a half times the total population of the country then. With increasing levels of development, literacy and communication, the aspirations of the people have soared, moving from *scarcity and survival* to *safety and surplus*. Today, we are looking at a completely different India, and country's governance systems need to be transformed to keep up with the changed India.
2. **Economic shift:** India's economy has undergone a paradigm shift. It has expanded by over a hundred times, going from a GDP of Rs 10,000 crore to Rs 100 lakh crore at current prices, to emerge as one of the world's largest. Agriculture's share in the GDP has seen a dramatic drop, from more than 50 per cent to less than 15 per cent. The plan size of Rs 43 lakh crore of the 12th Plan dwarfs the plan size of Rs 2,400 crore of the 1st Plan. Priorities, strategies and structures dating back to the time of the birth of the Planning Commission, must thus be *revisited*. To align with this shift and sheer scale, India need to *overhaul* the very *nature* of planning processes, the government says.
3. **Changed private sector:** The nature of the Indian economy, and the role of the government in it, has undergone a paradigm shift. Driven by an increasingly open and liberalized structure, India's private sector has matured into a vibrant and dynamic force. The sector is not operating just at the international cutting

edge, but also with a global scale and reach. This changed economic landscape requires a new *administrative paradigm* in which the role of the government must evolve from simply allocating resources in a command and control eco-system, to a far more nuanced one of directing, calibrating, supporting and regulating a *market eco-system*. National development must be seen beyond the limited sphere of the 'Public Sector'. Government must, thus, transition from being a 'provider of first and last resort' and 'major player' in the economy, to being a 'catalyst' nurturing an 'enabling environment', where the entrepreneurial spirits of all, from small self-employed entrepreneurs to large corporations, can flourish. This importantly, frees up the government to focus its precious resources on public *welfare* domains such as essential entitlements of food, nutrition, health, education and livelihood of vulnerable and marginalized groups of the society.

4. **Forces of globalisation:** In recent decades, the world at large has also evolved. We live today in a 'global village', connected by modern transport, communications and media, and networked international markets and institutions. In this milieu, India's economic actions 'contribute' to the global dynamics, while our economy also get influenced by the happenings far away from us. The framework of *policy making* together with the *functioning of governments* need to incorporate the realities of our continuing integration with the global economic system.
5. **Role of the states:** Indian states have evolved from being mere appendages of the Centre, to being the actual drivers of national development. The development of states must thus become the national goal, as the nation's progress lies in the progress of states. As a consequence, the *one-size-fits-all approach*, often inherent in centralized planning, is no longer practical or efficient. States need to be heard and given the flexibility required for effective implementation. The government quotes Dr. B. R. Ambedkar to bring the point home – "it is unreasonable to centralise powers where central control and uniformity is not clearly essential or is impracticable". Thus, while emanating from global experiences and national synergy, India's strategies needs to be calibrated and customized to *local needs* and opportunities.
6. **Technology paradigm:** Technology advancements and information access have unleashed the creative energy of India. They have integrated our varied regions and eco-systems in an interlinked national economy and society, opening up newer avenues of coordination and cooperation. Technology is also playing a substantial role in enhancing transparency as well as efficiency, holding government more accountable. Thus, India needs to make it central to systems of policy and governance.

CHANGE MUST COME

The above-given changes have been recognised by the experts for years now. With changing contours of the economy, the institutions guiding the economy should also change. The government quotes several such *instances* when appropriate changes were advised in the Planning Commission by the experts, committees, even the PC, among others:

(i) The ***8th Plan*** (1992–97) document (the very first after the reform process commenced in 1991) categorically

stated that, as the role of government was reviewed and restructured, the role and functions of the PC too needed to be rethought. The PC also needed to be reformed to keep up with changing trends, relieving itself of the old practices and beliefs, which had lost relevance, and adopting new ones based on past experiences of India as well as other nations. Specifically, the PC needed to be in tune with the process of economic reforms.

(ii) The ***Standing Committee on Finance*** of the 15th Lok Sabha observed in its 35th Report on Demand for Grants (2011–12) that the "PC has to come to grips with the emerging social realities to re-invent itself to make itself more relevant and effective for aligning the planning process with economic reforms and its consequences, particularly for the poor". This was the need of making the planning process relevant to the process of economic reforms.

(iii) The former Prime Minister, Dr. Manmohan Singh, in his farewell address to the PC (April 2014), also urged reflection on "what the role of the PC needs to be in this new world. Are we still using tools and approaches which were designed for a different era? What additional roles should the Planning Commission play and what capacities does it need to build to ensure that it continues to be relevant to the growth process?" This observation has quite high relevance, as Dr. Singh is himself a "noted" economist.

Taking the clues for a change, the government quotes Mahatma Gandhi before going for the change: "Constant development is the law of life, and a man who always tries to maintain his dogmas in order to appear consistent drives himself into a false position". The government adds further, keeping true to this principle our institutions of governance and policy must evolve with the changing dynamics of the new India, while remaining true to the founding principles of the Constitution of India, and rooted in our *Bharatiyata* or wisdom of our *civilizational history* and *ethos*. It was, in every sense, a kind of pledge to devise India's own means, methods, tools and approaches to promote development.

For the government, the NITI Aayog is to be the *institution* to give life to these aspirations (discussed above). The Aayog is being formed based on extensive consultation across a spectrum of stakeholders, including inter alia state governments, relevant institutions, domain experts and the people at large.

Functions of NITI Aayog

With the process of maturity and deepening in Indian nationhood, the country has embraced a greater measure of pluralism and decentralisation. This necessitates a *paradigm shift* in Central government's approaches to the governments at the state, as well as local levels. The *states governments* and the *local bodies* must be made equal partners in the development process through the following changes:

(i) understanding and supporitng their developmental needs and aspirations,

(ii) incorporating varied local realities into national policies and programmes with the required flexibility.

This way the new body, NITI Aayog, is designed to live up to the principle of 'Team India' with its following **officially demarcated functions:**

1. *Cooperative and Competitive Federalism:* It will be the 'primary platform' for operationalising cooperative federalism, enabling states to have active participation in the formulation

of national policy, as well as achieving time-bound implementation of quantitative and qualitative targets through the combined authority of the Prime Minister and the Chief Ministers. This will be by means of systematic and structured interactions between the Union and state governments, to better understand developmental issues, as well as forge a consensus on strategies and implementation mechanisms. The above would mark the replacement of the *one-way* flow of policy from centre-to-state, with a genuine and continuing *Centre-State partnership*. The Aayog is supposed to further this cooperation with the enhanced vibrancy of *Competitive Federalism;* the Centre competing with the states and vice versa, and the states competing with each other, in the joint pursuit of national development.

2. *Shared National Agenda:* It will 'evolve' a shared vision of national development priorities and strategies, with the active involvement of states. This will provide the framework 'national agenda' for the Prime Minister and Chief Ministers to implement.
3. *State's Best Friend at the Centre:* It will support states in addressing their own challenges, as well as building on strengths and comparative advantages. This will be through various means, such as *coordinating* with ministries, championing their ideas at the Centre, providing 'consultancy' support and 'building capacity'.
4. *Decentralised Planning:* The new body is to 'restructure' the planning process into a "bottom-up model", empowering states, and guiding them to further empower local governments in developing mechanisms to formulate credible plans at the village level, which are progressively aggregated up the higher levels of government. The maturing of India's governmental institutions has enabled increasing the specialisation of their functions. There is, thus, a need to separate as well as energize the distinct 'strategy' element of governance from the usual 'process' and 'implementation' element. As a dedicated "Think Tank" of the government, NITI Aayog will carry out this 'directional' role, strategically charting the future of the nation. It will provide specialised inputs—strategic, functional and technical—to the Prime Minister and the government (Centre as well as State), on matters critical to the fulfilment of the national development agenda. It means, the new body is to function like a 'think tank'.
5. *Vision & Scenario Planning:* To 'design' medium and long-term strategic frameworks of the big picture vision of India's future—across schemes, sectors, regions and time; factoring in all possible alternative assumptions and counterfactuals. These would be the 'drivers of the national reforms agenda', especially focussed on identifying critical gaps and harnessing untapped potentialities. The same would need to be intrinsically dynamic with their progress and efficacy constantly monitored for necessary mid-course recalibration; and the overall environment (domestic and global) continuously scanned for incorporating evolving trends and addressing emerging challenges. This would mean a fundamental transition from merely planning for where the nation's money goes, to planning where we want the nation to go. And given its

unique position as the aggregator and integrator of all developmental initiatives of the Government of India and states, the new body would be ideally suited for the same.

6. *Domain Strategies:* To 'build' a repository of specialised domain expertise, both sectoral and cross-sectoral; to assist Ministries of the Central and state governments in their respective development planning as well problem solving needs. This will especially enable the imbibing of good governance best practices, both national as well as international; especially with regards to structural reforms in the country.
7. *Sounding Board:* To be an 'in-house sounding board' whetting and refining government positions, through objective criticisms and comprehensive counter-views in the economy.
8. *Network of Expertise:* To 'main-stream' external ideas and expertise into government policies and programmes through a collaborative community of national and international experts, practitioners and other partners. This would entail being government's link to the outside world, roping in academia (universities, think tanks and research institutions), private sector expertise, and the people at large, for close involvement in the policymaking process. To bring the point home, the document quotes the Rigveda – 'let us welcome noble thoughts flowing in from all directions'.
9. *Knowledge and Innovation Hub:* The body to be an 'accumulator' as well as 'disseminator' of research and best practices on good governance, through a state-of-the-art Resource Centre which identifies, analyses, shares and facilitates replication of the same. The document durther adds, an increasingly mature Indian population has steadily increased the focus on, and demand for, actual delivery and results. To keep up with such enhanced aspirations, the new body will have the mandate to go beyond mere planning and strategizing, to facilitating *implementation* of the development agenda as well. This would involve making implementation central to the planning process, through an emphasis on tangible outcomes, realistic targets, strict time lines and robust monitoring and evaluation—a transition from the isolated conceptualisation of merely 'planning', to 'planning for implementation'. It will also act as a 'catalyst' to the government machinery at large—filling gaps, enhancing capabilities and de-clogging bottlenecks, as and where required.
10. *Harmonisation:* To 'facilitate harmonisation' of actions across different layers of the government, especially when involving cross-cutting and overlapping issues across multiple sectors through: communication, coordination, collaboration and convergence amongst all stakeholders. The emphasis will be on bringing all together on an integrated and holistic approach to development.
11. *Conflict Resolution:* To provide a 'platform' for mutual resolution of inter-sectoral, inter-departmental, inter-state as well as centre-state issues; facilitating consensus acceptable and beneficial to all, to bring about clarity and speed in execution.
12. *Coordinating interface with the World:* It will be the 'nodal point' for strategically harnessing global expertise and resources in India's developmental process—

coming in from across nations, multilateral institutions and other international organisations.

13. *Internal Consultancy:* It will offer an internal 'consultancy' function to Central and state governments on policy and programme design—providing frameworks adhering to basic design principles such as decentralisation, flexibility and a focus on results. This would include specialised skills such as structuring and executing Public-Private Partnerships.
14. *Capacity Building:* To enable 'capacity building' and 'technology up-gradation' across governments, benchmarking with latest global trends and providing managerial and technical knowhow.
15. *Monitoring and Evaluation:* It will 'monitor' the implementation of policies and programmes, and 'evaluate' their impact; through rigorous tracking of performance metrics and comprehensive programme evaluations. This will not only help identify weaknesses and bottlenecks for necessary course-correction, but also enable data-driven policymaking; encouraging greater efficiency as well as effectiveness.

THE GUIDING PRINCIPLE

The government document has categorically pointed out the very 'purpose' of the new body —in the process of carrying out its functions, the Aayog will be guided by an overall vision of development which is inclusive, equitable and sustainable. The instituion is to follow a strategy of empowerment built on human dignity and national self-respect—the document quote Swami Vivekanada to emphasise this: "to encourage everyone in his struggle to live up to his own highest idea". The new body to follow a development model which is ***all round, all pervasive, all inclusive*** and ***holistic.***

Antyodaya: To prioritize service and uplift of the poor, marginalised and downtrodden, (the document quotes the idea of 'Antodaya' as articulted by Pandit Deendayal Upadhyay). Development is incomplete and meaningless, if it does not reach the farthest individual. "Nothing is more dreadfully painful than poverty" (the centuries old sage-poet Tiruvallur has been quoted).

Inclusion: To empower vulnerable and marginalised sections, redressing identity-based inequalities of all kinds gender, region, religion, caste or class—highlighted its need by the document quoting from Sankar Dev—"to see every being as equivalent to one's own soul is the supreme means (of attaining deliverance)". Weaker sections must be enabled to be masters of their own fate, having equal influence over the choices the nation makes.

Village: To integrate our villages into the development process, to draw on the vitality and energy of the bedrock of our *ethos, culture* and *sustenance.*

Demographic Dividend: To harness our greatest asset, the people of India; by focussing on their development, through *education* and *skilling,* and their *empowerment,* through productive livelihood opportunities.

People's Participation: To transform the developmental process into a *people-driven* one, making an awakened and participative citizenry—the driver of good governance. This includes our extended Indian family of the non-resident Indian community spread across the world, whose significant geo-economic and geo-political strength must be harnessed.

Governance: To nurture an open, transparent, accountable, pro-active and purposeful style of

governance, transitioning focus from *Outlay to Output to Outcome.*

Sustainability: Maintain sustainability at the core of our planning and developmental process, building on our ancient tradition of respect for the environment.

STRUCTURE OF THE NITI

The Aayog will be a lean organisation, modelled as a network of expertise; focusing on functionality, flexibility and domain knowledge with the following 'structure' and 'mechnaism':

(i) *Chairman:* the Prime Minister of India (de-facto).

(ii) *Governing Council:* will comprise the Chief Ministers of all states and Lt. Governors of union territories.

(iii) *Regional Councils:* will be formed to address specific issues and contingencies impacting more than one state or region. Strategy and planning in the Aayog will be anchored from state-level; with regional councils convened by the Prime Minister for identified priority domains, put under the joint leadership of related sub-groups of states (grouped around commonalities which could be geographic, economic, social or otherwise) and central ministries. The regional councils will have the following features:

(a) Will have specified tenures, with the mandate to evolve strategy and oversee implementation.

(b) Will be jointly headed by one of the group Chief Ministers (on a rotational basis or otherwise) and a corresponding Central Minister.

(c) Will include the sectoral central ministers and secretaries concerned, as well as state ministers and secretaries.

(d) Will be linked with corresponding domain experts and academic institutions.

(e) Will have a dedicated support cell in the Aayog's secretariat.

(iv) *Special Invitees:* It will have experts, specialists and practitioners with relevant domain knowledge as special invitees nominated by the Prime Minister.

(v) *Full-time Organisational Framework:* In addition to PM as its Chairman it will comprise:

(a) Vice-Chairperson—to be appointed by the PM.

(b) Members: all as full-time.

(c) Part-time Members: maximum of 2, from leading universities, research organisations and other relevant institutions in an *ex-officio* capacity. Part time members will be on a rotational basis.

(d) Ex-Officio Members: maximum of 4 members of the Union Council of Ministers to be nominated by the PM.

(e) Chief Executive Officer: to be appointed by the PM for a fixed tenure, in the rank of Secretary to the Government of India.

(f) Secretariat: as deemed necessary.

SPECIALISED WINGS IN THE AAYOG

The Aayog will house a number of specialised 'Wings', as per the government document:

(i) **Research Wing:** It will develop in-house sectoral expertise as a dedicated think tank of top notch domain experts, specialists and scholars.

(ii) **Consultancy Wing:** It will provide a market-place of whetted panels of expertise and funding, for Central and state governments to tap into; matching their requirements with solution providers, public and private, national and international. By playing match-maker instead of providing the entire service itself, NITI Aayog will be able to focus its resources on priority matters, providing guidance and an overall quality check to the rest.

(iii) **Team India Wing:** It will comprise representatives from every State and Ministry and will serve as a permanent platform for national collaboration. Each representative in this Wing will:

(a) Ensure every state/ministry has a continuous voice and stake in the Aayog.

(b) Establish a direct communication channel between the state/ministry and the Aayog for all development related matters, as the dedicated liaison interface.

A national "Hub-Spoke" institutional model will be developed, with each state and ministry encouraged to build dedicated *mirror institutions*, serving as the interface of interaction. These institutions, in turn, will nurture their own networks of expertise at State and ministry level. NITI Aayog will function in close cooperation, consultation and coordination with the ministries of the Central government, and state governments. While it will make recommendations to the Central and state governments, the responsibility for taking and implementing decisions will rest with them.

VEHICLE OF GOOD GOVERNANCE

The Aayog will seek to facilitate and empower the critical requirement of good governance, which is people-centric, participative, collaborative, transparent and policy-driven. It will provide critical directional and strategic input to the development process, focussing on deliverables and outcomes. This, along with being as incubator and disseminator of fresh thought and ideas for development, will be the core mission of NITI Aayog. The document, at the end, quotes from Chanakya to emphasise the importance and need of good governance – "good governance is at the root of a nation's wealth, comfort and happines".

This way, the idea of the NITI Aayog looks not only 'innovative' in its approach but contemporary, too – imaginatively forging into the emerging idea and need of 'happiness' (as being sponsored by the UNO in the *World Happiness Report*). It gives a call for inclusion of *ethos* and *cultural elements* of India in the development model, delicately linking the issue of growth and development to the 'behavioural' dimensions of the people of India (rightly in sync with the recent proposition of the World Bank in its *World Development Report 2015*). We find several such shining 'stars' in the newly set up body which will be surely analysed and discussed again and again by the analysts, experts, scholars in future. At the end, we can wisely conclude that the old body PC was aimed at serving some purposes which was suitable for the old time while the current times require us to carry on the legacy to a new level where we can build India, which can combine and integrate the energy and potential of all who belong to the nation being all open to the world (agreeing categorically to the idea of globalisation).

CHAPTER

6

ECONOMIC REFORMS

- Introduction
- Economic Reforms
- Economic Reforms in India
- Liberalisation
- Privatisation
- Globalisation
- Generations of Economic Reforms
- Current Sceneario

*An important feature of India's reform programme, when compared with reforms underway in many other countries, is that it has emphasised gradualism and evolutionary transition rather than rapid restructuring or 'shock therapy'. This gradualism has often been the subject of unfavourable comment by the more impatient advocates of reform both inside and outside the country.**

** Montek S. Ahluwalia addressing the inaugurating of the Seminar on 'India's Economic Reforms' at Merton College, Oxford University, London, June 1993.*

INTRODUCTION

The economic reforms initiated in 1991 is now into the 25th year. In this period there was hardly a day that some news, news analysis, write up or article did not appear in the newspapers regarding the reform process. Several highly acclaimed books have been authored on India's economic reforms by some of the best experts of economics from India and abroad. Still students, especially coming from non-economics background, are generally at a loss on the 'pros' and 'cons' of the reform process.

ECONOMIC REFORMS

Popularly, economic reforms denote the process in which a government prescribes declining role for state and expanding role for the private sector in an economy. So let's unravel the reform process based on the author's classroom interaction with students. It is safer to see economic reform as a policy shift in an economy from one to another or ***'alternative development strategies'***. Economists attribute the differences in the performance of economies to the differences in the 'strategies' they follow. The different strategies of development evolved through a long period of trial and error by different countries under the influence of different sets of ideologies. But the process has been like an educational trip. To understand the term 'economic reform' and more so to clarify the confusion concerning it in the Indian context, we must see the different 'alternative development strategies' which evolved through time. A brief description is given below:

1. PLANNING MODEL

Till the rise of the Soviet Union, the prevalent development strategy in the Euro-American countries was the capitalist system of economy, which promoted the principles of laissez-faire and dominant role for private capital in the economy. Once the Soviet Union went for the planning model (including the East European countries and finally China in 1949) most of the developing countries after their independence were influenced by socialism and the governments there took a central role in planned development. As these economies were dominated by foreign colonisers, they worried that opening themselves to foreign investment would lead to a new form of domination, the domination by large multinationals. That is why most of these countries went for 'protectionist' economic policy with ***import substitution*** as one method, side by side. But by the 1970s, the world was having convincing proofs that the socialist as well as the planned economies[1] were inclined to follow their kind of development strategy—because either they had very slow and lower growth rates or were stagnating. The experiences of these economies gave rise to a new ideology which is popular as the ***'Washington Consensus'***.

2. WASHINGTON CONSENSUS

By the early 1980s, a new development strategy emerged. Though it was not new, it was like the old idea getting vindicated after failure of a comparatively newer idea. After the world recognised the limits of a state-dominated economy, arguments in favour of the market, i.e., the private sector, was promoted emphatically. Many countries shifted their economic policy just to the other extreme arguing for a minimal role of the government in the economy. Governments of the socialist or the planned economies were urged/ suggested to privatise and liberalise, to sell off state-owned companies and eliminate government

1. There were many developing non-socialist countries which also accepted the economic planning as their development strategy (France should not be counted among them as it was a developed economy by then). These countries were following the 'mixed economy' but their form was closer to the command economy, i.e., the state economy or the socialist economy.

intervention in the economy. These governments were also suggested to take the measures which could boost the aggregate demand in the economy (***i.e., macroeconomic stability measures***). The broad outlines of such a development strategy were called as the ***Washington Consensus.***[2]

This consensus is broadly termed as the popular meaning of the 'economic reform' followed by almost all the socialist, communist and planned developing economies during the 1980s in one form or the other[3]—the term economic reform got currency around the world during this period. The term was usually seen as a corollary of promoting 'naked capitalism', openness in the economy and an open attitude towards foreign investments, etc. The governments of the developing economies were criticised by the political parties in the opposition and the critiques for being soft to the dictates of the IMF and the WB, and becoming a party to promote 'neo-imperialism'.

But these policies, in many cases proved little better than the previous policies in promoting growth over an extended period of time. But somehow a mood in favour of the market economy had gained ground. The United Kindom under Mrs. Thatcher had gone for politically most vocal privatisation moves without any political debates (the only such example of privatisation moves among the democracies, till date).[4] It should be noted here that after the Great Depression of 1929 a 'strong state intervention' was suggested (by J.M. Keynes) and such a policy did really help the Euro-American countries to mitigate the crisis. The favour for the state intervention in the economy was being reversed by the Washington Consensus. But soon this consensus was also to be replaced by another development strategy. More detailed discusstion on the Washington Concensus is given in the *Chapter 1*.

3. MIXED ECONOMY

By the mid-1990s, it had become increasingly clear that neither of the extremes—the Washington Consensus or the state-led planned economy—were the ultimate strategies of development.[5] The success achieved by the East Asian economies even if we take into account their setback due to the financial crisis of 1997–98, stands out in marked contrast to the experiences of the other economies of the time who were following the Washington Concensus strategy of the planning model.[6] The East Asian economies have not only been able to propel higher growth rates but they have been greatly successful in reducing poverty, promoting education and healthcare, too.

The East Asian economies had promoted a development strategy which had its most distinctive feature as the balance they were able to strike between the roles of the state/ government and the market/the private sector in their economies. This was really a new kind of mixed economy which was never permanently inclined towards either state intervention or the free market, but always a balanced mix of the state and the market according to the requirement of the socio—economic situation of the economy. The East Asian countries had pursued market-oriented policies that encouraged development of the private sector—augmenting and governing the market, not replacing it.[7]

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2. As the strategy was advocated by the IMF, the WB and the US Treasury (i.e., US Ministry of Finance) all located in Washington, therefore it got such a name.
3. Without changing the broad contours of economic policy, the Government in India had also come under the influence of this consensus and a great many ***liberal*** policies were followed by the country (during Rajiv Gandhi's regime) in the 1980s.
4. ***Collins Dictionary of Economics,*** Glasgow, 2006, pp. 417–18.
5. WB, ***The East Asia Miracle,*** Washington, 1993.
6. ***Ibid***.
7. As is concluded by Stiglitz and Walsh, p. 800, op. cit.

Technically speaking, shifting of economic policy of a country from one to the other above-given three 'alternative development strategies' is economic reform. But in the history of world economy, it was inclination of the economies towards the market economy, which have been referred as economic reforms. In the Indian case, economic reform has been always used in this sense. Here, one should note that when India started the programme of economic reforms in the early 1990s, the world view was in favour of privatisation, liberalisation, de-nationalisation, etc., as the main plank of economic reforms. But by the mid-1990s, not only the world view has polarised in favour of 'mixed economy', but one another change was about to sweep the world economies, i.e., the favour for globalisation sponsored by the World Trade Organisation (WTO). Now, the developing economies (mixed economies with planning as their development strategy) as well as the transition economies (Russia and the whole Eastern Europe, China)—who were already promoting the market-oriented reform process were faced with a dilemma. To prosper and compete in the globalising environment while they needed immediate liberation from their state-dominated mode of economies at one hand they also needed to strike a balance between the state and the market on the other. Each one of them tried to strike the balance in their own way with mixed results. In India, the governments have not been able to convince the masses that the economy needs reforms and the attempted reforms will benefit all. In every election since the reforms of 1991, the voters have not supported a pro-reform government. Though the process of economic reforms started in India with the slogan ***'reforms with human face'***—the slogan has utterly failed to garner the empathy of the masses. We may hope that in coming times the masses will start connecting to the reforms and are able to get the message clear, i.e., reforms are to benefit all.

ECONOMIC REFORMS IN INDIA

On July 23, 1991, India launched a process of economic reforms in response to a fiscal and balance-of-payment (BoP) crisis. The reforms were historic and were going to change the very face and the nature of the economy in the coming times. The reforms and the related programmes are still going on with changing emphasis and dimensions, but they are criticised as being slow ever since the UPA Government came to power in May 2004. Back in the mid-1980s, the governments had taken its first steps to economic reforms. While the reforms of the 1980s witnessed rather limited nature of deregulation and 'partial liberalisation of only a few aspects of the existing control regime, the reforms started in early 1990s in the fields of industries, trade, investment and later to include agriculture, were much 'wider and deeper'.[8] Though liberal policies were announced by the governments during the reforms of the 1980s itself, with the slogan of 'economic reforms', it was only launched with full conviction in the early 1990s. But the reforms of the 1980s, which were under the influence of the famous ***'Washington Consensus'*** ideology had a crippling impact on the economy. The whole Seventh Plan (1985–90) promoted further relaxation of market regulations with heavy external borrowings to increase exports (as the thrust of the policy reform). Though the thrust increased the growth rate led by higher industrial growth rate (riding on costly imports supported by foreign borrowings, which the industries would not be able to pay back and service) it also led to a substantial increase in

8. Jeffrey D. Sachs, Ashutosh Varshney and Nirupan Bajpai, ***India in the Era of Economic Reforms,*** Oxford University Press, N. Delhi, 1999, p. 1.

foreign indebtness that played a major role in the BoP crisis of 1991.[9] The crisis was immediated by the First Gulf War (1991) which had two-pronged negative impact on the Indian foreign exchange (forex) reserves. First, the war led the oil prices to go upward forcing India to use its forex reserves in comparatively shorter period and second, the private remittances from Indians working in the Gulf region fell down fast (due to their emergency evacuation)—both the crises were induced by a single cause, i.e., the Gulf War. But the balance of payments crisis also reflected deeper problems of rising foreign debt, a fiscal deficit of over 8 per cent of the GDP and a hyper-inflation (over 13 per cent) situations.[10]

The minority government of the time had taken a highly bold and controversial step in the form of economic reforms criticised throughout the 1990s by one and all—right from the opposition in the Parliament, to the communist parties, to the industrial houses, the business houses, media, experts and by the masses also. By now as the benefits of the reforms have accrued to many, the criticism has somewhat calmed down, but still the reform process is considered as 'anti-poor' and 'pro-rich' by at least the masses—the people who decide the political mandate for the country to rule. At least one belief is followed by everybody, i.e., the benefits of reforms are not tickling to the masses (the ***'aam aadami'***) with the desirable pace.[11] The need of the hour is to go for 'distributive growth' though the reform has led the economy to a higher growth path.

OBLIGATORY REFORM

Similar reform process started by some other economies since the 1980s were voluntary decisions of the concerned countries. But in the case of India it was an involuntary decision taken by the government of the time in the wake of the BoP crisis. Under the Extended Fund Facility (EFF) programme of the IMF, countries get external currency support from the fund to mitigate their BoP crisis, but such supports have some obligatory conditionalities put on the economy to be fulfilled. There are no set rules of such conditions already available with the IMF though they are devised and prescribed to the BoP-crisis-ridden economy at the time of need. A point needs to be referred here is that the conditionalities put upon India were of the nature which required all the economic measures to be formulated by them. It means that the reforms India carried or is carrying out at present were neither formulated by India nor mandated by the public. Yes, there was a large section of experts inside and outside the government who believed in similar economic measures to bring the economy on the right path. Some of them were arguing the same since 1970s itself, while many other experts believed in them since the mid-1980s.[12] But why after all was the Rao-Manmohan Government credited to start the reform process in India? It is because they thought it suitable to follow and make it politically possible in India. Imagine, a government proposing to sell the state-owned companies to the private sector or closing them down in a country which

9. J. Barkley Rosser, Jr. and Marina V. Rosser, ***Comparative Economics in a Transforming World Economy,*** Prentice Hall of India, N. Delhi, 2nd Ed., 2005, p. 469.
10. Vijay Joshi and I.M.D. Little, ***India's Economic Reforms, 1991–2001,*** Oxford, Clarendon Press, 1996, p. 17.
11. The feeling is even shared by the government of the present time. One may refer to the similar open acceptance by India's Minister of Commerce at the Davos Summit of the World Economic Forum (2007). In an interview to the ***CNN-IBN*** programme, the Cabinet Minister for Panchayat Raj, and the North East (Mani Shankar Aiyar) on 20 May 2007 opined that benefits of higher growth are going to the selected 'classes' and not to the 'masses'.
12. The Seventh and the Eight Plans have many such suggestions to give to the governments of the time, especially the latter Plan has called for the same nature of the reform process, very clearly.

has been convinced that these companies will be the 'temples of modern India'. The masses were convinced that the government has bowed down to the dictats of the IMF, the imperialist forces, the multinationals, etc. Even today such feelings are there in several quarters of the economy. The politics of economic reforms damaged India more than the reform has benefitted the country. It would not be an exaggeration if we conclude that economic reforms had no political consensus. Political parties in India are divided on the issue of reforms—the parties together with the masses lack the level of political maturity required for the success of the reforms programme. It is right, democratic maturity comes to a multi-party political system, but it takes time. It takes even more time where masses are unaware and ignorant. The emotional issues of religion, caste, etc., play their own roles in such situations.

The **IMF conditions** put forth for India were as under:

(i) Devaluation of the rupee by 22 per cent (which was effected in two phases and the Indian rupee fell down from Rs. 21 to Rs. 27 per US dollar).

(ii) Drastic reduction in the peak import tariff from the prevailing level of 130 per cent to 30 per cent (India completed it by 2000–01 itself and now it is voluntarily cut to the level of 15 per cent).

(iii) Excise duties (i.e., CENVAT now) to be hiked by 20 per cent to neutralise the revenue short falls due to the custom cut (a major tax reform programme was launched to streamline, simplify and modernise the Indian tax structure which is still going on).

(iv) All government expenditure to be cut down by 10 per cent, annually (i.e., cutting the cost of running the government and denotes, interests; pays, pension and PF; subsidies. A pressure on the government to consolidate the fiscal deficit and go for fiscal prudence).

Though India was able to pay back its IMF dues in time, the structural reform of the economy was launched to fulfil the above-given conditions of the IMF. The ultimate goal of the IMF was to help India bring about equilibirium in its BoP situation in the short-term and go for macroeconomic and structural adjustments so that in future the economy faces no such crisis.

There was enough scope for the critics to take India's economic reforms as prescribed and dictated by the IMF. The process of economic reforms in India had to face severe criticism from almost every quarter of the economy concerned, although the reforms were aimed to boost growth and deliver competitiveness to the economy.[13]

Reform Measures

The economic reform programme, that India launched, consisted of ***two*** categories of measures:

1. Macroeconomic Stabilisation Measures

It includes all those economic policies which intend to boost the aggregate ***demand*** in the economy—be it domestic or external. For the enhanced domestic demand, the focus has to be on increasing the purchasing power of the masses which entails an emphasis on the creation of gainful and quality employment opportunities.

2. Structural Reform Measures

It includes all the policy reforms which have been initiated by the government to boost the aggregate supply of goods and services in the economy. It naturally entails unshackling the economy so that it may search for its own potential of enhanced

13. ***Economic Survey, 1991–92 & New Industrial Policy, 1991***, GoI, New Delhi.

productivity and production. For the purchasing capacity of the people to be increased, the economy needs increased income which comes from increased levels of activities. Income so increased is later distributed among the people whose purchasing power has to be increased—this will take place by properly initiating a suitable set of macroeconomic policies. For the income to get distributed among the target population, it takes time, but the efforts a government initiates to increase the supply, i.e., increasing production becomes visible soon. As production is done by the producers (i.e., the capitalists), *prima facie* the structural reform measures look 'pro-rich' and 'pro-industrialist' or 'pro-capitalist', known with different names. Ignorant people easily get swayed by the logic that everything which is 'pro-rich' has to be necessarily 'anti-poor'. But it was not the case with the process of economic reforms. Unless the economy is able to achieve higher growth (i.e., income) wherefrom the purchasing power of the masses will be enhanced? And increased income takes time to reach everybody. If the economy lacks political stability, this process takes even more time due to short-term goals set by the unstable and frequently changing governments—the exact case is with India.

THE LPG

The process of reforms in India has to be completed via three other processes namely, liberalisation, privatisation and globalisation, known popularly by their short-form—the LPG. These three processes specify the characteristics of the reform process India initiated. Precisely seen, liberalisation shows the ***direction*** of reform, privatisation shows the ***path*** of reform and globalisation shows the ultimate ***goal*** of the reform. However, it would be useful to see the real meanings of these terms and the exact sense in which they are being used worldwide and particularly in India.

LIBERALISATION

The term liberalisation has its origin in the political ideology 'liberalism' which took its form by early nineteenth century (it developed basically in the previous three centuries). The term is sometimes protrayed as a ***meta-ideology*** capable of embracing a broad range of rival values and beliefs. The ideology was the product of the breakdown of feudalism and the growth of a ***market*** or ***capitalist*** society[14] in its place which became popular in economics via the writings of Adam Smith (its founding father in the USA) and got identified as a principle of ***laissez-faire.***[15]

The term liberalisation will have the same connotation in economics as its root word liberalism has. Pro-market or pro-capitalistic inclination in the economic policies of an economy is the process of liberalisation. We see it taking place in the whole Euro-America in the 1970s and particularly in the 1980s.[16] The most suitable example of this process could be China of the mid-1980s when it announced its ***'open door policy'***. Though China lacks (even today) some trademark traits of liberalism, as for example individualism, liberty, democratic system, etc., still China was called a liberalising economy.

We may take an example from the history of the world economy—putting the USA of the early 20th century and the communist China on the two poles of the scale—thus representing the best historical example of the liberal economy and China being the best example of the 'illiberal' economy. With the USA on the south pole and China on the north any policy movement towards 'the south' is 'liberalisation'. The movement

14. Andrew Heywood, ***Politics,*** Palgrave, New York, 2002, p. 43.
15. Robert Nisbet, ***Prejudices: A Philosophical Dictionary,*** Harvard University Press, Massachusetts, 1982, p. 211.
16. **'Economics: Making Sense of the Modern Economy'** ***The Economist,*** London, 1999, pp. 225–26.

from the south to the north will be known as 'illiberalisation'.

It means that the process of decreasing traits of a state economy and increasing traits of a market economy is liberalisation. Similarly, the opposite will be the process of illiberalisation. Technically speaking, both the processes will be known as the processes of economic reforms, since 'reform' as a term does not say anything about the 'direction'. All the economic reforms in the world have been from the 'north to the south'. Similar is the case with the process of liberalisation.

It means, in the Indian case the term liberalisation is used to show the direction of the economic reforms—with decreasing influence of the state or the planned or the command economy and increasing influence of free market or the capitalistic economy. It is a move towards capitalism. India is attempting to strike its own balance of the 'state-market mix'. It means, even if the economic reforms have the direction towards market economy it can never be branded a blind-run to capitalism. Since the economy was more like the state economy in the former years, it has to go for a greater degree of mix of the market. But in the long run, Liberalism curtails the powers of Parliaments.[17]

PRIVATISATION

The decades of the 1980s and 1990s witnessed a 'rolling back' of the state by the governments, especially in the USA and UK under the inspiration of the New Right priorities and beliefs.[18] The policies through which the 'roll back' of the state was done included deregulation, **privatisation** and introduction of market reforms in public services. Privatisation at that time was used as a process under which the state assets were transferred to the private sector.[19] The root of the term privatisation goes to this period which got more and more currency around the world once the East European nations and later the developing democratic nations went for it. But during the period several connotations and meanings of the term 'privatisation' have developed. We may see them as follows:

(i) Privatisation in its purest sense and lexically means **de-nationalisation,**[20] i.e., transfer of the state ownership of the assets to the private sector to the tune of 100 per cent. Such bold moves took place only once anywhere in the world without any political fallouts—in the early 1980s of the UK under the Thatcher regime. This route of privatisation has been avoided by almost all democratic systems. In the mid-1990s some West European nations—Italy, Spain and France—besides the USA went for such moves.[21] India never ventured into any such privatisation move.

(ii) The sense in which privatisation has been used is the process of **disinvestment** all over the world. This process includes selling of the shares of the state-owned enterprises to the private sector. Disinvestment is de-nationalisation of less than 100 per cent ownership transfer from the state to the private sector. If an asset has been sold out by the government to the tune of only 49 per cent the ownership remains with the state though it is considered privatisation. If the sale of

17. J.K. Galbraith, ***A History of Economics,*** Penguin Books, London, pp. 123,178.
18. Andrew Heywood, ***Politics,*** p.100.
19. Stiglitz and Walsh, ***Economics,*** p. 802–3.
20. Collins, Oxford, Penguin, ***Dictionary of Economics,*** relevent pages.
21. Samuelson and Nordhaus, ***Economics,*** p.199.

shares of the state-owned assets has been to the tune of 51 per cent, the ownership is really transferred to the private sector even then it is termed as privatisation.

(iii) The third and the last sense in which the term privatisation has been used around the world, is very wide. Basically, all the economic policies which directly or indirectly seem to promote the expansion of the private sector or the market (economy) have been termed by experts and the governments as the process of privatisation. We may cite a few examples from India—de-licencing and de-reservation of the industries, even cuts in the subsidies, permission to foreign investment, etc.[22]

Here we may connect liberalisation to privatisation in India. Liberalisation shows the direction of reform in India, i.e., inclination towards the dominance of market. But how will it be achieved? Basically, privatisation will be ***the path*** to reform. It means, everything which includes promotion to the 'market' will be the path of the reform process in India.

GLOBALISATION

The process of Globalisation has always been used in economic terms though it has always taken the political and cultural dimensions. Once economic changes occur it has several socio-political manifestations.[23] Globalisation is generally termed as 'an increase in economic integration among nations'.[24] Even before several nation-states were not even born, the countries around the world had gone for globalisation, i.e., 'a closer integration of their economies'.[25] This globalisation lasted from 1800 to almost 1930, interrupted by the Great Depression and the two Wars which led to retrenchment and several trade barriers were erected since early 1930s.[26]

The concept was popularised by the Organisation of Economic Cooperation and Development (OECD) in the mid-1980s again after the Wars. In its earlier deliberation, the organisation had defined globalisation in a very narrow and business-like sense—***'any cross-border investment by an OECD company outside its country of origin for its benefit is globalisation'.*** After this summit of the OECD, proposals for replacing the GATT by the WTO were pushed by the developed economies of the world, better known as the starting of the Uruguay Round of GATT deliberations which ends in Marrakesh (1994) with the birth of WTO. In the meantime, the OECD had defined (1995) globalisation officially, too— "a shift from a world of distinct national economies to a global economy in which production is internationalised and financial capital flows freely and instantly between countries."[27]

The official meaning of globalisation for the WTO is movement of the economies of the world towards ***"unrestricted cross border movements of goods and services, capital and the labour force".*** It simply means that the economies who are signatories to the process of globalisation (i.e., signatories to the WTO) for them there will be nothing like foreign or indigenous goods and services, capital and labour. The world becoming

22. New Industrial Policy, 1991 & several documents of GoI since then.
23. Talcott Parsons, ***The Structure of Social Action***, McGraw-Hill, New York, 1937.
24. Samuelson and Nordhaus, ***Economics,*** p. 32.
25. Stiglitz and Walsh, ***Economics,*** p. 804.
26. Thomas L. Friedman, ***The World is Flat,*** Penguin Books, London, 2006, p. 9; Stiglitz & Walsh, ***Economics,*** p. 804.
27. As quoted in Andrew Heywood, ***Politics,*** p. 139.

a flat and level-playing field emerging in the due process of time.[28]

For many political scientists (which is today a very dominant force in the world), globalisation is the emergence of a situation when our lives are increasingly shaped by the events that occur at a great distance from us about which the decisions are not taken by our conscious self. One section of experts believe that globalisation subordinates the state while the other section argues that the local, national and global events constantly interact under it without any subordination of one by the other. Rather, globalisation highlights the deepening as well as broadening of the political process in this sense.[29]

India became one of the founding members of the WTO and was obliged to promote the process of globalisation, though its economic reforms started with no such obligation. It is a different thing that India started the process of globalisation right after the reforms were started in 1991, itself.[30]

Now we may connect the three simultaneous processes—the LPG with which India launched its reform programme. The process of liberalisation shows movement of the economy towards the market economy, privatisation is the path/route through which it will travel to realise the ultimate 'goal', i.e., globalisation.

It should be noted here that the Indian idea of globalisation is deeply and frequently inclined towards the concept of the welfare state, which keeps coming in the day to day public policy as an emphatic reference. The world, including the IMF, the WB and the developed nations have now increasingly shown their recognition to the fact that the official goal of globalisation of the world economies would not take place without giving the poor of the world a better standard of living. Even if globalisation is complete without including almost one-fifth of the world population, the poor, will it be called development of the world?

GENERATIONS OF ECONOMIC REFORMS

Though there were no such announcements or proposals while India launched its reforms in 1991, in the coming times, many 'generations' of reforms were announced by the governments.[31] A total of ***three*** generations of reforms have been announced till date while experts have gone to suggest the ***fourth*** generation, too. We may substantiate the components of the various generations of reforms to properly understand the very characteristics and the very nature of the reform process in India, as given below:

First Generation Reforms (1991–2000)[32]

It was in the year 2000–01 that the government, for the first time, announced the need for the Second Generation of economic reforms and it was launched the same year. The ones which had been initiated by then (i.e., from 1991 to 2000) were called by the government as the reforms of

28. As Friedman shows in his best-seller, ***The World is Flat,*** op.cit.
29. As put by the ***Oxford's Dictionary of Politics,*** N. Delhi, 24 pp. 222–25 & Andrew Heywood, ***Politics,*** p.138.
30. It should be noted here that the whole Euro-America has already started promoting globalisation by the mid-1980s as the WTO deliberations at Uruguay started. The formation of the WTO only gave globalisation an official mandate in 1995 once it started its functions. It means, for India, globalisation was a reality by 1991 itself–one has to move as the dominant forces move
31. It should be noted here that many economists believe the economic reforms of the mid-1980s as the First Generation. But the governments of the time have not said anything like that. It was only in the year 2000–01 that India officially talks about the generations of reform for the first time.
32. Based on the ***New Industrial Policy, 1991*** & several ***Economic Surveys*** as well as many announcements by the governments.

the First Generation. The broad coordinates of the First Generation of reforms may be seen as under:

(I) Promotion to Private Sector

This included various important and liberalising policy decisions, i.e., 'de-reservation' and 'de-licencing' of the industries, abolition of the MRTP limit, abolition of the compulsion of the phased-production and conversion of loans into shares, simplifying environmental laws for the establishment of the industries, etc.

(II) Public Sector Reforms

The steps taken to make the public sector undertakings profitable, efficient, their disinvestment (*token*), their corporatisation, etc., were the major parts of it.

(III) External Sector Reforms

They consisted of policies like—abolishing quantitative restrictions on import, switching to the floating currency regime of exchange rate, announcing full current account convertibility, reforms in the capital account, permission to foreign investment (direct as well as indirect), promulgation of a liberal Foreign Exchange Management Act (the FEMA replacing the FERA), etc.

(IV) Financial Sector Reforms

Several reform initiatives were taken up in the areas of the banking sector, capital market, insurance, mutual funds, etc.

(V) Tax Reforms

This consisted of all the policy initiatives directed towards simplifying, broadbasing, modernising, checking evasion, etc.

A major re-direction was ensued by this generation of reforms in the economy—the 'command' type of the economy moved strongly towards a market-driven economy, private sector (domestic as well as foreign) to have greater participation in the future.

Second Generation Reforms (2000–01 onwards)[33]

The government launched this generation of the reforms in the year 2000-01. Basically, the reforms India launched in the early 1990s were not taking place as desired and a need for another set of reforms was felt by the government which were initiated with the title of the Second Generation of economic reforms. The reforms of this generation were not only deeper and delicate but required a higher political will power from the governments. The major components of the reform are as given below:

(I) Factor Market Reforms

Considered as the 'backbone' for the success of the reform process in India itself, it consists of dismantling of the Administered Price Mechanism (APM). There were many products in the economy whose prices were fixed/regulated by the government, viz., petroleum, sugar, fertilizers, drugs, etc. Though a major section of the products under the APM were produced by the private sector, they were not sold on market principles which hindered the profitability of the manufacturers as well as the sellers and ultimately the expansion of the concerned industries leading to a demand-supply gap. Under market reforms these products were to be brought into the market fold.

In the petroleum segment now only kerosene oil and the LPG remained under the APM while

33. Based on the ***Economic Survey, 2000–01*** **and** ***Union Budget, 2001–02*** especially besides other official announcements by the GoI in the coming years.

petrol, diesel (by March, 2014), lubricants have been phased out. Similarly, the income tax paying families don't get sugar from the TPS on subsidies; only urea, among the fertilizers, remain under APM, while many drugs have also been phased out of the mechanism. Opening the petroleum sector for private investment, cutting down the burden of levy on sugar (levy obligation was abolished by mid-2013), etc., are now giving dividends to the economy. But we cannot say that the Factor Market Reforms (FMRs) are complete in India. It is still going on. Cutting down subsidies on essential goods is a socio-political question in India. Till market-based purchasing power is not delivered to all the consumers, it would not be possible to complete the FMRs.

(II) Public Sector Reforms

The second generation of reforms in the public sector especially emphasises on the areas like greater functional autonomy, freer leverage to the capital market, international tie-ups and greenfield ventures, disinvestment[34] (*strategic*), etc.

(III) Reforms in the Government and Public Institutions

This involves all those moves which really go to convert the role of the government from the 'controller' to the 'facilitator' or the administrative reform, as it may be called.

(IV) Legal Sector Reforms

Though reforms in the legal sector were started in the first generation itself, now it was to be deepened and newer areas were to be included—abolishing outdated and contradictory laws, reforms in the Indian Penal Code (CrPC), Labour Laws, Company Laws and enacting suitable legal provisions for new areas like Cyber Law, etc.

(V) Reforms in the Critical Areas

The second generation reforms also commit to suitable reforms in the infrastructure sector (i.e., power, roads, especially as the telecom has been encouraging), agriculture, agricultural extension, education and the healthcare, etc. These areas have been called by the government as the ***'critical areas'***.[35]

These reforms have two segments. The first segment is similar to the FRMs, while the second segment provides a broader dimension to the reforms, viz., corporate farming, research and development in the agriculture sector (which was till now basically taken care of by the government and needs active participation of the private sector), irrigation, inclusive education and healthcare.

Other than the above-given focus of this generation of reforms, some other important areas were also emphasised:

(a) **State's Role in the Reform:** For the first time, an important role to the state was designed, in the process of economic reforms. All new steps of the reforms were now to be started by the state with the centre playing a supportive role.

(b) **Fiscal Consolidation:** The area of fiscal consolidation, though it was a major co-ordinate of reform in India since 1991 itself, gets a constitutional commitment and responsibility. The FRBM Act is passed by the Centre and the Fiscal

34. Basically 'disinvestment' started in India in its 'token' form which is selling of the minority shares of the PSUs in its symbolic form. While in the Second Generation the government went for the 'strategic' kind of it which basically involved the transfer of ownership of the PSUs from the state to the private sector—MFI2, BALCO, etc., being the firsts of such disinvestments. Once the UPA Government came to power in May 2004, the latter form of disinvestment was put on hold. We will discuss it in detail in the chapter ***Indian Industry.***

35. ***Ministry of Finance Economic Survey, 2000–01,*** GoI, N. Delhi, 2001.

Responsibility Act (FRAs) is followed by the states as an era of new commitments to the fiscal prudence starts in the country.

(c) **Greater Tax Devolution to the States:** Though there was such a political tendency[36] by the mid-1990s itself, after the second generation reforms started, we see a visible change in the central policies favouring greater fiscal leverage to the states. Even the process of tax reforms takes the same dimension. Similarly, the Finance Commissions as well as the Planning Commission start taking greater fiscal care of the states. And for the first time the states had a net revenue surplus collections in the fiscal 2007–08.[37]

(d) **Focussing on the Social Sector:** The social sector (especially the healthcare and education) gets increased attention by the government with manifold increases in the allocations as well as show of a greater compliance to the performance of the development programmes.

We see mixed results of the second generation reforms though the reforms continue.

THIRD GENERATION REFORMS

Announcement of the third generation of reforms were made on the margins of the launching of the Tenth Plan (2002–07). This generation of reforms commits to the cause of a fully functional Panchayati Raj Institution (PRIs), so that the benefits of the economic reforms, in general, can reach to the grassroots.

Though the constitutional arrangements for a decentralised developmental process was already effected in the early 1990s, it was in the early 2000s that the government gets convinced of the need of 'inclusive growth and development'. Till the masses are not involved in the process of development, the development will lack the 'inclusion' factor, it was concluded by the government of the time. The Eleventh Plan goes on to ratify the same sentiments (though the political combination at the centre has changed) and views regarding the need for the third generation of reforms in India.

FOURTH GENERATION REFORMS

This is not an official 'generation' of reform in India. Basically, in early 2002, some experts coined this generation of reforms which entail a fully 'information technology-enabled' India. They hypothesised a 'two-way' connection between the economic reforms and the information technology (IT), with each one reinforcing the other.

NOTE

The different generations of economic reforms in India should not be seen as the completion/ending of the former and commencement of the later generations of reforms. Basically, all of the generations are going on at present simultaneously, so that the goal of reforming the economy is objectified. The various generations of reforms in India also verify the fact that 'reform' is a continuous process which needs 'fine-tuning' in accordance with the changing situation. Reform is not the aim of the economy, but reforming the economy is the aim. Reform is a means to an end.

We saw a general decline in the government's eagerness towards furthering the cause of economic reforms once the UPA came to power in 2004 — largely due to the nature of the coalition which included the Left Front supporting it from outside

36. We see it, especially, when the Coalition Government (i.e., the UF Government) goes to amend the constitution so that the Alternative Method of Devolution (AMD) of the tax suggested by the Tenth Finance Commission becomes a law before the recommendations of the Eleventh Finance Commission. It should be noted that the AMD has increased the gross tax devolution to the states by a hefty 5 per cent.
37. The Comptroller and Auditor General, ***Provisional Report***, May 2007.

(outside support is considered the weakest and the most delicate thing for a government by the world political thinkers and analysts). The returning of the UPA to power in 2009, with a bit different coalition partners could not ensue any new pace regarding furthering the reform process. Almost everyone, including the major industrial houses remarked the policy-paralysis of the government as the cause of hurting the pace of growth in the economy. The government document,[38] *Economic Survey 2011–12*, says that though it is hard to quantify and for that reason is contestable, there has been seen a slackening in the pace of reforms—one consequence of increased awareness of high-profile corruption scandals in different parts of India and welcome civil-society activism has been a sense of caution among civil servants in taking crucial decisions. Since one way to avoid the charge of an ill-considered or, worse, bad-intentioned decision is to take no decision, it is arguable that some civil servants have resorted to precisely this strategy, concludes the *Survey*. This would cause a slowdown in the decision making process. In addition, coalition politics and federal considerations played their role in holding up economic reforms on several fronts, ranging from diesel and LPG pricing and taxation reform like the goods and services tax (GST) and direct taxes code (DTC), to FDI in retail and reform of the APMC Act, says the document.

Other than the above-discussed reasons the recent financial developments in the global economy, especially, the US and European economies which followed in the aftermath of the *US Sub-prime Crisis* also placed an ideological dilemma in front of India. This fact has been given no attention by the contemporary Indian media or the intelligentia, probably due to its academic nature (which can hardly be understood by the masses, the voters, who had already numerous reservations regarding the economic reform process followed by the government.[39] The so-called affinity to the idea of the ***Washington Consensus*** among the Euro-American nations has now almost lost ground in the region where it was proposed, cemented and propagated around the world through the IMF/WB. What should be the course of action in future towards greater dependence on the private capital is still to be decided by the world financial body in clear terms. Meanwhile, a certain degree of liberal attitude towards promoting the process of economic reforms has been suggested by the IMF/WB to India.[40]

CURRENT SCENARIO

The process of economic reforms decelerated during the 2009–2014 due to several factors. The 'gradualist' reform (already having a slower pace in comparison to the other emerging economies) of the Indian economy had almost reached a point of halt. Experts, together with corporate India cited this as a situation of 'policy paralysis' (to which the government of the time remained in clear 'denial mode') – but the new Government officially accepted this situation (in the *Full Union Budget 2014–15*). Since the new government assumed office, 'a slew of economic reforms has led to a partial revival of investor sentiment'.[41] Tentative signs that the worst is over are evident, for example, in data that shows that the rate of stalled projects has begun to decline and that the rate of their revival is inching up. But increasing capital flows are yet to translate into a durable pick-up of real investment,

38. Ministry of Finance ***Economic Survey 2011-12,*** GoI, N. Delhi, p. 30.
39. Various issues of ***The Economist*** and the ***Economic & Political Weekly*** between July, 2007 and May, 2012.
40. ***An IMF/WB Release*** dated 28th April, 2012, Washington DC, USA.
41. **Economic Survey 2014-15**, MoF, GoI, N. Delhi, Vol 1, p. 25.

especially in the private sector. This owes to at least **five interrelated factors** (challenges) that lead to what the *Mid-Year Economic Analysis* called the "*balance sheet syndrome with Indian characteristics*". As per the *Economic Survey 2014–15,* these factors are:

(i) Weak profitability and over-indebtedness have eroded the investment capability of the Indian corporate sector. One key indicator of profitability—the interest cover ratio, which if less than one implies firms' cash flows are not sufficient to pay their interest costs—has also worsened in recent years. Further, the debt-equity ratio of the top 500 non-financial firms have been steadily increasing, and their level now is amongst the highest in the emerging market world.

(ii) Weak institutions relating to bankruptcy means that the over-indebtedness problem cannot be easily resolved (the stock and 'difficulty-of-exit' challenge). This is reflected in the persistence of *stalled projects*, which have been consistently around 7 to 8 per cent of the GDP in the last four years.

(iii) Even if some of these problems were solved, the PPP model at least in infrastructure need to be re-fashioned to become more viable and forward looking (the institutional challenge).

(iv) Since a significant portion of the infrastructure was financed by the banking system, especially the public sector banks (PSBs), their balance sheets have deteriorated.[42] For example, the sum of non-performing and stressed assets has risen sharply, for the PSBs for over 12 per cent of the total assets.[43] Uncertainty about accounting and valuation, and indeed the history of banking difficulties across time and space, counsel in favour of over-rather than under recognising the severity of the problem. When banks' balance sheets are stressed they are less able to lend, leading to reduced credit for the private sector (the financing challenge).[44]

(v) In a peculiarly Indian twist, this financing problem is aggravated by generalised risk-aversion (the challenge of inertial decision-making).[45] For the public sector banks in particular, which are exposed to governmental accountability and oversight, lending in a situation of NPAs is not easy because of a generic problem of caution, afflicting bureaucratic decision-making.

42. According to RBI's **Financial Stability Report**, December 2014, the contribution of mining, iron and steel, textiles, aviation and other infrastructure to total advances stands at 28 percent whereas their contribution in stressed assets is 54 percent.

43. **Economic Survey 2014-15**, MoF, GoI, N. Delhi, Vol 1, p. 28.

44. Suggestions on how capital markets can play a greater role in infrastructure financing are elaborated in the **Economic Survey 2013-14** in detail.

45. **Economic Survey 2014-15**, MoF, GoI, N. Delhi, Vol 1, p. 26.

CHAPTER

7

INFLATION AND BUSINESS CYCLE

*Fluctuations in the level of economic activity, alternating between periods of depression and boom, led by one prominent factor, i.e., the expectations of the future demand – intertwined with the inflation – has always been a fascinating topic for economists.**

Section-A

- Introduction
- Definition
- Why Inflation Occurs
- Types of Inflation
- Other Variants of Inflation
- Other Important Terms
- Base Effect
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- Inflation in India
- Household Inflation Expectations
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Section-B

- Introduction
- Depression
- Recovery
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- Recession
- Growth Recession
- Double-Dip Recession
- Abenomics
- Conclusion

* *See Joseph E. Stiglitz and Carl E. Walsh,* ***Economics****, W W Norton, New Yok, USA, 4th Edition, 2006, pp. 494-496.* ***Collins internet-linked Dictionary of Economics,*** *Glasgow, Scotland, UK, 2006, pp. 48-49.*

SECTION-A

INTRODUCTION

For a layman, inflation is just price rise. It becomes a matter of everyday discussion if the prices of daily or weekly items start rising. Whatever impact it might be having on other areas of economy, inflation might take an ugly turn and lead to a political crisis—at least in the developing economies. India has seen governments thrown out of power in elections due to price rise in daily-use items. This is not the case in the developed economies, but inflation takes its political toll there, too. In the developed economies, more aware and informed voters get carried away by the greater impact of higher or lower inflations in the elections. In this chapter, we will try to examine the concept of inflation from all possible dimensions to have an overall understanding.

DEFINITION

A rise in the general level of prices[1]; a sustained rise in the general level of prices[2]; persistent increases in the general level of prices[3]; an increase in the general level of prices in an economy that is sustained over time[4]; rising prices across the board[5]—is inflation. These are some of the most common academic definitions of inflation. If the price of one good has gone up, it is not inflation, it is inflation only if the prices of ***most*** goods have gone up.[6]

When the general level of prices is falling over a period of time this is ***deflation***, the opposite situation of inflation. It is also known as ***disinflation***. But in contemporary economics, deflation or disinflation not used to indicate fall in prices. Instead, a price rise is termed a 'rise in inflation' and a price fall is termed a 'fall in inflation'. The terms deflation or disinflation have become part of the macroeconomic policy of modern governments. In policy terms, the terms show a reduction in the level of national income and output, usually accompanied by a fall in the general price level. Such a policy is often deliberately brought about by the governments with the objective of reducing, inflation and improving the balance of payments (BoP) by reducing import demand. As instruments of deflation, any policy includes fiscal measures (as for example, tax increase) and monetary measures (as for example, increase in interest rate).

The rate of inflation is measured on the basis of price indices which are of two kinds—Wholesale Price Index (WPI) and Consumer Price Index (CPI). A price index is a measure of the average level of prices, which means that it does not show the exact price rise or fall of a single good. The rate of inflation is the rate of change of general price level which is measured as follows:

Rate of inflation (year x) = Price level (year x) –Price level (year x-1) / Price level (year x-1)×100

This rate shows up in percentage form (%), though inflation is also shown in ***numbers,*** i.e., ***digits***. A price index is a weighted average of the prices of a number of goods and services. In

1. Samuelson, Paul A. and Nardhaus, William D., ***Economics***, Tata McGraw-Hill, N. Delhi, 2006, p. 439.
2. Mc Cormick, B.J. et.al, ***Introducing Economics***, Penguin Education, Great Britain, 1974, p.609.
3. ***Penguin Dictionary of Economics***, Penguin Books, London, 7th Ed., 2003.
4. ***Collins internet-linked Dictionary of Economics***, Harper-Collins Publishers., Glasgow, 2006.
5. Mathew Bishop, ***Pocket Economist***, *The Economist,* London, 2007, p. 121.
6. Stiglitz, Joseph E. and Walsh, Carl E., ***Economics***, W.W. Norton & Company, New York, 2005, p. 509.

the index the total weight is taken as 100 at a particular year of the past (the ***base year***), this when compared to the current year shows a rise or fall in the prices of current year, there is a rise or fall in the '100' in comparison to the base year—and this inflation is measured in digits.

Inflation is measured '***point-to-point***'. It means that the reference dates for the annual inflation is January 1 to January 1 of two consecutive years (not for January 1 to December 31 of the concerned year). Similarly, the weekly rate of inflation is the change in one week reference being the two consecutive last days of the week (i.e., 5 p.m. of two Fridays in India).

WHY INFLATION OCCURS

Economists have been giving different explanations throughout the 19th and 20th centuries for the occurrence of inflation—the debate still goes on. But the debate has certainly given us a clearer picture of inflation. We shall see the reasons responsible for inflation in two parts—

1. Pre-1970s

Till the rise of the monetarist school, economists used to agree upon two reasons behind inflation:

(A) Demand-Pull Inflation

A mis-match between demand and supply pulls up prices. Either the demand increases over the same level of supply, or the supply decreases with the same level of demand and thus the situation of demand-pull inflation arise. This was a Keynesian idea. The Keynesian School suggests cuts in spending as the way of tackling excess demand mainly by increasing taxes and reducing government expenditure.

In practice, the governments keep tracking the demand-supply matrix to check such inflation. At times, the goods in short supply are imported, interest on loans increased, wages revised, depending upon the situation.

(B) Cost-Push Inflation

An increase in factor input costs (i.e., wages and raw materials) pushes up prices. The price rise which is the result of increase in the production cost is cost-push inflation. The Keynesian school suggested controls on prices and incomes as direct ways of checking such inflation and 'moral suasions' and measures to reduce the monopoly power of trade unions as the indirect measures (basically, cost-push inflations chiefly used to happen due to higher wage demanded by the trade unions during the era).

Today, the governments of the world use many tools to check such inflations—reducing excise and custom duties on raw materials, wage revisions, etc.

2. Post-1970s

After the rise of Monetaristic School of Economics in the early 1970s (***monetarism developed in opposition to post-1945 Keynesian idea of demand management***), the school provided monetarist explanation for inflation, the so-called 'demand-pull' or the 'cost-push' which is excessive creation of money in the economy.

(A) Demand-Pull Inflation

For the monetarists a demand-pull inflation is creation of extra purchasing power to the consumer over the same level of production (which happens due to wage revisions at micro level and deficit financing at the macro level). This is the typical case of creating extra money (either by printing or public borrowing) without equivalent creation in production/supply, i.e., 'too much money chasing too little output'—the ultimate source of demand-pull inflation.

(B) Cost-Push Inflation

Similarly for the monetarists, 'cost-push' is not a truly independent theory of inflation—it has

to be financed by some extra money (which is created by the government via wage revision, public borrowing, printing of currency, etc.). A price rise does not get automatically reciprocated by consumers' purchasing. Basically, people must have got some extra purchasing power created that's why they start purchasing at higher prices also. If this has not been the reason, people would have cut-down their consumption (i.e., overall demand) to the level of their purchasing capacity and the aggregate demand of goods would have gone down. But this does not happen. It means every cost-push inflation is a result of excessive creation of money—increasing money flow or money supply.

For the monetarists, a particular level of money supply for a particular level of production is healthy for an economy. Extra creation of money over the same level of production causes inflation. They suggested proper monetary policy (money supply, interest rates, printing of currencies, public borrowing etc.), to check the situations of inflationary pressure on the economy. Monetarists cancelled the Keynesian theory of inflation.

3. Measures to Check Inflation

From the above-given reasons for inflation and the measures to control it, which measure the governments of the world should apply in their policy making? In practice, governments around the world distanced themselves from this debate and have been taking recourse to all possible options while controlling inflation. The governments resort to following options to check rising inflation:

(i) As a ***supply side measure,*** the government may go for the import of goods which are in short-supply—as a short-term measure (as happened in India in the case of 'onion'[7] and meeting the buffer stock norm of wheat). As a long-term measure, governments go on to increase the production to matching the level of demand. Storage, transportation, distribution, hoarding are the other aspects of price management of this category.

(ii) As a ***cost side measure,*** governments may try to cool down the price by cutting down the production cost of the goods showing price rise with the help of tax breaks—cuts in the excise and custom duties (as happened in June 2003 in India in the case of crude oil and steel[8]). This helps as a short-term measure. In the long-term, better production process, technological innovations, etc., are helpful. Increasing income of the people is the monetary measure to avoid the heat of such inflation.

(iii) The governments may take recourse to tighter monetary policy to cool down either the demand-pull or the cost-push inflations. This is basically intended to cut down the money supply in the economy by siphoning out the extra money (as RBI increases the Cash Reserve Ratio of banks in India)[9] from the economy and by making money costlier (as RBI increases the Bank Rate or Repo Rate in India)[10]. This is a short-term measure. In

7. As per the ***Economic Survey, 1997–98,*** Ministry of Finance, GoI, N. Delhi, p. 89.
8. As per the ***Economic Survey, 2003–04,*** p. 90.
9. As the CRR for banks was revised upward to 6.5 per cent by the RBI in its Credit and Monetary Policy for April 2007 onwards and again increased to 7 per cent in the Review, July 31, 2007.
10. As the RBI increased the Repo Rate to 7.75 per cent in its ***Credit & Monetary Policy*** announced on March 31, 2007.

the long-run, the best way is to increase production with the help of the best production practices.

Again, this measure does not work if the price rise is taking place in the items of everyday use such as salt, onion, wheat, etc. (because nobody purchases such goods by borrowing from the banks). This measure helps if the prices are rising due to extra demand of cement, iron and steel, etc.

The governments might utilise any of the above or all the three measures to check and manage inflation in their day to day price management policy making.

TYPES OF INFLATION

Depending upon the range of increase, and its severity, inflation may be classified into three broad categories.

1. Low Inflation

Such inflation is slow and on predictable[11] lines which might be called small or gradual[12]. This is a comparative term which puts it opposite to the faster, bigger and unpredictable inflations. Low inflation takes place in a longer period and the range of increase is usually in 'single digit'. Such inflation has also been called as '***creeping inflation***'.[13] We may take an example of the monthly inflation rate of a country for six months being 2.3 per cent, 2.6 per cent, 2.7 per cent, 2.9 per cent, 3.1 per cent and 3.4 per cent. Here the range of change is of 1.1 per cent and over a period of six months.

2. Galloping Inflation

This is a "***very high inflation***" running in the range of double-digit or triple digit (i.e., 20 per cent, 100 per cent or 200 per cent a year).[14] In the decades of 1970s and 1980s, many Latin American countries such as Argentina, Chile, and Brazil had such rates of inflation—in the range of 50 to 700 per cent. The Russian economy did show such inflation after the disintegration of the ex-USSR in the late 1980s.

Contemporary Journalism has given some other names to this inflation—*hopping inflation, jumping inflation* and *running or runaway inflation.*[15]

3. Hyperinflation

This form of inflation is '***large and accelerating***'[16] which might have the annual rates in million or even trillion[17]. In such inflation not only range of increase is very large but the increase takes place in a very short span of time, prices shoot up overnight.

The best example of hyperinflation that economists cite is of Germany after the First World War—in early 1920s. At the end of 1923, prices were 36 billion times higher than two years earlier.[18] This inflation was so severe that paper German currencies (the Deutsche Mark) were more valuable as stove fuel than as actual money.[19] Some recent examples of hyperinflation had been the Bolivian inflation of mid-1985 (24,000 per cent per annum) and the Yugoslavian inflation of 1993 (20 per cent per day). [20]

11. Samuelson and Nordhaus, ***Economics*** p. 671.
12. ***Collins Dictionary of Economics***, op.cit., p. 251.
13. Ibid.
14. Samuelson & Nordhaus, ***Economics***, p. 671
15. As popularised by ***The Economist, The Wall Street Journal, The Economic Times*** (India), etc.
16. ***Collins Dictionary of Economics***, op.cit., p. 251
17. Samuelson & Nordhaus, ***Economics***, p. 671.
18. Thomas Sargent, "The Ends of Four Big Inflations", in R.Hall, Ed. ***Inflations, Causes and Effects***, University of Chicago Press, Chicago, 1982, pp. 74–75 (as quoted by Stiglitz & Walsh, ***Economics,*** p. 513).
19. Stiglitz & Walsh, ***Economics***, p. 512.
20. Sachs, Jeffery, ***The End of Poverty***, Penguin Books, London, 2005, pp. 92–108.

Such an inflation quickly leads to a complete loss of confidence in the domestic currency and people start opting for other forms of money, as for example physical assets, gold and foreign currency (also known as "inflation proof" assets) and people might switch to barter exchange.[21]

OTHER VARIANTS OF INFLATION

Other than the three broad categories we analysed above, some other variants of inflation are also considered by governments in their policy making:

I. Bottleneck Inflation

This inflation takes place when the supply falls drastically and the demand remains at the same level. Such situations arise due to supply-side accidents, hazards or mismanagement which is also known as 'structural inflation'. This could be put in the 'demand-pull inflation' category.

II. Core Inflation

This nomenclature is based on the inclusion or exclusion of the goods and services while calculating inflation. Popular in western economies, core inflation shows price rise in all goods and services excluding ***energy*** and ***food articles***. In India, it was first time used in the financial year 2000–01 when the government expressed that it was under control—it means the prices of manufactured goods were under control.[22] This was criticised by experts on account of excluding food articles and energy out of the inflation and feeling satisfied on the inflation front. Basically, in the western economies, food and energy are not the problems for the masses, while in India these two segments play the most vital role for them.

OTHER IMPORTANT TERMS

Inflationary Gap

The excess of total government spending above the national income (i.e., fiscal deficit) is known as the inflationary gap. This is intended to increase the production level which ultimately pushes the prices up due to extra-creation of money during the process.

Deflationary Gap

The shortfall in total spending of the government (i.e., fiscal surplus) over the national income creates deflationary gap in the economy. This is a situation of producing more than the demand and the economy usually heads for a general slowdown in the level of demand. This is also known as the ***output gap***.

Inflation Tax

Inflation erodes the value of money and the people who hold currency suffer in this process. As the governments have authority of printing currency and circulating it into the economy (as they do in the case of deficit financing), this act functions as an income to the governments. This is a situation of sustaining government expenditure at the cost of people's income. This looks as if inflation is working as a tax.[23] That is how the term inflation tax is also known as ***seignorage***. It means, inflation is always the level to which the government may go for deficit financing—level of deficit financing is directly reflected by the rate of inflation.

It could also be used by the governments in the form of prices and incomes policy under which the companies pay inflation tax on the

21. Hyperinflation erodes, the value of money very fast and that too at a very high scale. We may put it with an example suppose the annual rate of inflation is 100 per cent, money loses half its value every year. It means that a note of '100 will have a value of just '3 after five years.
22. Ministry of Finance, ***Economic Survey, 2000–01***, GoI, N. Delhi.
23. Stiglitz & Walsh, ***Economics***,, p. 511.

salary increases above the set level prescribed by the government.[24]

Inflation Spiral

An inflationary situation in an economy which results out of a process of wage and price interaction '***when wages press prices up and prices pull wages up***'[25] is known as the inflationary spiral. It is also known as the ***wage-price 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.[26]

Inflation Accounting

A term popular in the area of corporate profit accounting. Basically, due to inflation the profit of firms/companies gets overstated. When a firm calculates its profits after adjusting the effects of current level of inflation, this process is known as inflation accounting. Such profits are the real profit of the firm which could be compared to a historic rate of inflation (inflation of the base year), too.

Inflation Premium

The bonus brought by inflation to the borrowers is known as the inflation premium. The interest banks charge on their lending is known as the ***nominal*** interest rate which might not be the real cost of borrowing paid by the borrower to the banks. To calculate the real cost a borrower is paying on its loan, the nominal rate of interest is adjusted with the effect of inflation and thus the interest rate we get is known as the real interest rate. Real interest is always lower than the nominal interest if the inflation is taking place—the difference is the inflation premium.

Rising inflation premium shows depleting profits of the lending institutions. At times, to neutralise the effects of inflation premium, the lender takes the recourse to increase the nominal rate of interest.[27] In recent times, it was done by the Indian banks in July 2003 to ward off their depleting profits when inflation had crossed the 7 per cent level—the level of inflation was threatening to deplete even the capital base of the banks. Since then the RBI has been following a tighter credit policy as inflation was going beyond the upper limit of its healthy range (i.e., 4–5 per cent in the Indian case).

Phillips Curve

It is a graphic curve which advocates a relationship between inflation and unemployment in an economy. As per the curve there is a 'trade off' between inflation and unemployment, i.e., an inverse relationship between them. The curve suggests that lower the inflation, higher the unemployment and higher the inflation, lower the unemployment.[28] During 1960s, this idea was among the most important theories of the modern economists. This concept is known after the economists who developed it—Alban William Housego Phillips (1914–75). Bill Phillips (popular name) was an electrical engineer from New Zealand and was an economist at the London School of Economics when propounded the idea. In ***'The Relation between Unemployment and the Rate of Change of Money Wage Rates in the United Kingdom, 1861–1957'*** (published in *Economica* in 1958), he provided empirical evidence to support his ideas.[29]

24. ***Penguin Dictionary of Economics***, op. cit.
25. Ibid.
26. Galbraith, J.K, ***A History of Economics***, Penguin Books, London, 1991, pp. 205, 267–70.
27. Patrick Lane, ***Economics***, *The Economist*, London, 1999, p. 270.
28. Stiglitz & Walsh, ***Economics***, pp. 821–822.
29. ***Penguin Dictionary of Economics***, op. cit. pp. 297–298.

By the early 1960s, an economic wisdom emerged around the world that by following a certain kind of monetary policy, unemployment could be checked forever and at the cost of a slightly higher inflation, unemployment could be reduced permanently. The central banks of the developed world started framing the required kind of monetary policies mixing the trade-off between inflation and unemployment. The idea became popular among the developing economies too by the late 1960s, though they were a bit confused, as most of them were fighting the menace of higher inflations (double digit) along with high level of unemployment.[30]

By the early 1970s, two American economists, Milton Friedman (Nobel Laureate, 1976) and Edmund Phelps challenged the idea of the Phillips Curve. According to them the trade-off between inflation and unemployment was only short-term, because once people came to expect higher inflation they started demanding higher wages and thus unemployment will rise back to its '***natural rate***' (the unemployment rate that occurs at full employment when the economy is producing at potential output, it is usually called the natural rate of unemployment).[31] They advocated that there was no long-term trade-off between inflation and unemployment. In the long run, monetary policy can influence inflation. They suggested that if monetary policy tried to hold unemployment below its natural rate, inflation will be rising to higher level—which is also known as the **non-accelerating inflation rate of unemployment (NAIRU)**.[32] The NAIRU is that rate of unemployment which is consistent with a constant rate of inflation. It means at NAIRU, the upward and downward forces on price (inflation) and wage (unemployment) neutralise each other and there is no tendency of change in the rate of inflation. We may say that the NAIRU is the lowest unemployment rate that an economy can sustain without any upward pressure on inflation rate.

REFLATION

Reflation is a situation often deliberately brought by the government to reduce unemployment and increase demand by going for higher levels of economic growth.[33] 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.

Reflation can also be understood from a different angle—when 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

A situation in an economy when inflation and unemployment both are at higher levels, contrary to conventional belief. Such a situation first arose in 1970s in the US economy (average unemployment rate above 6 per cent and the average rate of inflation above 7 per cent)[34] and in many Euro-American economies. This took place as a result of oil price increases of 1973 and

30. Meier, Gerald M. and Ranch, James E., ***Leading Issues in Economic Development***, Oxford University Press, N. Delhi, 2006, pp. 37–39.
31. Stiglitz & Walsh, ***Economics***, p. 822.
32. Samuelson & Nordhaus, ***Economics***, pp. 680–687.
33. ***Collins Dictionary of Economics***, op. cit., p. 446
34. Stiglitz & Walsh, ***Economics***, p. 478.

1979 and anticipation of higher inflation. The stagflationary situation continued till the early 1980s. Conventional thinking that a trade-off existed between inflation and unemployment (i.e., Phillips Curve) was falsified and several economies switched over to alternative ways of economic policies such as monetaristic and supply-side economics.

When the economy is passing through the cycle of stagnation (i.e., long period of low aggregate demand in relation to its productive capacity) and the government shuffles with the economic policy, a sudden and temporary price rise is seen in some of the goods—such inflation is also known as stagflation. Stagflation is basically a combination of high inflation and low growth.[35]

Inflation Targeting

The announcement of an official target range for inflation is known as inflation targeting. It is done by the Central Bank in an economy as a part of their monetary policy to realise the objective of a ***stable*** rate of inflation[36] (the Government of India asked the RBI to perform this function in the early 1970s).

India commenced inflation targeting 'formally' in *February 2015* when an agreement between the GoI and the RBI was signed related to it—the **Agreement on Monetary Policy Framework.** The agreement provides the aim of inflation targeting in this way – "it is essential to have a modern monetary framework to meet the challenge of an increasingly complex economy. Whereas the objective of monetary policy is to primarily maintain *price stability*, while keeping in mind the objective of *growth*." The highlights of the agreement is as given below:

1. The RBI will aim to bring CPI-C Inflation below 6 per cent by January 2016. The Target for financial year 2016–17 and all subsequent years shall be 4 per cent with a band of +/- 2 per cent (it means the *'healthy range of inflation'* to be 2–6 per cent).
2. RBI to publish the *Operating Target (s)* and establish an *Operating Procedure* of Monetary Policy to achieve the Target. Any change in the operating target (s) and operating procedure in response to eveolving macro-financial conditions shall also be published.
3. Every six months, the RBI to publish a document explaining:
   (a) Source of Inflation;
   (b) Forecasts of Inflation for the period between six to eighteen months from the date of the publication of the document; and
4. The RBI shall be seen to have failed to meet the Target if inflation is:
   (a) More than 6 per cent for three consecutive quarters for the financial year 2015–16 and all subsequent years.
   (b) Less than 2 per cent for three consecutive quarters in 2016–17 and all subsequent years.
5. If the RBI fails to meet the target it shall set out in a report to the GoI:
   (a) the reasons for its failure to achieve the Target under set in this agreement;
   (b) remedial actions proposed to be taken by the RBI; and
   (c) an estimate of the time-period within which the Target would be achieved pursuant to timely implementation of proposed remedial actions.

35. C. Rangarajan, ***Indian Economy: Essays on Money and Finance***, UBSPD, 1998, p. 58.
36. Samuelson & Nordhaus, ***Economics***, p. 723.

6. Any dispute regarding the interpretation or implementation of the agreement to be resolved between the Governor, RBI and the GoI.

It should be noted that the *Urjit Patel Committee* set by the RBI on monetary policy gave similar advices by early 2014 – the move is seen as a follow up to this. This way India joined the club of inflation targeting countries such as USA, UK, European Union, Japan, South Korea, China, Indonesia and Brazil. It was New Zealand which went for inflation targeting in 1989 for the first time in the world.[37]

SKEWFLATION

Economists usually distinguish between inflation and a relative price increase. 'Inflation' refers to a sustained, across-the-board price increase, whereas 'a relative price increase' is a reference to an episodic price rise pertaining to one or a small group of commodities. This leaves a ***third phenomenon***, namely one in which there is a price rise of one or a small group of commodities over a sustained period of time, without a traditional designation. '**Skewflation**' is a relatively new term to describe this third category of price rise.

In India, food prices rose steadily during the last months of 2009 and the early months of 2010, even though the prices of non-food items continued to be relatively stable. As this somewhat unusual phenomenon stubbornly persisted, policymakers conferred on how to bring it to an end. The term 'skewflation' made an appearance in internal documents of the Government of India, and then appeared in print in the ***Economic Survey 2009–10*** GoI, MoF.

The **skewedness** of inflation in India in the early months of 2010 was obvious from the fact that food price inflation crossed the 20 per cent mark in multiple months, whereas wholesale price index (WPI) inflation never once crossed 11 per cent. It may be pointed out that the skewflation has gradually given way to a lower-grade generalised inflation (with the economy in the middle of 2011 inflating at around 9 per cent with food and non-food price increases roughly at the same level).

Given that other nations have faced similar problems, the use of this term picked up quickly, with the ***Economist*** magazine *(January 24, 2011)*, in an article entitled *'Price Rises in China: Inflated Fears'*, wondering if China was beginning to suffer from an Indian-style skewflation.

GDP DEFLATOR

This is the ratio between GDP at *Current Prices* and GDP at *Constant Prices*. If GDP at Current Prices is equal to the GDP at Constant Prices, GDP deflator will be 1, implying no change in price level. If GDP deflator is found to be 2, it implies rise in price level by a factor of 2, and if GDP deflator is found to be 4 , it implies a rise in price level by a factor of 4. GDP deflator is acclaimed as a *better measure* of price behaviour because it covers all goods and services produced in the country (because the weight of services has not been equitably accounted in the Indian 'headline inflation', i.e., inflation at the WPI).

BASE EFFECT

It refers to the impact of the rise in 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). 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,

37. New Zealand passed a law to do this with a target of 0 to 2 per cent inflation with a provision that the Reserve Bank of New Zealand governor could be fired if inflation crossed the 2 per cent upper limit—now this target range has been revised to 1 to 3 per cent (Stiglitz & Walsh, ***Economics***, p. 849).

therefore, a similar absolute increase in the Price index in the current year will lead to a 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. For example:

	Price Index				Inflation		
	2007	2008	2009	2010	2008	2009	2010
Jan	100	120	140	160	20	16.67	14.29

The index has increased by 20 points in all the three years – 2008, 2009, 2010. However, the inflation rate (calculated on 'year-on-year' basis) tends to decline over the three years from 20 per cent in 2008 to 14.29 per cent in 2010. This is because the absolute increase of 20 points in the price index in each year increases the *base year price index* by an equivalent amount, while the absolute increase in price index remains the same. The 'year-on-year' inflation is calculated by the formula :

Current Inflation Rate = [(Current Price Index – Last year's Price Index)] ÷ Last year's Price Index] x 100

EFFECTS OF INFLATION

There are multi-dimensional effects of inflation on an economy both at the micro and macro levels. It redistributes income: distorts relative prices: destabilises employment, tax, saving and investment policies, and finally it may bring in recession and depression in an economy. We may have a brief and objective look on the effects of inflation as given below:

1. On Creditors and Debtors

Inflation redistributes wealth from creditors to debtors, i.e., lenders suffer and borrowers benefit out of inflation. The opposite effect takes place when inflation falls (i.e., deflation).

2. On Lending

With the rise in inflation, lending institutions feel the pressure of higher lending. Institutions don't revise the nominal rate of interest as the 'real cost of borrowing' (i.e., nominal rate of interest minus inflation) falls by the same percentage with which inflation rises.

3. On Aggregate Demand

Rising inflation indicates rising aggregate demand and indicates comparatively lower supply and higher purchasing capacity among the consumers. Usually, higher inflation suggests the producers to increase their production level as it is generally considered as an indication of higher demand in the economy.

4. On Investment

Investment in the economy is boosted by the inflation (in the short-run) because of two reasons:

(i) Higher inflation indicates higher demand and suggests enterpreneurs to expand their production level, and

(ii) Higher the inflation, lower the cost of loan (as shown above in no. 2)

5. On Income

Inflation affects the income of individual and firms alike. An increase in inflation makes the 'nominal' value of income increase while the 'real' value of income remains the same. Increased price levels erode the puchasing power of the money in the short-run but in the long-run the income levels also increase (making the nominal value of income going upward). It means, in a given period of time income may go up due to two reasons, viz., inflationary siituation and increased earning. The concept 'GDP Deflator' (GDP at current prices divided by GDP at constant prices) gives the idea of 'inflation effect' on income over a period.

6. On Saving

Holding money does not remain an intelligent economic decision (because money loses value with every increase in inflation) that is why people visit banks more frequently and try to hold least money with themselves and put maximum with the banks in their saving accounts. This is also known as the ***shoe leather cost***[38] of inflation (as it consumes the precious time of the people visiting the bank frequently tagging their shoe). It means that saving rate increases. But this happens as a short-term effect of inflation. In the long-run, higher inflation depletes the saving rate in an economy. Just the opposite situation arises when inflation falls or shows falling traits with decreasing saving, in the short-run and increasing saving in the long-run, respectively.

7. On Expenditure

Inflation affects both the forms of expenditures —consumption as well as investment. Increased prices make our consumption levels fall as goods and services we buy get costlier. We see a tendency among the people to cut their consumption levels aimed at neutralising the impact of price rise—making consumption expenditure fall. Exact opposite happens once prices head downward.

On the other hand inflations makes 'investment' expenditure increase as a result of decreased cost of money/finance (inflation brings benefit to borrower—known as 'inflation premium'). In times of price fall just opposite happens.

8. On Tax

On tax structure of the economy, inflation creates two distortions:

(i) Tax-payers suffer while paying their direct and indirect taxes. As indirect taxes are imposed ad valorem (***on value***), increased prices of goods make tax-payers to pay increased indirect taxes (like cenvat, vat, etc., in India).

Similarly, due to inflation, direct tax (income tax, interest tax, etc.) burden of the tax-payers also increases as tax-payer's gross income moves to the upward ***slabs*** of official tax brackets (but the real value of money does not increase due to inflation; in fact, it falls). This problem is also known as ***bracket creep***—i.e., ***inflation-induced tax increases.***[39] Some economies (as in the US and many European countries) have ***indexed*** their tax provisions to neutralise this distortion on the direct tax payers.

(ii) The extent to which tax collections of the government are concerned, inflation increases the nominal value of the gross tax revenue while real value of the tax collection does not compare with the current pace of inflation as there is a lag (***delay***) in the tax collection in all economies.

But governments get an advantage on their interest burden on their borrowings as inflation benefits borrowers. This benefit, however, depends upon the contemporary levels of fiscal deficit and the total national debt.

In the case of a government incurring high fiscal deficit (increased borrowing, printing currency) inflation functions as a tax, i.e., ***inflation tax*** via which the government fulfils its expenditure by cutting down the expenditure and consumption of the people.

38. Samuelson & Nordhaus, op. cit., p. 674.
39. Samuelson & Nordhaus, op. cit., p. 674.

9. On Exchange Rate

With every inflation the currency of the economy ***depreciates*** (loses its exchange value in front of a foreign currency) provided it follows the flexible currency regime. Though it is a comparative matter, there might be inflationary pressure on the foreign currency against which the exchange rate is compared.

10. On Export

With inflation, exportable items of an economy gain competitive prices in the world market. Due to this, the volume of export increases (keep in mind that the value of export decreases here) and thus export income increases in the economy. It means export segment of the economy benefits due to inflation. Importing partners of the economy exert pressure for a stable exchange rate as their imports start increasing and exports start decreasing (see the next point).

11. On Import

Inflation gives an economy the advantage of lower imports and import-substitution as foreign goods become costlier. But in the case of compulsory imports (i.e., oil, technology, drugs, etc.) the economy does not get this benefit and loses more foreign currency instead of saving it.

12. On Trade Balance

In the case of a developed economy, inflation makes trade balance favourable while for the developing economies inflation is unfavourable for their trade balance. This is because of composition of their foreign trade. The benefit to export which inflation brings in to a developing economy is usually lower than the loss they incur due to their compulsory imports which become costlier due to inflation.

13. On Employment

Inflation increases employment in the short-run but becomes neutral or even negative in the long run (see the Phillips Curve and the NAIRU in the earlier sections).

14. On Wages

Inflation increases the nominal (face) value of the wages while their real value falls. That is why there is a negative impact of inflation on the purchasing power and living standard of the wage employees. To neutralise this negative impact the Indian government provides ***dearness allowance*** to its employees twice a year.

15. On Self-employed

Inflation has a neutralising impact on the self-employed people in the short-run. But in the long run they also get affected as the economy as a whole gets affected.

16. On Economy

All the segments discussed above belong to an economy, but we must know the overall short-term and long-term impacts of inflation on an economy.

Experiences of the world economies in the late 1980s that a particular level of inflation is healthy for an economy. This specific level of inflation was called as the 'range' of inflation and every economy needs to calculate its own range. Inflation beyond both the limits of the range is never healthy for any economy. In the case of India it is considered 4 to 5 per cent which is also known as the 'comfort zone' of inflation in India. Similarly for Australia, New Zealand, the USA, Canada and the European Union healthy range today is 1 to 3 per cent. This is why every economy today utilises ***inflation targeting*** as part of its monetary policy.

Inflation beyond the limits of the decided/prescribed range brings in recession to depressions. (We will see them in the Section B of this Chapter 'Business Cycle.)

INFLATION IN INDIA

Every economy calculates its inflation for efficient financial administration as the multi-dimensional effects of inflation make it necessary. India calculates its inflation on two price indices i.e., the wholesale price index (WPI) and the consumer price index (CPI). While the WPI-inflation is used at the macro level policy making, the CPI-inflation is used for micro level analyses. The inflation at the WPI is the inflation of the economy. Both the indices follow the 'point-to-point' method and may be shown in ***points*** (i.e .,digit) as well as in ***percentage*** relative to a particular ***base year***.

WHOLESALE PRICE INDEX

The first index number of wholesale prices commenced in India for the week January 10, 1942. It was having the base week ending August 19, 1939 = 100 which was published by the office of the Economic Adviser to the Government of India (Ministry of Industry).[40] Independent India followed the same series with more number of commodities included in the index. Several changes regarding inclusion of commodities, assigning them the logical weights took place in the coming times including revisions in the ***base years*** for the WPI. The WPI base year has been revised five times till date. The base years are as given below:

(i) 1952–53 Base Year (112 Commodities) issued from June 1952.

(ii) 1961–62 Base Year (139 Commodities) issued from July 1969.

(iii) 1970–71 Base Year (360 Commodities) issued from January 1977.

(iv) 1981–82 Base Year (447 Commodities) issued from January 1989.

(v) 1993–94 Base Year (435 Commodities) issued from July, 1999.

(vi) 2004-05 Base Year (676 Commodities) released in September 2011.

(vii) 2011–12 Base Year (676 Commodities), revised in January 2015.

NEW SERIES OF WPI

With the purpose of making inflation data in India more transparent, updated and similar to the practices among most of the economies, a ***Working Group for Revision of WPI Number*** was set up under the Chairmanship of the Planning Commission member, Prof. Abhijit Sen. In light of the recommendations the government recently announced the *New Series of Wholesale Price Index.*

Headline inflation in India is measured in terms of Wholesale Price Index (WPI) and the Office of the Economic Adviser, Department of Industrial Policy & Promotion is entrusted with the task of releasing this index. 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.

It is one of the key variables for monetary policy changes by the Reserve Bank of India. In addition to its role as a policy variable, WPI is also used by various departments for arriving at the escalation costs of various contracts.

Considering the importance of WPI as a tool for various policy decisions, it is necessary to disseminate the most comprehensive, credible and

40. ***Economic Survey, 2006–07,*** MoF, GoI, p. 85

accurate information, reflecting the realities of the present economic situation of the country. In order to capture the structural changes happening in the economy, the base year of WPI needs to be updated.

The Office of the Economic Adviser undertook the work relating to revision of the existing series of WPI (base 1993–94=100), which not only addressed the issue of change in the base year, but also revised the entire commodity basket and the weighting diagram so as to better reflect the price trends in economy. The revised series of WPI was officially launched on **September 14, 2010** by the Ministry of Commerce & Industry.

Features of the Revised Series of WPI

A representative commodity basket comprising **676 items** has been selected in the new series (base 2004–05=100) as against 435 in the old series (base 1993–94=100) and weighting diagram has been derived for the new series consistent with the structure of the economy. There has been a substantial increase in the number of quotations selected for collecting price data for the above items. The number of price quotations for the new series is **5482** whereas in the old series, it was 1918.

The selection of the base year and the commodity basket was made on the basis of the recommendations of the Working Group set up specifically for this purpose. The Working Group was headed by Professor Abhijit Sen, Member, Planning Commission and included as its members all stake–holders covering the users of the price data and the providers of the prices. The working group in its Technical Reports gave detailed recommendations with regard to the choice of the base year, the method of selection of items, preparation of weighting diagram and the collection of prices. The new index along with the base year and the commodity basket was also examined by the Technical Advisory Committee (TAC) on Prices and Cost of Living based in Central Statistical Organisation. Before the launch of the new index, inter-departmental consultations were held and opinions obtained from the Economic Advisory Council of the Prime Minister.

A comparative statement of weights, number of items and number of quotations between the **old series** and **new series** at Group level is as below:

Major Group / Group	*Weight*		*No. of items*		*No. of Quotations*	
	2004–05	*1993–94*	*2004–05*	*1993–94*	*2004–05*	*1993–94*
All Commodities	100.00	100.00	676	435	5482	1918
Primary Articles	20.12	22.02	102	98	579	455
Fuel & Power	14.91	14.23	19	19	72	72
Manufactured Products	64.97	63.75	555	318	4831	1391

Many new items have been included in the new series basket such as flowers, lemon and crude petroleum in **Primary Articles** and ice cream, canned meat, palm oil, readymade/ instant food powder, mineral water, computer stationary, leather products, scooter / motorcycle tyre, polymers, petrochemical intermediates, granites, marbles, gold and silver, construction machinery, refrigerators, computers, dish antenna, transformer, microwave oven, communication equipments (telephone instruments), TV sets, VCD, washing machine and auto parts in **Manufactured Products**.

REVISED SERIES: NEW INITIATIVES

There has been a substantial increase, both in terms of the number of commodities and its geographical coverage, in the revised series of WPI (base 2004–05=100), as compared to the earlier revisions undertaken so far.[41] This would, undoubtedly, disseminate the more realistic and reliable data, facilitating better decision making and policy intervention.

The revised series of WPI (base 2004–05=100) has also addressed the issue of flow of regular data. The NIC unit of the Office of the Economic Adviser has developed an online data transmission mechanism, whereby, the manufacturing units can supply price data through internet. Also, an arrangement has been made with National Sample Survey Office (Field Operations Division) to get price data on regular basis. These measures have improved the flow of price data.

The launch of the new series of WPI with base year 2004–05 has been one of the major initiatives of the Ministry of Commerce & Industry. New series of WPI in likely to be released mid-2015.

Since **November 2009** the WPI data are already being released in the following way:

(i) the first set of data of WPI (for the *'Manufacturing Products'*) are released on monthly basis.

(ii) the second set of data of WPI (for the *'Primary Articles'* and *'Energy and Fuel Group'*) are released on weekly basis.

CONSUMER PRICE INDEX

Other than the WPI, India also calculates inflation at the consumer level, similar to all the economies of the world. As consumers in India show wide differentiation of their choice of consumption, purchasing powers. etc., a single consumer price index (CPI) has not been possible yet which can encompass all the Indian consumers.[42]

Depending upon the socio-economic differentiations among consumers, India has four differing sets of CPI with some differentials in the basket of commodities allotted to them. Though these four types of CPIs is proposed to be withdrawn in coming times, data for them are still released. A brief account of the four CPIs are as under:

1. CPI-IW

The Consumer Price Index for the industrial workers (CPI-IW) has 260 items (plus the services) in its basket with 2001 as the base year[43] (the first base year was 1958–59). The data is collected at 76 centres with one month's frequency and the index has a time lag of one month.

Basically, this index specifies the government employees (other than banks' and embassies' personnel). The wages/salaries of the central government employees are revised on the basis of the changes occurring in this index, the dearness allowance (DA) is announced ***twice*** a year. When the Pay Commission recommends pay revisions, the base is the CPI (IW).

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41. The three major classifications of the items in the WPI were followed for the first time when India went for the third revision of the prices with 1970–71 as the base year which was introduced in January 1977. The same classification is followed till date with changes in the assignments of weights to the items (***MoF, Economic Survey*** 2006–07, GoI N. Delhi, p. 85).
42. The economies of the Euro-American region have a single CPI as the majority of consumers show the same consumer behaviour (see Rosser and Rosser, ***Comparative Economics in a Transforming World Economy,*** Prentice-Hall, MIT Press, Cambridge, USA, 2004).
43. ***Economic Survey 2006–07,*** op. cit, p. 90.

2. CPI-UNME

The Consumer Price Index for the Urban Non-Manual Employees (CPI-UNME) has 1984–85 (first base year was 1958–59) as the base year and 146–365 commodities in the basket for which data is collected at 59 centres in the country—data collection frequency is monthly with two weeks time lag.[44]

This price index has limited use and is basically used for determining dearness allowances (DAs) of employees of some foreign companies operating in India (i.e., airlines, communications, banking, insurance, embassies, and other financial services). It is also used under the Income Tax Act to determine ***capital gains*** and by the CSO (Central Statistical Organisation) for deflating selected service sector's contribution to the GDP at factor cost and current prices to calculate the corresponding figure at constant prices.

On the advice of its governing council the NSSO (National Sample Survey Organisation) is at present conducting a Family Living Survey (FLS) to obtain the profile of the present consumption pattern of urban non-manual employees so that the CPI (UNME) could be shifted to the present base year.

Presently, the CSO is also examining the possibility of constructing a consumer price index for the urban employees (a new index which might be like CPI–UE).

3. CPI-AL

The Consumer Price Index for Agricultural Labourers (CPI-AL) has 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.

This index is used for revising minimum wages for agricultural labourers in different states. As the consumption pattern of agricultural labourers has changed since 1986–87 (its base year), the Labour Bureau proposes to revise the existing base year of this index. For the revision, the consumer expenditure data collected by the NSSO during its 61st NSS Round (2004–05) is proposed to be used.

The governments at the Centre and states remain vigilant regarding the changes in this index as it shows the price impact on the most vulnerable segment of the society, this segment spends almost 75 per cent of its total income on the purchase of food articles. Governments' failure to stabilise the index in the long range can make them politically volatile and be translated into political debacles. That is why the FCI is always kept ready to supply cheaper foodgrains in the situations of any price rise.

4. CPI-RL

There is yet another Consumer Price Index for the Rural Labourers (CPI-RL) with 1983 as the base year, data is collected at 600 villages on monthly frequency with three weeks time lag, its basket contains 260 commodities.

The agricultural and rural labourers in India create an overlap, i.e., the same labourers work as the rural labourers once the farm sector has either low or no employment scope. Probably, due to this reason this index was dropped by the government in 2001–02.[45] But after the government change at the Centre the index was revived again.[46]

Revision in the CPI

It was in 2011 that the government announced a new Consumer Price Index (CPI) – CPI (Rural);

44. ***Economic Survey 2001–02,*** op. cit, p. 90.
45. ***Economic Survey, 2001–02,*** op. cit., p. 91.
46. ***Economic Survey, 2006–07,*** op. cit., p. 90.

CPI (Urban) and by combining them a 'national' CPI-C (where 'C' stands for 'Combined'). Menawhile, the data for the existing four CPIs were also being published by the CSO. The Base Year was also revised from the existing 2004–05 to 2010–11.

In **February 2015,** the CPI was ***again*** revised by the CSO. Together with changing the Base Year, in this revision, many ***methodological changes*** have been incorporated, in order to make the indices more robust. The major changes introduced in the revised series are as given below:

1. The Base Year has been changed from 2010=100 to 2012=100.
2. The basket of items and their weighing diagrams have been prepared using the Modified Mixed Reference Period (MMRP) data of Consumer Expenditure Survey (CES), 2011–12, of the *68th Round* of National Sample Survey (NSS). This has been done to make it consistent with the *international practice* of shorter reference period for most of the food items and longer reference period for the items of infrequent consumption. The weighing diagrams of old series of CPI were based on the Uniform Reference Period (URP) data of CES, 2004–05, of the 61st Round of NSS.

   With this change in the weighing diagrams, the gap between Weight Reference Year and Price Reference Year (Base Year), which was *six years* in the old series, has now been reduced to *six months* only. Due to change in the *consumption pattern* from 2004–05 to 2011–12, the weighing diagrams (share of expenditure to total expenditure) have changed. A comparison of weighing diagrams of the old and revised series is given below:

Comparison of weighing diagrams of the existing and revised series of CPI

Group Description	Old Series of CPI (Weights computed on the basis CES 2004–05)			Revised Series of CPI (Weights computed on the basis CES 2011–12)		
	Rural	Urban	Combd.	Rural	Urban	Combd.
Food and beverages	56.39	35.81	47.58	34.18	36.29	45.86
Pan, tobacco and intoxicants	2.72	1.34	2.13	3.26	1.36	2.35
Clothing and Foodwear	5.36	3.91	4.73.	7.36	5.57	6.53
Housing	–	22.54	9.77	–	21.67	10.07
Fuel and Light	10.42	8.40	9.49	7.94	5.50	6.84
Miscellaneous	24.91	28.00	26.31	27.26	29.53	28.32
Total	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**

Source: CSO, February 2015. Here, 'Combd.' stands for Combined while '-' stands for 'not available'.

3. The number of *Groups,* which was five in the old series, has now been increased to **six**. 'Pan, tobacco and intoxicants', which was a Sub-group under the Group 'Food, beverages and Tobacco', has now been made as a separate Group. Accordingly, the Group 'Food, beverages and Tobacco' has been changed to 'Food and beverages'.
4. Egg, which was part of the Sub-group 'Egg, fish and meat' in the old series, has now been made as a separate Sub-group. Accordingly, the earlier Sub-group has been modified as 'Meat and fish'.

5. The elementary/item indices are now being computed using Geometric Mean (GM) of the Price Relatives of Current Prices with respect to Base Prices of different markets in consonance with the international practice. In the old series, Arithmetic Mean (AM) was used for that purpose. The advantage of using GM is that it moderates the volatility of the indices as GM is less affected by extreme values.
6. Prices of PDS items under Antyodaya Anna Yojana (AAY) have also been included for compilation of indices of PDS items, in addition to Above Poverty Line (APL) and Below Poverty Line (BPL) prices being taken in the old series.
7. Sample size for collection of house rent data for compilation of *House Rent Index,* which was 6,684 rented dwellings in the old series, has now been doubled to 13,368 rented dwellings in the revised series.
8. Apart from All-India CPIs (Rural, Urban, Combined) for Sub-group, Group and General Index (All-Groups), which were released for the old series, all India Item CPIs (Combined) will also be available.
9. The Consumer Food Price Indices (Rural, Urban, Combined) will be compiled as weighted average of the indices of following Sub-groups, as practiced earlier in the old series (only the weights have been revised):

All India Weights of different Sub-groups within Consumer Food Price Index

Sub-Group Code	Sub-group Description	Rural	Urban	Combined
(1)	(2)	(3)	(4)	(5)
1.1.01	Cereals and products	26.14	22.24	24.77
1.1.02	Meat and fish	9.26	9.23	9.25
1.1.03	Egg	1.05	1.21	1.10
1.1.04	Milk and products	16.34	17.98	16.92
1.1.05	Oils and fats	8.90	9.49	9.11
1.1.06	Fruits	6.10	9.80	7.40
1.1.07	Vegetables	15.78	14.88	15.46
1.1.08	Pulses and products	6.25	5.84	6.11
1.1.09	Sugar and confectionery	3.61	3.28	3.49
1.1.10	Spices	6.57	6.05	6.39
All Sub-groups of CFPI		100.00	100.00	100.00

Source: CSO, February 2015. Here, CPFI stands for Consumer Food Price Index.

TRENDS IN INFLATION

Inflation has been a highly sensitive issue in India right since Independence and it has been so during the ongoing reforms process period, too. It has an incessant tendency of resulting into 'double digits', taking politically explosive proportions like governments falling at the Centre and state levels due to price rise of the commodities such as edible oil, onion, potato, etc. In such situations the government in general has been taking recourse to tighter money supply to contain the state level disturbances due to price rise of the commodities such as edible oil, onion, potato, etc., although it has contained inflation,

but at the cost of higher growth. Price rise got rooted in India's political psyche in such a way that the government did check frequent famines quickly at the cost of long-term endemic hunger and sustained malnutrition.[47]

Decadal inflation in India looks comparatively normal with reference to many developing economies.[48] But it has sporadic incidences of double-digit tendencies mainly due to supply-side shortfalls caused by droughts (monsoon failures), price rise of crude oil in the international market or fund diversions due to wars (the Chinese war of 1962 and the Pakistan wars of 1965–66 and 1971). The decadal inflation in India has been as given below:[49]

(i) *During 1950s:* remained at 1.7 per cent.

(ii) *During 1960s:* remained at 6.4 per cent.

(iii) *During 1970s:* remained at 9.0 per cent.

(iv) *During 1980s:* remained at 8.0 per cent.

(v) *During 1990s:* remained at 9.5 per cent (though it reached 0.5 per cent by the fourth quarter of the fiscal 1998–99)

(vi) *During 2000s:* Inflation was at lower levels between 2000–08 (from 3 to 5 per cent). But from 2009 onwards it started moving upward with 'sttuborn' tendencies.[50] Between 2009–13, the headline inflation remained stuck at uncomfortable levels, primarily due to 'food articles' *(food inflation)* led by protein-rich items *(protein inflation)* in the consequence of shift in dietary habit, income effect (via MGNREGA kind of schemes), increased wages, increase in prices of commodities in the global market (specially, food articles), costlier fodder, costlier energy and fuel, etc. By late 2010, India had the phenomenon of *'skewflation'* with inflation being in the range of 9–10 per cent.

(vii) *During 2010s:* Headline inflation remained persistently high at 6-9 per cent during 2011–13 *(Economic Survey 2014–15)*. It started moderating by mid-2014. By ***March 2015*** it was in negative (-2.06 per cent)—remaing in negative for the fourth straight month. The softening in inflation was primarily led by fall in the prices of oil, food articles (vegetables, fruits).[51] It gave the RBI a space for 'rate cut' aimed at promoting investment in the economy.

An analysis of inflationary trends in India does not pin-point any one reason behind it. Economists have pointed out all possible reasons (the so-called ***'good'*** and ***'bad'***) behind the inflationary pressures in the economy of which we may have a brief review:

1. Structural Inflation

With few exceptional years, India has been facing the typical problem of bottleneck inflation (***i.e., structural inflation***) which arises out of shortfalls in the supply of goods, a general crisis of a developing economy, rising demand but lack of investible capital to produce the required level of goods.[52] Whenever the government managed to go for higher growths by managing higher

47. Pranab Bardhan agrees to Amartya Sen *(How is India doing?*, New York Review of Books, Dec. 1982) in *A Political Economy Perspective on Development* in Bimal Jalan ed. *Indian Economy; Problems and Prospects,* Penguin Books, N. Delhi, 1992, p. 369.
49. Rosser, J.B and Rosser, M.V, op. cit.
49. Based on Rangarajan, C., 1998, op. cit., p. 63; Jalan, Bimal, 2004, op. cit., pp. 182–191.
50. **Economic Survey 2013-14**, MoF, GoI, N. Delhi, pp. 75-77.
51. **Economic Survey 2014-15**, MoF, GoI, N. Delhi, Vol. 2, pp. 69-75.
52. Desai, Meghnad, 'Development Perspectives' ***in I.*** J. Ahluwalia and I.M.D. Little, Ed., ***India's Economic Reforms and Development,*** Oxford University. Press, N. Delhi, 1998, p. 41.

investible capital it had inflationary pressures on the economy (seen during 1970s and 1980s, especially) and growth was sacrificed at the altar of lower inflation (which was politically more justified).[53] Thus, the supply-side mismatch remained a long-drawn problem in India for higher inflation. After some time even if the government managed higher expenditure, most of it went to the non-developmental areas which did show low growth with higher inflation–signs of a stagnating economy.

2. Cost-Push Inflation

Due to 'inflation tax' the price of goods and services in India have been rising as the government took alternative recourse to increase its revenue receipts.[54] We see it taking place due to higher ***import duties*** on the raw materials also.[55] The ***non-value-added*** tax (non-VAT) structure of India in the past was also having cascading effect on the prices of commodities in the country.[56] The government needed higher revenues to finance its planned development thus the above given factors looked inescapable.

3. Fiscal Policy

To finance the developmental requirements of the economy, the governments became trapped in the cyclical process of over-money supply. At first it was done by external borrowings, but by the late 1960s onwards (once ***deficit financing*** got acceptance around the world) the governments started taking recourse to heavy internal borrowings as well as printing of fresh currency too. A major part of the government's internal borrowing is contributed by the Reserve Bank of India (RBI) which leads to price rise.[57] For any government deficit if the Central Bank (RBI) is purchasing primary issues of the Government securities or creating fresh advances to the government the combined effect has to be higher inflation, lower savings rates and lower economic growth[58]—the vices of unsound fiscal policy. The higher fiscal deficit tends to bring about higher interest rates as demand for funds rise, excess demand raises expected inflation and expected depreciation of the currency[59]. Once the foreign exchange (Forex) reserves started increasing with a faster pace by the early 2000–01 fiscal, its cost of maintenance has been translated into higher prices, as the RBI purchases the foreign currencies it supplies into equivalent rupees into the economy which creates extra demand and the prices go up.[60]

The higher revenue deficits (driven by high interest payments, subsidies, salaries and pensions, basically) and fiscal deficits make the government supply more money which push the inflation in the upward direction. Once the Fiscal and Budget Management Act came into force in 2003, the scenario improved in the coming times. Though the period from 1999 to 2003 did show high growth with low inflation and the lowest interest rates in India.

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53. Jalan Bimal, ***India's Economic Policy,*** Penguin Books, N. Delhi, 1992, pp. 52–58.
54. Rangarajan, C., 'Development, Inflation and Monetary Policy', in Ahluwalia and Little , Ed., ***India's Economic Reforms and Development***, op.cit., pp. 56–57.
55. Jalan, Bimal, pp. 191–203.
56. ***Chelliah Committee Report,*** 1993.
57. Dandekar, V.M. 'Forty Years After Independence', ***India's Economic Policy,*** in the Bimal Jalan Ed., ***Indian Economy: Problems and Prospects,*** pp. 84–88.
58. Reddy, Y. V., ***Lectures on Economic and Financial Sector Reforms in India,*** Oxford University Press, N. Delhi, 2002, pp. 176–177.
59. Goyal, Ashima, 'Puzzles in Indian Performance: Deficits without Disasters', in Kirit S. Parikh and R. Radhakrishna (Eds.) IGIDR's ***India Development Report,*** 2004–05, Oxford University Press, N. Delhi, 2005, p. 191–208.
60. Basu, Kaushik, ***India's Emerging Economy: Performance and Prospects in the 1990s and Beyond,*** Oxford University Press, N. Delhi, 2004, pp. 89–103.

HEALTHY RANGE OF INFLATION

Higher inflation and higher growth as a trade-off was questioned in the late-1980s by the developed economies as the economic and social costs of higher inflation also needed policy attention—a costly 'trade-off'.[61] In coming times, most of the world economies went in favour of a stable inflation (i.e., ***inflation targeting***) though the idea has been ***protested.***[62] India also started inflation targeting by the early 1970s. It was in 1973 that the inflation crossed 20 per cent mark on account of the international oil price rise and the government (the Indira Gandhi Government) devised a severe anti-inflation package which included directly restricting the disposable incomes of the people (this measure was used for the *first* time in India[63]). The package had an impact and by March 1975 the inflation calmed down to 5.7 per cent. This was the time when the RBI was given a new function 'inflation stabilization' and India entered the era of monetary controls for inflation. With inflation targeting there started a debate concerning the healthy range of inflation for the Indian economy, i.e., by mid-1970s. We may have some official and non-official versions of the suitable range of inflation pointed out from time to time:

(i) The ***Chakravarty Committee (1985)*** treated 4 per cent inflation acceptable for the economy in its report on the monetary system. He also added that this level of price rise will facilitate the purpose of attracting investment for the desired level of growth.

(ii) The ***Government of India*** accepted a range of 4 to 6 per cent inflation as acceptable for the economy citing the world average of 0 to 3 per cent at the time (1997–98).[64]

(iii) The RBI Governor ***C. Rangarajan*** advocated that inflation rate must come down initially to 6 to 7 per cent and eventually to 5 to 6 per cent on an average over the years.[65]

(iv) The ***Tarapore Committee*** on Capital Account Convertibility recommended an acceptable range of 3 to 5 per cent inflation for the three year period (1997–98 to 1999–2000).[66]

In the recent times (June 2003 onwards) the government/the RBI has maintained a general policy of keeping inflation below 5 per cent mark—at any cost—as if fixing 4 to 5 per cent as the healthy range of inflation for the economy.[67]

The medium-term objective (i.e., target) of the government is to keep inflation in the 4–4.5 per cent range.[68] One thing should be kept in mind that inflation has always been a political matter in the country. Every time the RBI tried to check the rising inflation via monetary measures a majority of experts objected to it by calling it

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61. Fischer, S., 'Modern Central Banking', in F. Capie, C. Goodhart, S. Fischer and N. Schnadt, Eds, ***The Future of Central Banking, The Tercentenary Symposium of the Bank of England,*** Cambridge University Press, Cambridge, 1994, pp. 262–308.
62. Krugman, P., **'Stable Prices and Fast Growth: Just Say No'**, ***Economist 31***, 1996, pp. 15–18.
63. Ahluwalia and Little, ***India Economic Reforms and Development***, p. 2.
64. ***MoF, Economic Survey 1997–98,*** GoI, p. 92.
65. Rangarajan, C., 1998, op. cit., pp. xii & 61–63.
66. We may refer to almost all the Credit and Monetary Policies announced by the RBI during this period.
67. As the RBI put it in its Credit and Monetary Policy Review of July 31, 2007.
68. It should be noted here that the level of inflation was below 5 per cent till the new Government came to power and the outgoing Government was blamed to freeze the inflation data to a more politically digestable level (i.e., below 5 per cent). The new Government in the process of preparing a producer price index (PPI) has also committed to make the inflation data automated like the share indices.

a move to sacrifice growth for lower price levels. A tighter monetary policy decelerates investment and growth, hampers the growth prospects of the middle class in general and the entrepreneurs in particular while the wage-earners as well as the poor segment of society feels relieved (at least in short term).

By **February 2015**, the GoI did put in place a mechnaism to 'target' inflation (Agreement on Monetary Policy Framework) under which the Consumer Price Index (Combined) is to be targeted by the RBI between the range of 2 to 6 per cent on the annual basis. Thus, the focus is shifting to the CPI from WPI. This way, in place of the WPI-based inflation, the CPI-C inflation has been made the 'anchor' rate of inflation for mentary policy purpose.

Producer Price Index

A working group was set up in mid-2003–04 under the chairmanship of Prof. Abhijit Sen, Member, Planning Commission to fulfil the twin tasks of:

(i) revising the current series of WPI (i.e., base 1993–94) and
(ii) recommending a producer price index (PPI) for India which could replace the WPI.

The sub-groups of the working group have submitted their reports and the procees of revision in the base year for WPI is at the final stage. The new series (***base year***) for the WPI has been revised to 2004–05.

The proposal of switching over to the PPI (from the WPI) came up from the government by mid-2003 and the working group has been getting inputs from the IMF regarding it. The PPI measures price changes from the perspective of the producer while the consumer price index (CPI) measures it from the consumers' perspective. Wholesellers charge higher prices to retailers, in turn retailers charge higher prices to consumers and the price increase is translated into the higher consumer prices—thus the PPI is useful in having an idea of the consumer prices in the future.[69] In PPI, only basic prices are used while taxes, trade margins and transport costs are excluded. This index is considered a better measure of inflation as price changes at primary and intermediate stages can be tracked before it gets built into the finished goods stage.[70] Due to its better use many economies have switched over to the PPI—the oldest such series is maintained by the Bureau of Labor Statistics (BLS) for the US economy—the index is capable of measuring prices at the wholesaler or the producer stage—widely used by private business houses in their price targetting.[71]

Once India shifts from the WPI to the upcoming PPI, the economy is supposed to have a better idea about the trends of inflation.

Housing Price Index

India's official Housing Price Index (HPI) was launched by the Finance Minister on 9 July 2007 in Mumbai. Basically developed by the Indian home loans regulator, the National Housing Bank (NHB) the index is named ***NHB Residex***. Presently, the index has been introduced as a pilot project for five cities—Bangalore, Bhopal, Delhi, Kolkata and Mumbai, which covers different localities in each of these cities for the five-year period (2001–05).

There are various concepts of housing price indices, and many sources and ways for compilling price data—both private and public. The methodology of constructing such indices

69. Stiglitz and Walsh, op. cit., p. 517.
70. ***Economic Survey 2006–07,*** op. cit., p. 92.
71. Samuelson and Nordhaus, op. cit., p. 441.

varies from country to country depending upon the use and purpose as well as the data availability. A Technical Advisory Group (TAG) was set up under the chairmanship of an adviser from the Ministry of Finance in 2006–07 which had members and experts from public and private bodies of the concerned field, i.e., NHB, CSO, RBI, HDFC, HUDCD, LIC Housing Finance Ltd., Labour Bureau, Dewan Housing Finance Corporation Ltd., and the Society for Development Studies (SDS). After reviewing international best practices and the methodology, sampling techniques, collection of price data for construction of real estate price indices in the USA (index developed by the office of Federal Housing Enterprise Dversight), Canada (New Housing price Index) and the UK (Halifax Index), the TAG suggested a proper methodology for India.

The TAG decided to take 2001 as the ***base year*** for the index which was consistent with the base period of the other indices, i.e., 2001 for the revised CPI (IW), 2000–01 for the revised WPI and 1999–2000 for the revised GDP series. The base year was revised to 2007 in March 2014.

With an overall objective of bringing transparency in the Indian real estate market, the index is expected to serve some highly important and timely purposes:

(i) Whether a broker is quoting too high a price for houses in the cities.

(ii) Banks/housing finance bodies will be able to estimate only if the loan applications are realistic for the properties.

(iii) This will also show the level of non-performing assets in the housing sector.

(iv) And most importantly it will serve as a realistic price index for the buyers. (At present a buyer has no means, to judge whether a rise in property price was in the offing with the general level of inflation (i.e., at WPI) in the country, or has been scaled up disproportionately. Other than quotes from brokers, there are no means at present to evaluate the changes in price in this sector. At present the only index that gave some idea of housing price changes was the CPI (IW) which being a national index did not show the ***regional variations***.)

In the next phase, the NHB will compile indices for 35 cities/towns with a population of more than a million (as per the census 2001). These indices are planned to be prepared on a half-yearly basis, to be subsequently expanded to cover 63 cities/towns covered under the Jawaharlal Nehru National Urban Renewal Mission (JNNURM).

SERVICE PRICE INDEX

The contribution of the tertiary sector in India's GDP has been strengthening for the past 10 years and today it stands above 60 per cent. The need for a service price index (SPI) in India is warranted by the growing dominance of the sector in the economy.[72] 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.

The need for such an index was recommended by the working group (under the Chairmanship of Prof. Abhijit Sen, Member, Planning Commission) set up to revise the WPI (1993–94) series which was reiterated by the National Statistical Commission (headed by C. Rangarajan). The office of the Economic Adviser, Ministry of Commerce and Industry has been making an effort to develop sector-specific service price index

72. ***Economic Survey 2006–07,*** op. cit., p. 94.

for the country with the technical assistance being received under the World Bank Assisted Economic Reforms Projects (WBAERPs). 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).

The basic studies of index construction are complete. Before formal launching of the index, the complete study is supposed to be discussed with academicians, practitioners and the users of the services. The need to construct a service price index for the economy was felt more after the *OECD-Eurosat Report of 2005* on the subject.[73]

HOUSEHOLD INFLATION EXPECTATIONS

Since September 2005, the RBI has been conducting quarterly inflation expectation surveys of households. The results of the latest survey covering 5,000 urban households across 16 cities were released in December 2014. The survey captures the inflation expectations for the next three-month and one-year period. The current inflation perceptions and inflation expectations have moderated in the latest round (38th Round).

The median inflation expectations over the next three months and one year have corrected sharply during the latest survey to 8.3 per cent from 14.6 per cent and to 8.9 per cent from 16 per cent in the previous quarter, respectively. ***Inflation in 2015–16*** is closely linked to the following factors, as per the survey:

(a) Crude oil prices may correct and start moving upward;
(b) Supply pressures due to lower oilseeds and pulses acerage;
(c) Capacity constraints in warehousing and cold-storage; and
(d) Seasonal commodities.

GOVERNMENT STEPS TO CONTROL INFLATION

The stubborn inflation of the last three years (particularly, the 'food inflation') cooled down by late 2014. The decline in inflation was substantial in commodities—the government took a series of measures to improve availability of foodgrains and de-clog the distribution channel. The ***major steps*** *(Economic Survey 2014–15)* taken by the government in recent times are as follows:

(a) Allocation of additional 5 million tonnes of rice to BPL and APL families pending implementation of the National Food Security Act (NFSA), and allocation of 10 million tonnes of wheat under open market sales for domestic market in 2014–15;
(b) Moderation in increases in the MSPs during the last and current season;
(c) Advisory to the states to allow free movement of fruits and vegetables by delisting them from the Agricultural

73. 'The number of National Statistical Agencies collecting service producer prices data, though growing, is still small', points out the ***OECO-Eurosat, 2005 Inquiry on National Collection of Services Producer Prices Preliminary Report,*** giving information on 45 such countries. The report further adds that while some such agencies have focused exclusively on the price of services provided to enterprises, others have approached the subject more broadly through the development of services producer price indices with varying approaches and coverage. As per the report, at present, 30 countries collect services producer prices while prelimilary works have started in the other countries, particularly the European countries under the auspices of the Eurosat. Other than the developed Euro-American economies some other countries which worked as inspiration for India which have such an index are China, Hong Kong, Czech Republic, Slovak Republic, Poland, Lithuania, Israel and Vietnam.

Produce Marketing Committee (APMC) Act;

(d) Bringing onions and potatoes under the purview of the Essential Commodities Act 1955, thereby allowing state governments to impose stock limits to deal with cartelization and hoarding, and making violation of stock limits a non-bailable offence;

(e) Imposing a minimum export price (MEP) of US$ 450 per MT for potatoes with effect from June 2014 and US$ 300 per MT for onions with effect from August 2014.

As per the *Survey*, for keeping food inflation low in a sustainable manner, more radical measures will have to be taken to revamp agriculture and food sector production, storage, marketing, and distribution – including the public distribution system (PDS) and NFSA.

CURRENT SCENARIO

After remaining high for a prolonged period, inflation has finally started trending down. India is supposed to see comfortable inflation levels during 2015–16. As per the *Economic Survey 2014–15:*

1. The Wholesale Price Index inflation declined to a comfortable level of around 3 per cent by November 2014. It breached the *psychological level* of 0 per cent by end- November 2014 and remained in 'negative' upto March 2015 (–2.06 per cent).
2. Consumer price inflation released by the CSO (base 2012=100) reached 5.1 per cent in January 2015. This is lower than the targets of 8 per cent set for January 2015 and 6 per cent for January 2016 given by the Reserve Bank of India in its report on the new Monetary Policy Framework. Prices of the major commodity groups contributing to high inflation, namely 'eggs, meat, and fish', fruits and vegetables, and fuel, have all softened.
3. The major developments driving the stubborn inflation down were:
   (a) Falling global commodity prices, especially of crude oil,
   (b) Decline in the growth rate of rural wages,
   (c) Moderation in the increase in minimum support prices as also
   (d) Economic slowdown.

Structural shift in the inflationary process is underway (as elaborated in the *Mid-Year Economic Analysis* 2014–15) by lower oil prices and deceleration in agriculture prices and wages. These are simultaneously being reflected in dramatically improved household inflation expectations.

SECTION-B

BUSINESS CYCLE

INTRODUCTION

The discussion on growth and development has shown their internal interdependence. If the quality of life in an economy is to be enhanced, there is a need of conscious public policy which can spend and invest in areas like food, nutrition, health, education, shelter, social security, etc.

But for such expenditures and investments, the economy needs equitable level of income, too. The income enhancement in any economy takes place via increasing the level of production in the economy, i.e., real gross national product (GNP). It means, development requires higher growth, i.e., higher levels of economic activities. With the help of suitable kind of economic policies, the government of an economy keeps trying to maintain a higher level of economic activity. But, at times, economy keeps failing in this objective. And, thus economies fluctuate between the best and the worst levels of economic activities which is known in economics as ***boom*** and ***depression***, respectively. They can be called different phases of the economic activities of the economies. In between boom and depression, there might be many other situations of the economic activities, such as—***stagnation***, ***slowdown***, ***recession*** and ***recovery***. The fluctuations in the level of economic activity between the depressions and booms has been called by the economists as ***business cycle*** or ***trade cycle*** with recession and recovery as the main intermediate stages.[74] Stagnation[75] and slowdown may be considered as other intermediate stages of the business cycle. We intend here to understand the actual meanings of each of the stages. Economists have pointed out that the business cycle is characterised by ***four*** phases or ***stages*** in which economies alternate:

(i) Depression
(ii) Recovery
(iii) Boom
(iv) Recession

DEPRESSION

Though depression has visited the world economy only once in 1929, economists have pin-pointed enough number of traits to recognise it. The ***major*** traits of depression could be as given below:

(i) an extremely low aggregate demand in the economy causes activities to decelerate;
(ii) the inflation being comparatively lower;
(iii) the employment avenues start shrinking forcing unemployment rate to grow fast;
(iv) to keep the business going, production houses go for ***forced labour-cuts*** or ***retrenchment*** (***to cut down production cost and be competitive in the market,***) etc.

The economic situations become so chaotic in the phase of depression that governments have almost no control over the economy. The Great Depression of 1929[76] gave rise to the ideas of ***strong government intervention***[77] in the economy, such as deficit financing, monetary management, etc.

What the governments may do if depression visits the economy? The simple answer the world has been able to find is to repeat the policy measures of 1929. The best way to avoid depression is not to let it visit. This is why every modern economy keeps extra-vigil on the major symptoms of its economy so that the prevention-measures can be taken in time and depression is avoided.

RECOVERY

An economy tries to come out of the low production phase to survive. The low production phase might

74. *Collins internet-linked Dictionary of Economics,* Glasgow, 2006 & *Oxford Business Dictionary,* N. Delhi, 2004.
75. Cox, Simon ed. *Economics,* The Economist, London; 2007, p. 60.
76. A very lively description of the Great Depression has been presented by ***Lee Iacocca*** in his autobiography. This is known as the Great Depression due to its length and depth—the economies could recover fully out of it only by the mid-1940s (*Stiglitz & Walsh, op.cit; p. 495*).
77. Suggested by John Meynard Keynes in his seminal work ***The General Theory of Employment, Interest and Money*** (Harcourt, New York, first published in 1935).

be depression, recession or slowdown with the former being the worst and rare, governments take many new fiscal and monetary measures to boost demand and production and ultimately a recovery in an economy is managed. The business cycle of recovery may show the following ***major*** economy traits:

(i) an upturn in aggregate (total) demand which has to be accompanied by increase in the level of production;

(ii) production process expands and new investments become attractive;

(iii) as demand goes upward, inflation also moves upward making borrowing cheaper for investors;

(iv) with an upturn in production, new employment avenues are created and unemployment rate starts declining; etc.

With the above symptoms, people's income go for a certain increase which creates new demand and a cycle of demand and production (supply) starts playing hand-in-hand to recover the economy. To recover an economy, governments usually go for tax-breaks, interest cuts, an increase in salaries of its employees, etc. Assimilation of innovations by the entrepreneurs and search for new frontiers of enterprise do play a very vital role in the process of recovery provided these activities are at first incentives by the governments.

The Euro-American economies recovered out of the Great Depression with the help of the measures cited above. Such recoveries have been seen many times around the world when economies recovered from slowdown or the recessionary phases. The best example of recent times could be cited from India of 1997 to 2002 when the economy suffered severe bouts of slowdown and recession.[78]

BOOM

A strong upward fluctuation in the economic activities is called boom.[79] As economies try to recover out of the phases of slowdown, recession and depression at times the measures taken by the governments as well as the private sector might put economic activities as such which the economic systems fail to digest. This is the phase of the ***boom.*** The ***major*** economic traits of boom may be listed as given below:

(i) an accelerated and prolonged increase in the demand;

(ii) demand peaks up to such a high level that it exceeds sustainable output/production levels;

(iii) the economy heats up and a demand-supply lag is visible;

(iv) the market forces mismatch (***i.e., demand and supply disequilibirium***) and tend to create a situation where inflation start going upward;

(e) the economy might face structural problems like shortage of investible capital, lower savings, falling standard of living, creation of a sellers' market.

The phase of recovery is considered good for the economy and it reaches the stage of boom which is considered better. But the boom has its negative side also. Boom is usually followed by price rise.[80] As a boom is a strong upward fluctuation in an economy, the supply-side pattern of the economy starts lagging behind the pace of the accelerated aggregate demand.[81] But the dilemma of recovery puts every economy on the path to boom—this has been the experience in the developed world during the 1990s, especially in the US economy. The same scenario developed in India after the

78. ***Economic Surveys, 1996–97 to 2002–03,*** MoF, GoI, N. Delhi.
79. Stiglitz & Walsh, op. cit., p. 945.
80. Samuelson and Nordhaus, op.cit. pp. 680–84.
81. Stiglitz and Walsh, op.cit. pp. 495–796.

economy recovered from the recessionary period of 1996–97 by the year 2002–03 when the rate of inflation peaked to almost 8 per cent for a few months. Majority of the experts felt that Indian economy at that time was passing through a phase of boom and we have seen how the government has been facing difficulty in containing inflation around the 5 per cent mark. Even the government accepted that the economy was over-heating by mid-2007. *The symptoms of overheating are as follows:*

(i) There is a downturn in the aggregate demand on overall fall in the demand;
(ii) as demand falls, the level of production (output) in the economy also falls;
(iii) as producers cut down their production levels, new employment opportunities are not created—thus employment growth rate falls;
(iv) as demand keeps on falling, usually producers start cutting down their labour force to adjust their overhead expenditure and the cost of production (labour-cut is not 'forced' here but, 'voluntary')—resulting in increase in the unemployment rate;
(v) if the government fails to rescue the economy from the phase of recession, the dangerous stage of ***depression*** remains the logical follow up;
(vi) the rate of inflation always remains at lower levels—discouraging new investments and lending.

RECESSION

This is somewhat similar to the phase of 'depression' — we may call it a *mild form* of depression — fatal for economies as this may lead to depression if not handled with care and in time. The financial crises which followed the US 'sub-prime crisis' in almost the whole Euro-American economies has basically brought in 'severe recessionary' trends there. Major traits of recession, to a great extent, are similar to that of 'depression' [except the point (iv) of the Depression, discussed earlier]—may be summed up as follows:

(i) there is a general fall in demand as economic activities takes a downturn;
(ii) inflation remains lower or/and shows further signs of falling down;
(iii) emloyment rate falls/unemployment rate grows;
(iv) Industries resort to 'price cuts' to sustain their business.

In the financial year 1996–97, the Indian economy was taken up by the cycle of recession—basically due to a general downturn in domestic as well as foreign demands, initiated by the South East Asian Currency Crisis of mid-1990s.[82] The whole plan of economic reforms in India was derailed and it was only by the end of 2001–02 that the economy was able to recover. What may a government do to rescue the economy from the phase of recession? The usual remedies are given below:

(i) Direct and indirect taxes should be cut down, so that the consumers have higher disposable incomes (income after paying direct tax, i.e., income tax) on the one hand and the goods should become cheaper on the other hand, thus there is hope that the demand might pick up.
(ii) The burden of direct taxes, especially the income tax, divdend tax, interest tax are slashed to enhance the disposable income (***i.e, income after direct tax payment***)—
(iii) Salaries and wages should be revised by the government to encourage general

82. ***Economic Survey, 1996–97***, MoF, GoI, N. Delhi.

spending by the consumers (as the Government of India implemented the recommendations of the fifth pay commission without much deliberation in 1996–97).

(iv) Indirect taxes such as custom duty, excise duty (cenvat), sales tax, etc., should be cut down so that produced goods reach the market at cheaper prices.

(v) The government usually goes on to follow a cheap money supply policy by slashing down interest rates across the board and the lending procedure is also liberalised.

(vi) Tax breaks are announced for new investments in the productive areas, etc.

All the above-given measures were taken up by the United Front Government in 1996–97 to pull the economy out of the menace of the recession.[83] The forthcoming government took several other such measures by the end of 1998–99 onwards (the NDA Government). Ultimately, the measures taken up by the governments acompanied by a general recovery in the world economy, the Indian economy started recovering from the bout of recession. Many experts had already predicted a possibility of depression with a zero per cent rate of inflation.[84] Although this did not happen.[85]

GROWTH RECESSION

An expression coined by economists to describe an economy that is growing at such a slow pace that more jobs are being lost than are being added. The lack of job creation makes it "feel" as if the economy is in a recession, even though the economy is still advancing. Many economists believe that between 2002 and 2003, the United States' economy was in a growth recession. In fact, at several points over the past 25 years the U.S. economy is said to have experienced a growth recession. That is, in spite of gains in real GDP, job growth was either non-existent or was being destroyed at a faster rate than new jobs were being added.

Experts have revived this term in the wake of the ongoing financial crises in the Euro-American economies since 2010. The situation is better described by the term ***'double-dip recession'.***

DOUBLE-DIP RECESSION

The concept of 'recession' in the USA and Euro Zone is quite precise and technical—'*two consecutive quarters of falling* GDP'—is how it is defined in these economies. And the idea of the 'double-dip recession' is an extension of it. A double-dip recession refers to a recession followed by a short-lived recovery, followed by another recession—the GDP growth sliding back to negative after a quarter or two of positive growth. The causes for such a recession vary but often include a slowdown in the demand for goods and services because of layoffs and spending cutbacks done in the previous downturn. A double-dip (which may be even 'triple-dip') is a worst-case scenario—fear/speculation of it moves the economy into a deeper and longer recession and recovery becomes too difficult. As the world saw in the case of the Euro Zone crisis—there was a fear of such a recession by first quarter of 2013.

For discussion on '**Retrocession**' see *Chapter 22*.

83. ***Economic Survey, 1996–97,*** MoF, GoI, N. Delhi.
84. It should be noted here that as an impact of recession the rate of inflation (at WPI) had been falling down throughout the mid 1998–99 fiscal finally to the level of 0.5 per cent for a fortnight (***Economic Survey, 1998–99,*** GoI, N. Delhi).
85. The literature of Economics and the empirical world experiences suggest that the phase of recession has all the symptoms of depression except one. Every thing being the same till producers are cutting the labour by force 'involuntarily (***i.e. forced labour cut***) it is the starting of depression—to be competitive in the market every producer starts 'forced labour cuts'—ultimately putting the economy into the grip of a full grown depression.

ABENOMICS

This new term has been in news for some time now. The term originates from the name of the Japanese Prime Minister **Shinzo Abe** and indicates the 'set of economic measures' he took to rejuvenate the sluggish Japanese economy from the spells of recession-like situation—after his December 2012 re-election to the post he last held in 2007. This is also known as the '*Three Arrows of Abenomics*'—the three economic measures under it are:

(i) **Fiscal Stimulus:** The government has initiated a massive fiscal stimulus to encourage public and private investments in the desired areas of the economy—investment in public works/infrastructure (which are by now 50 years old and need heavy investments), fiscal, concessions to private sector companies which invest in research & development, create jobs, increase salary, etc.

(ii) **Quantitative Easing:** The Bank of Japan (its Central bank) has been maintaining the official interest rate (like India's Repo Rate) near sub-zero to encourage lending by the banks. The aim is to double the amount of money in circulation by 2014 and reach the annual inflation target of 2 per cent. This makes the Japanese currency (Yen) to depreciate, too. Thus, this measure is intended to boost both domestic and external demands to propel the growth prospects of the economy. This measure, while at one hand increase the government expenditures, at the other it cuts the government's tax revenue, too – leading to higher fiscal deficit. This measure revolves around the current strength of the economy to 'absorb' higher levels of inflation (which plays a major role in the growth process).

(iii) **Structural Reforms:** Under this measure the government has promised a variety of deregulations in the economy, mainly aimed at increasing 'competitiveness' of the economy and attaining a sustained growth path. This arrow still remains least concrete. By now, the government has set up a *Group of Experts* (mainly formed of CEOs of large, medium and small companies) that is supposed to propose suitable measures to the government in the next three years regarding required set of 'structural' reforms needed by the economy. This measure also includes Japanese plan to 'join' TPP (Trans Pacific Partnership) and to go for a new FTA (Free Trade Agreement) between the countries in the Asis-Pacific region aimed at increasing its export potential.

The *Three Arrows of Abenomics* are a suite of economic measures which any economy may try in situations of any of the bad stages in the 'Economic Cycle'. Such economic measures were suggested by J. M. Keynes for the first time (in wake of the Great Depression of 1929). Today, its most famous exponent is the Nobel Economist Paul Krugman. Meanwhile, experts have mixed opinions on the success possibilities of the Abenomics.

CONCLUSION

Business cycles are basically fluctuations in the production levels of economies above and below the trend of the equilibirium levels.[86] But why do economies fluctuate? There are many factors which are said to be responsible for it, as per the experts:

86. Cox, Simon, op. cit., p. 58.

(i) Economic instability and uncertainty (due to logical or illogical expectations) may discourage investments thereby reducing growth in the long-term.

(ii) A lack of the creative destruction (i.e. innovation) may put the economy in a slump or slowdown in its overall production.

(iii) Anti-inflationary government policies (especially when general elections are nearing) may direct the attraction of investors in the economy.

(iv) Unforseen disasters may cause economies to fluctuate.

CHAPTER

8

AGRICULTURE AND FOOD MANAGEMENT

- ⇨ Introduction
- ⇨ Kharif & Rabi
- ⇨ Food Philosophy of India
- ⇨ Land Reforms
- ⇨ Green Revolution
- ⇨ Cropping Patterns
- ⇨ Animal Rearing
- ⇨ Food Management
- ⇨ Buffer Stock
- ⇨ Storage
- ⇨ Food Subsidy
- ⇨ Farm Subsidies
- ⇨ Restructuring of FCI
- ⇨ Agriculture Marketing

*Between 2000 and 2010, the contribution of cereals and pulses in the overall per capita food expenditure reduced from 40 per cent to 28 per cent, while that of animal-based products and fruits and vegetables rose from 36 per cent to 42 per cent–this change in consumption pattern has improved productivity of Indian farmers as well and studies show agricultural output per worker increased two times between 2000 and 2010. Barring this small tract, however, India's agriculture presents a dismal scenario with stagnating yield and low farmers income.**

* See ***Third Food and Agriculture Integrated Development Action Report*** titled *'India as an Agriculture and High-value Food Powerhouse: A New Vision for 2030'*, prepared jointly by *CII* and *McKinsey & Company*, N. Delhi, Released on 12th April 2013.

- ⇨ Agricultural Credit
- ⇨ Commodity Futures Market
- ⇨ Upstream & Downstream Requirements
- ⇨ Supply Chain Management
- ⇨ Farm Waste Debate
- ⇨ Irrigation
- ⇨ National Food Security Mission (NFSM)
- ⇨ Macro Management of Agriculture (MMA)
- ⇨ Rashtriya Krishi Vikas Yojana (RKVY)
- ⇨ ISOPOM
- ⇨ National Horticulture Mission (NHM)
- ⇨ National Bamboo Mission (NBM)
- ⇨ National Agricultural Policy, 2000
- ⇨ Agricultural Insurance
- ⇨ Research and Extension
- ⇨ Farm Mechanization
- ⇨ National Mission For Sustainable Agriculture (NMSA)
- ⇨ Second Green Revoution
- ⇨ WTO and the Indian Agriculture: Prospects and Challenges
- ⇨ WTO and Agricultural Subsidies
- ⇨ National Food Security Act
- ⇨ Food Processing
- ⇨ Current Agricultural Scenario

INTRODUCTION

Agriculture remains the most important sector of the Indian economy, whether it be the pre-independence or the post-independence periods. This fact is emphatically proved by the large number of people who depend on it for their livelihood. Before starting any discussion on Indian agriculture, we must look into its ***special features***:

(i) From the monetary point of view the share of the agriculture sector in the economy remains at ***14.1 per cent of the GDP***.[1] In the fiscal 1950–51 agriculture accounted for 55.4 per cent in the GDP.

(ii) The share of agriculture has been falling in the country's gross income, while industrial and services sectors' shares have been on a rise constantly. But from the livelihood point of view still ***55 per cent*** people of India depend on the agriculture[2] sector. This makes it a more important sector than the industry and the services (for Nepal and Tanzania the dependency for livelihood on agriculture is still higher at 93 per cent and 81 per cent, respectively). It means that 55 per cent of the population lives with only 18 per cent of the total income of the Indian economy—this fact clearly substantiates the reason why the people who depend on agriculture are poor. In the developed economies such as the USA, France, Norway, the UK and Japan, agriculture contributes only 2 per cent of their GDP with only 2 per cent people dependent on this sector for their livelihood.

(iii) Agriculture is not only the biggest sector of the economy, but also the biggest private sector too. It is the only profession which still carries no burden of individual income tax.

(iv) This is the biggest ***unorganised sector*** of the economy accounting for more than 90 per cent share in the total unorganised labour-force (93 per cent of the total labour force of the economy, i.e., 39.7 crores is employed in the unorganised sector)[3].

(v) India has emerged as a significant agri exporter in a few crops, viz., cotton, rice, meat, oil meals, pepper and sugar. As per the *World Trade Organization's Trade Statistics*, the shares of India's agricultural exports and imports in world trade in 2013–14 were 2.69 and 1.31 per cent respectively.[4] Agricultural exports as a percentage of agricultural GDP have increased from 9.10 per cent in 2008–09 to 14.05 per cent in 2013–14. During the same period, agricultural imports as a percentage of agricultural GDP also increased from 3.94 per cent to 5.50 per cent.

(vi) According to the export figures, agriculture is deeply related to industrial growth and the national income in India—1 per cent increase in the agricultural growth leads to 0.5 per cent increase in industrial output (growth) and 0.7 per cent increase in the national income of India.[5]

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1. ***Economic Survey 2014–15,*** MoF, GoI, N. Delhi, pp. 76-77.
2. **India 2015,** Pub. Div., N. Delhi, p. 86
3. ***Labour Bureau,*** GoI, N. Delhi, March 2012.
4. ***Economic Survey 2014–15***, MoF, GoI, N. Delhi, Vol. 2, p. 89.
5. This corelation has been pointed out by many great economists in India since 1960s, for example, by ***Prof. Raj Krishna (1976), S. Chakravarty (1974–79)*** and ***C. Rangarajan, 1982*** to quote some of the most important names.

(vii) The industrial sector was selected as the ***'prime moving force'*** of the economy in the late 1940s. But due to market failure the sector failed to lead the economy. Without increasing the income of the people who depend on agriculture for their livelihood, the market was not going to support the industries. As a result, the Government of India announced agriculture as the prime moving force of the economy in 2002.[6]

(viii) With 1 per cent increase in the share of agriculture in India's total exports, the money which flows puto agriculture is calculated to be Rs. 8,500 crores.[7]

(ix) In **2014–15**, total foodgrains production in the country is estimated at 257.07 million tonnes (AE).[8] As compared to last year's production of 265.57 million tonnes, current year's production of foodgrains is lower by 8.5 million tonnes. This decline has occurred on account of lower production of rice, coarse, cereals and pulses due to erratic rainfall conditions during the monsoon season-2014.

(x) ***Productivity Gap*** *between on-the-field and ideal farm practices decreasing*. As per the recent release of the GoI, the average productivity of rice, wheat and pulses which was 2,202 kg, 2,802 kg and 625 kg per hectare in 2007–08 increased to 2,346 kg, 3,026 kg and 649 kg per hectare during 2011–13.[9]

(xi) Nearly 66 per cent of the cropped area in the economy still depends on the uncertainties of ***monsoon*** for their irrigational requirements.[10]

KHARIF & RABI

There are certain special terms used to understand the cropping seasons of India. The agricultural crop year in India is from *July to June*. The Indian cropping season is classified into two main seasons- (i) kharif and (ii) rabi based on the monsoon. The kharif cropping season is from *July to October* during the South-West/Summer Monsoon and the rabi cropping season is from *October to March* (North-East/Returning/Winter Monsoon). The crops grown between March and June are summer crops, known as of *jayads*.

Pakistan and Bangladesh are two other countries that are using the term 'kharif' and 'rabi' to describe about their cropping patterns. The terms 'kharif' and 'rabi' originate from Arabic language where kharif means *autumn* and rabi means *spring*.

The kharif crops include rice, maize, sorghum, pearl millet/bajra, finger millet/ragi (cereals), arhar (pulses), soyabean, groundnut (oilseeds), cotton, etc. The rabi crops include wheat, barley, oats (cereals), chickpea/gram (pulses), linseed, mustard (oilseeds) etc.

FOOD PHILOSOPHY OF INDIA

Indian food philosophy[11] is generally seen divided into three phases with their own objectives and challenges:

6. ***Approach Paper to the Tenth Five Year Plan,*** Planning Commission, GoI, N. Delhi, 2002.
7. This was the general opinion of the experts throughout 1990s but the official document which accepted this contention was the ***Foreign Trade Policy 2002-07,*** Ministry of Commerce, GoI, N. Delhi. The view has been continued with by the GoI in all of its forthcoming trade policies.
8. **Economic Survey 2014-15**, MoF, GoI, N. Delhi, Vol. 2, p. 77.
9. ***Press Release,*** Ministry of Agriculture, GoI, N. Delhi, May 22, 2013.
10. ***Economic Survey 2011-12,*** op. cit., p. 191.
11. ***Indian Council of Agricultural Research (ICAR),*** N. Delhi, 1998.

The First Phase

This phase continued for the first three decades after Independence. The main aim and the struggle of this phase was producing as much foodgrains as required by the Indian population, i.e., achieving ***physical access*** to food.

The idea of the Green Revolution at the end of this phase at least gave India the confidence of realising the objective. At the end of the 1980s, India was a self-sufficient country regarding food.

The Second Phase

Meanwhile India was celebrating its success of the first phase, a new challenge confronted India—achieving ***economic access*** to food. The situation went on worsening and by early 2000 there was a paradoxical situation in the country when it was having more than three times buffer stocks of foodgrains in the central pool, but in several states people were dying due to lack of food—a complete mockery of the logic behind maintaining buffer stock, success of green revolution and the concept of India being a welfare state.[12] The Supreme Court intervened after a PIL was filed by the People's Union for Civil Liberties (PUCL) and a national level Food for Work Programme came up (to be merged with the National Rural Employment Guarantee Scheme). The courts took the governments on task if foodgrains rot either in godowns or destroyed in oceans to manage market price for the foodgrains, or if the Centre had to go for exporting wheat at very low price. In this process India emerged as the ***seventh largest*** exporter of wheat (2002). Basically, we were exporting the share of wheat which was not consumed by many Indians due to lack of economic reach to food.

As the inputs of the Green Revolution were costlier, its output naturally were to be costlier. To fight the situation there should have been a time-bound and target-oriented macro-economic policy support, which could deliver comparative increase in the purchasing capacity of the masses to make food affordable for them. India badly failed in it. The crisis was managed by throwing higher and higher subsidies ultimately affecting government expenditure on the infrastructural shortcomings in the agriculture sector. Even after providing higher food subsidies, some people failed to purchase food and they were left with no option but to die of hunger.

India is still in this phase and trying to solve the crisis through twin approach firstly, by creating maximum number of gainful employment and secondly by cutting cost of foodgrains (via the second green revolution based on biotechnology).

It must be kept in mind that the food self-sufficiency happiness was a temporary thing for India. By the mid 1990s, India realised that its foodgrain production was lagging behind its population increase. It means India is still fighting to achieve physical reach to the required level of food.

The Third Phase

By the end of the 1980s, world experts started questioning the very way world was carrying on with different modes of production. Agricultural activitiy was one among them which had become hugely based on industries (chemical fertilizers, pesticides, tractors, etc.). All developed economies had declared their agriculture to be an industry.[13]

It was time to look back and introspect. By the early 1990s, several countries started going for ecologically friendly methods and techniques of industrial, agricultural and services sectors development. The much-hyped Green Revolution was declared ecologically untenable and the world headed for organic farming, green farming, etc.

12. ***India 2000*** and ***Economic Survey 2000–01,*** GoI, N. Delhi.
13. ***Brundtland Report*** on Sustainable Development after the deliberations at the summit ***"Our Common future",*** 1987.

It meant that achieving physical and economic reach to food was not the only challenge India was facing, but such aims should not be realised at the cost of the precious ecology and biodiversity—a new challenge! India needed a new kind of green revolution which could deliver it the physical, economic as well as *ecological access* to food—the Second Green Revolution—an all-in-one approach towards the agriculture sector.

LAND REFORMS

The official stance and emphasis on land reforms in India have been changing over the time in wake of the emerging issues, which may be seen in two phases:

PHASE-I

This phase commences just after Independence.

All economies were agrarian before they were industrialised, only their periods vary. Once democratic systems developed, the first thing the developed countries of today did was to complete the agrarian reforms in a time-bound way. As land remains the means of livelihood for the larger section of society in an agrarian economy, the successful completion of agrarian reforms benefitted the maximum number of people thereby improving their economic conditions. At the time of Independence, India was a typical agrarian economy and had inherited a very inequitable agrarian system. Land reforms will be a major plank of independent India and as part of the agrarian reforms it was made clear by the pledge of the Indian National Congress in 1935 itself. Land reforms in India had three objectives similar to the other economies which opted for it in the past:

(i) Removing ***institutional discrepancies*** of the agrarian structure inherited from the past which obstructed increasing agricultural production, such as—the size of agricultural holding, land ownership, land inheritance, tenancy reforms, abolition of intermediaries, introduction of modern institutional factors to agriculture, etc.

(ii) The other objective of the land reforms in India was related to the issue of ***socio-economic inequality*** in the country. The high inequality in land ownership not only had a its negative economic impact on the economy; but it was badly intertwined with the caste system in India and the allocation of social prestige and status by the society at large.[14] More than 80 per cent of the population from its livelihood inherited the agrarian system which had inequitable ownership of the asset, i.e., land to earn income. The government wanted to go for a restructuring of the land ownership in the economy on logical grounds and with public welfare approach. This objective of the land reforms got enough socio-political attention as it tried to dismantle the age-old agrarian structure in the country. It became such a hot issue that land reforms in India got a 'bad-name', synonymous to land-grabbing by the government and allotting them to the landless masses.

(iii) The third objective of the land reforms in India was highly contemporary in nature, which did not get enough socio-political attention—it was the objective of ***increasing agricultural production*** for solving the inter-related problems of poverty, malnutrition and food insecurity.

14. Rudolph, L.I and S.H. Rudolph, ***In Pursuit of Lakshmi: The Political Economy of the Indian State,*** Orient Longman, Bombay, 1987, pp. 45–50.

To realise the objectives of the land reforms, the government took three main steps which had many internal sub-steps:

1. Abolition of Intermediaries

Under this step, the age-old exploitative land tenure systems of the Zamindari, Mahalwari and Ryotwari were fully abolished.

2. Tenancy Reforms

Under this broader step, three inter-related reforms protecting the land–tenants were effected:

(i) *Regulation of rent* so that a fixed and rational rate of rent could be paid by the share-croppers to the land owners;

(ii) *Security of tenure* so that a share-cropper could be feel secure about his future income and his economic security; and

(iii) *Ownership rights to tenants* so that the landless masses (i.e., the tenants, the share-croppers) could get the final rights for the land they plough—*"land to the tillers"*.

3. Reorganisation of Agriculture

This step again has many inter-related and highly logical provisions in the direction of rational agrarian reforms:

(i) *Redistribution of land* among the landless poor masses after promulgating timely ***ceiling laws***—the move failed badly with few exceptions, such as West Bengal, Kerala and partially in Andhra Pradesh.

(ii) *Consolidation of land* could only succeed in the regions of the Green Revolution (i.e., Haryana, Punjab and western Uttar Pradesh) and remained marred with many loopholes and corruption.

(iii) *Cooperative farming,* which has a high socio-economic moral base, was only used by the big farmers to save their lands from the draconian ceiling laws.

The whole attempt of land reforms in India is considered a big failure by the majority of experts. Many consider the issue of land reforms in India as the most complex socio-economic problem of human history.[15] Data regarding the numerical achievements of land reforms have been highly discouraging.[16]

(i) Tenancy reforms made tenants have their rights but only on 4 per cent of the total operated areas of India (14.4 million hectares of operated area by 11 million tenants by 1992).

(ii) Redistribution of ownership rights of land took place but on only 2 per cent of the total operated area of the country (less than 2 million hectares among the 4.76 million people by 1992).

(iii) Taken together, the whole process of land reforms could benefit only 6 per cent of the operated area of the country with a negligible socio-economic positive impact.

It was the failure of land reforms which made the government easily attracted towards the new policy of the Green Revolution in the coming times—land reforms had failed to increase agricultural production thus the government opted the route of increasing the productivity to reach the same goal, i.e., the initiation of the new techiques of agriculture.

Reasons for Failure of Land Reforms

Out of many reasons forwarded by the experts responsible for the failure of the land reforms in

15. This was the view of the majority of the experts around the world by the late 1960s.
16. P.S. Appu, ***Land Reforms in India: A Survey of Policy, Legislation and Implementation,*** Land Reforms Unit, Lal Bahadur Shastri National Academy of Administration, Mussouri, 1995, pp. 232–33.

India, the following three could be considered the most important ones:

(i) Land in India is considered a symbol of social prestige, status and identity unlike the other economies which succeeded in their land reform programmes where it is seen as just an economic asset for income-earning.

(ii) Lack of political will which was required to affect land reforms and make it a successful programme.

(iii) Rampant corruption in public life, political hypocricy and leadership failure in the Indian democratic system.

Land Reforms & Green Revolution

Once the government launched the Green Revolution, the issue of land reforms almost got marginalised due to the following reasons:

(i) There is an inherent diabolic relationship between the Green Revolution and the land reforms as the former suits bigger and economic land holdings, while the latter intended to fragment the land among a large number of the masses.

(ii) The land reforms were socially opposed by the land-owning caste lobbies, while there was no such opposition to the Green Revolution.

(iii) The level of legislative attempts taken by the governments regarding the land reforms till date had almost no positive socio-economic impact on the country, while the GR was having all potential of proving higher yields of foodgrains.

(iv) The subsidised supplies of foodgrains under PL480 were hampering India from carving out its independent diplomacy, as well as there has always remained a doubt about the regular supplies of wheat.

(v) International pressure as well as the suggestions from the world Bank besides the success stories of the Green Revolution from the countries where it had increased the yield of wheat.

Phase-II

The second phase of land reforms can be traced in the process of economic reforms. Economic reforms exposed the economy to the new and emerging realities, such as, land acquisition and leasing, food-related issues and the agricultural provisions of the World Trade Organization (WTO). We see a shift *(Economic Survey 2012–13)* in the GoI thinking towards the issue of land reforms—a clear three step policy looks emerging:

(i) Mapping land carefully and assigning conclusive title,

(ii) Devising a fair but speedy process of land acquisition, and

(iii) Putting in place a transparent and effective land leasing policy.

Land is probably the single most valuable asset in the country today. Not only could greater liquidity for land allow more resources to be redeployed efficiently in agriculture, it could ease the way for land-utilizing businesses to set up. Perhaps, as important, it could allow land to serve as collateral for credit.

The **National Land Records Modernization Programme** (NLRMP), started in 2008, aims at updating and digitizing land records by the end of the 12th Plan. Eventually, the intent is to move from *presumptive title* (where registration of a title does not imply the owner's title is legally valid) to *conclusive title* (where it does). Important points related to this process may be summarised as follows:

(a) Digitisation will help enormously in lowering the costs of land transactions,

while conclusive title will eliminate legal uncertainty and the need to use the government as an intermediary for acquiring land so as to 'cleanse' title.

(b) Given the importance of this programme, its rollout in various states needs to be accelerated—easier and quicker land transactions will especially help small and medium enterprises that do not have the legal support or the management capacity that large enterprises have.

(c) Prohibitory *land leasing norms* raises the cost to rural-urban migration as villagers are unable to lease their land, and often have to leave the land untilled or leave a family member behind to work on the land. Lifting these restrictions can help the landless (or more efficient landowners) get land from those who migrate, even while it will allow landowners with education and skills to move to industry or services.

(d) Compulsory registration of leaseholds and of the owner's title would provide tenants and landowners protection. For such a leasing market to take off, owners should be confident that long–term tenancy would not lead to their losing ownership. With a vibrant leasing market, and clear title, there should be little reason for not strengthening ownership rights.

(e) For large projects with a public purpose, such as the National Industrial and Manufacturing Zones, which will facilitate the setting up of small and medium enterprises—large-scale land acquisition may be necessary.

(f) Given that the people currently living on the identified land will suffer significant costs including the loss of property and livelihoods, a balance has to be drawn between the need for economic growth and the costs imposed on the *displaced.*

Moving onwards, the GoI passed the *Land Acquisition Bill, 2013*. The bill, besides proposing to amend the *Land Acuisition, Rehabilitation and Resettlement Act, 2011* proposed to put in place a transparent, effective and speedy laws reagrding the need of land reforms related to leasing and acquisition. By **2015**, the new government at the Centre proposed a new land bill *(Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Bill, 2015)* aimed at removing the inadequacies of the Land Act of 2013—the Bill is being opposed by the political parties belonging to the opposition (it is still to be passed by the Parliament, though the government has done around ten amendments to it). The country cannot afford to compromise the economic security of land owners (farmers) in the process of evolving a speedier process of land acquisition—the law dealing with it should be transparent, justified, effective and speedier, too.

Finer points of this *PHASE* can be summed up in the following way:[17]

(a) Leasing seems a better choice in face of the opposition India has seen in recent times from the farmers in different states toward attempts of land acuisition. Again, if the country needs to attract investment from the organised private sector (domestic or foreign) land leasing seems a better option than acquisition.

17. The discussion is based on several volumes of the **Economic Survey** and **India** between the period 2010 to 2015 and the **12th Plan**.

(b) Corporate farming has not taken place in the country at a big scale, specially in the areas of foodgrains production which India needs to ensure food security and compete in the global grain market in particular and the agrimarket in general. This has become even more important in wake of the Right to Food given to a large segment of the population.

(c) Giving primacy to 'leasing' will solve several problems:
   (i) It will keep land ownership in the hands of the existing farmers;
   (ii) It will prevent mass landlessness and unemployment among the farmers;
   (iii) Farmers will get a permanent source of income (in the meantime, they might be imparted skills and provide better employment in industries); and
   (iv) It will make land easily available for the use of public and private purposes.

(d) In wake of the process of globalisation if the country intends to bring in benefits to agriculture sector it needs to enhance its agriculture production to surplus levels—and for this India needs to garner in the investment potential of the private sector. This cannot happen till the country is able to bring out an effective land leasing and acquisition policies.

(e) The recent emphasis on the promotion of the 'manufacturing sector' and 'smart cities' are hugely dependent on smoother and speedier process of land acquisition. Without expanding the industrial sector to its optimum levels, the agriculture sector can emerge a remunerative profession—the country needs to migrate the extra labour force of the agriculture sector to industry, smoothly.

(f) The issue of land acquisition is to establish a logical equation with 'environmental issue', in order to make the process of development sustainable (NITI Aayog gives a right call for it).

It should be noted that while the GoI has changed its orientation towards the issue of land reforms, the states of India are still trying to accelerate and continue the process of land reforms of *PHASE I* (but due to enough resistance from the land-owning section in the country, the process does not seem happening, politically).

Agriculture Holdings

The average size of land holding in India is continuously decreasing due to rapid and high population growth. The continuous division and fragmentation of holdings has increased the number of holdings, obviously of smaller size. As per the latest (9th) *Agriculture Census 2010–11*:

(i) The total number of operational holdings in the country has increased from 129 million in 2005–06 to 138 million 2010–11 (an increase of 6.61 per cent).

(ii) There is a marginal increase in the operated area from 158.32 million hectare (ha) in 2005–06 to 159.18 million ha in 2010-11 (an increase of 0.54 per cent). The operated area has primarily increased because the State of Jharkhand participated for the *first time* in Agriculture Census 2010–11 (since the state came into being in the year 2000).

(iii) The *average size* of operational holding has declined to 1.16 ha in 2010–11 as compared to 1.23 in 2005–06.

(iv) The percentage share of *female* operational holders has increased from 11.70 in 2005–06 to 12.79 in 2010–11, with the corresponding operated area of 9.33 and 10.36.

(v) The *small* and *marginal* holdings taken together (below 2.00 ha) constitute **84.97** per cent in 2010–11 against 83.29 in 2005–06 with a share of 44.31 per cent in the operated area in the current Census as against the corresponding figure of 41.14 per cent in 2005–06.

(vi) The *large* holdings (10.00 ha & above) were 0.73 per cent of the total number of holdings in 2010–11 with a share of 10.92 per cent in the operated area as against 0.85 per cent and 11.82 per cent respectively for 2005–06 Census.

(vii) Share of different *social groups* in operational holdings stands as—12.40 per cent for **SCs**, 8.71 per cent for **STs**, 0.18 per cent for institutional and 78.72 per cent for others.

(viii) In a total of **137.76** million *operational holdings* in the country, the highest number belonged to Uttar Pradesh (22.93 million) followed by Bihar (16.19 million) and Maharashtra (13.70 million).

(ix) Out of a total of **159.18** million hectares *operated area* in the country, the highest contribution was made by Rajasthan (21.14 million ha) followed by Maharashtra (19.84 million ha) and Uttar Pradesh (17.09 million ha).

Agricultural holdings have been classified into ***three*** categories:

1. Economic Holding

It is that holding which ensures a minimum satisfactory standard of living in a family. In other words, economic holding is a minimum essential area for profitable agriculture.

2. Family Holding

Family holding is that holding which gives work to an average size family having one plough under traditional farming system. In other words, family holding is a ***'plough unit'*** which is neither less nor more for an average size family to cultivate it properly.

3. Optimum Holding

Maximum size of the holding which must be possessed and owned by a family is called optimum holding.

GREEN REVOLUTION

It is the introduction of new techniques of agriculture which became popular by the name of Green Revolution (GR) in early 1960s—at first for ***wheat*** and by the next decade for ***rice***, too. It revolutionised the very traditional idea of food production by giving a boost by more than 250 per cent to the productivity level.[18] The Green Revolution was centred around the use of the High Yielding Variety (HYV) of seeds developed by the US agro-scientist Norman Borlaug doing research on a British Rockfellor Foundation Scholarship in Mexico by the early 1960s. The new wheat seeds which he developed *in vivo* claimed to increase its productivity by more than 200 per cent. By 1965, the seeds were successfully tested and were being used by farmers in food deficient countries such as Mexico, Taiwan.

COMPONENTS OF THE GREEN REVOLUTION

The Green Revolution was based on the timely and adequate supply of many inputs/components. A brief review on the Green Revolution is given below:

18. ***Consultative Group on International Agricultural Research*** (CGIAR), World Bank, Washington DC, 1971.

1. The HYV Seeds

They were popularly called the '***dwarf*** variety of seeds, with the help of repeated mutations, Mr. Borlaug had been able to develop a seed which was raised in its nature of nutrients supplied to the different parts of the wheat plant—against the leaves, stem and in favour of the grain. This made the plant dwarf and the grain heavier—resulting into high yield.[19]

These seeds were non-photosynthetic, hence non-dependent on sun rays for targeted yields.

2. The Chemical Fertilizers

The seeds were to increase productivity provided they got sufficient level of nutrients from the land. The level of nutrients they required could not be supplied with the traditional compostes because they have low concentration of nutrients content and required bigger area while sowing—it meant it will be shared by more than one seed. That is why a high concentration fertilizer was required which could be given to the trageted seed only—the only option was the chemical fertilizers—urea (N), phosphate (P) and potash (K).[20]

3. The Irrigation

For controlled growth of crops and adequate dilution of fertilizers, a controlled means of water supply was required. It made two important compulsions—firstly the area of such crops should be at least free of flooding and secondly, artificial water supply should be developed.[21]

4. Chemical Pesticides and Germicides

As the new seeds were new and non-acclimatised to local pests, germs and diseases than the established indigenous varieties, use of pesticides and germicides became compulsory for result-oriented and secured yields.

5. Chemical Herbicides and Weedicides

To prevent costlier inputs of fertilisers not being consumed by the herbs and the weeds in the farmlands, herbicides and weedicides were used while sowing the HYV seeds.

6. Credit, Storage, Marketing/Distribution

For farmers to be capable of using the new and the costlier inputs of the Green Revolution, availability of easy and cheaper credit was a must. As the farmlands suitable for this new kind of farming was region-specific (as it was only Haryana, Punjab and western Uttar Pradesh in India) storage of the harvested crops was to be done in the region itself till they were distributed throughout the country. Again, the countries which went for the Green Revolution were food-deficient and needed the new yield to be distributed throughout the country and a proper chain of marketing, distribution and transport connectivity was necessary. All these peripheral infrastructure were developed by the countries going for the Green Revolution with softer loans coming from the World Bank—India being the biggest beneficiary.[22]

IMPACT OF THE GREEN REVOLUTION

The Green Revolution had its positive as well as negative socio-economic and ecological impacts on the countries around the world, we will specially study India here:

19. ***International Maize and Wheat Improvement Centre*** (CIMMYT), Mexico, 1971.
20. This made it compulsory to use highly concentrate chemical fertilisers, pushing the traditional organic fertilisers (i.e., composte) out of fashion.
21. This was the reason why the GR was implemented firstly in the rainfall deficient regions of India i.e., Haryana, Punjab and western Uttar Pradesh.
22. ***India 2002,*** Pub. Div., GoI, N. Delhi.

1. Socio-economic Impact

Food production increased in such a way (wheat in 1960s and rice, by 1970s) that many countries became self-sufficient (self sufficiency of food must not be confused with the idea of food security) and some even emerged as food exporting countries.

But the discrepancy in farmers' income, it brought with itself increased the inter-personal as well as inter-regional disparities/inequalities in India.[23] Rise in the incidence of malaria due to water-logging, a swing in the balanced cropping patterns in favour of wheat and rice putting pulses, oilseeds, maize, barley on the margins, etc., were negative impacts.

2. Ecological Impact

The most devastating negative impact of the Green Revolution was the ecological one. When the issues related with it were raised by the media, scholars, experts and environmentalists, neither the governments nor the masses (what to say of the farmers of the GR region— they were not educated enough to understand the side effects of the inputs of the GR) were convinced. But a time came when the government and other government agencies both started doing studies and surveys focused around the ecological and environmental issues. The major ones among them may be glanced in their chronological order:

(i) Critical Ecological Crisis: On the basis of on-field studies[24] it was found that critical ecological crises in the GR region are showing up—

(a) *soil fertility being degraded* (due to the repetitive kind of cropping pattern being followed by the farmers as well as the excessive exploitation of the land; lack of a suitable crop combination and the crop intensity, etc.).

(b) *Water table falling down* (as the new HYV seeds required comparatively very high amount of water for irrigation—5 tonnes of water needed to produce 1 kg of rice.

(c) *Environmental degradation* due to excessive and uncontrolled use of chemical fertilizers, pesticides and herbicides have degraded the environment by increasing pollution levels in land, water and air. In India it is more due to *deforestation* and extension of cultivation in ecologically fragile areas. At the same time, there is an excessive pressure of animals on forests—mainly by goats and sheeps).

(ii) Toxic Level in Food Chain: Toxic level in the food chain of India has increased to such a high level that nothing produced in India is fit for human consumption. Basically, unbridled use of chemical pesticides and weedicides and their industrial production combined together had polluted the land, water and air to such an alarmingly high level that the whole food chain had been a prey of high toxicity.

CONCLUSION

The above studies and the reports were eye-openers in the area of ecologically non-sustainable kind of agriculture as well as a big question mark on it. This was the time when agro-scientists suggested for a really 'green' (eco-friendly) green revolution, which is today known among the experts with many more names—the *evergreen revolution,* the *second*—green revolution the *green farming.*

23. Various ***Economic Surveys,*** specially 1985–86 to 1994–86 to 1994–95, GoI, N. Delhi.
24. Based on various empirical studies in the 1990s conducted separately by ***Vandana Shiva, C.H. Hanumantha Rao, ICAR, Planning Commission, etc.***

CROPPING PATTERNS

The set and combination of crops which farmers opt for in a particular region, in their farm practices, is cropping pattern of the region. Multiplicity of cropping systems has been one of main features of Indian agriculture and it is attributed to rainfed agriculture and prevailing socio-economic situations of farming community.

The cropping pattern in India has undergone significant changes over time. As the cultivated area remains more or less constant, the increased demand for food, because of increase in population and urbanisation, puts agricultural land under stress resulting in *crop intensification* and *crop substitution* of food crops with commercial crops.

Cropping systems of a region are decided by and large, by a number of soil and climatic parameters, which determine overall agro-ecological setting for nourishment and appropriateness of a crop or set of crops for cultivation. Nevertheless, at farmers' level, potential productivity and monetary benefits act as guiding principles while opting for a particular crop or a cropping system. These decisions with respect to choice of crops and cropping systems are further narrowed down under influence of several other forces related to infrastructure facilities, socio-economic and technological factors, all operating interactively at micro-level. These factors are:

(i) Goegraphical factors: Soil, landforms, precipitation, moisture, altitude, etc.
(ii) Socio-cultural factors: Food habits, festivals, tradition, etc.
(iii) Infrastructure factors: Irrigation, transport, storage, trade and marketing, post-harvest handling and processing, etc.
(iv) Economic factors: Financial resource base, land ownership, size and type of land holding, household needs of food, fodder, fuel, fibre and finance, labour availability, etc.
(v) Technological factors: Improved varieties of seeds and plants, mechanisation, plant protection, access to information, etc.

PREVALENT CROPPING SYSTEMS

Multiplicity of cropping systems has been one of the main features of Indian agriculture. This may be attributed to following two major factors:

(i) Rainfed agriculture still accounts for over 92.8 million hectare or 65 per cent of the cropped area. A large diversity of cropping systems exists under rainfed and dryland areas with an over-riding practice of intercropping, due to greater risks involved in cultivating larger area under a particular crop.
(ii) Due to prevailing socio-economic situations (such as, dependency of large population on agriculture, small land-holding size, very high population pressure on land resource, etc.).

Improving household food security has been an issue of supreme importance to many million farmers of India, with the following farm holdings—

(a) 56.15 million marginal (<1.0 hectare),
(b) 17.92 million small (1.0–2.0 hectares), and
(c) 13.25 million semi-medium (2.0–4.0 hectares).

They together are 90 per cent of 97.15 million operational holdings. An important consequence of this has been that crop production in India remained to be considered, by and large, a *subsistence* rather than *commercial* activity. One of the typical characteristics of subsistence farming is that most of the farmers resort to grow a number of crops on their farm holdings, primarily to fulfil their household needs and follow the practice

of rotating a particular crop combination over a period of 3–4 year interchangeably on different farm fields.

Under influence of all above factors, cropping systems remain dynamic in time and space, making it difficult to precisely determine their spread using conventional methods, over a large territory. However, it has been estimated that more than **250** double cropping systems are followed through out the country. Based on rationale of spread of crops in each district in the country, ***30 important cropping systems*** have been identified—rice-wheat, rice-rice, rice-gram, rice-mustard, rice-groundnut, rice-sorghum, pearlmillet-gram, pearl millet-mustard, pearl millet-sorghum, cotton-wheat, cotton-gram, cotton-sorghum, cotton-safflower, cotton-groundnut, maize-wheat, maize-gram, sugarcane-wheat, soybean-wheat, sorghum-sorghum, groundnut-wheat, sorghum-groundnut, groundnut-rice, sorghum-wheat, sorghum-gram, pigeonpea-sorghum, groundnut, sorghum-rice, groundnut-sorghum and soybean-gram.

Changes in the Cropping Patterns

Due to various reasons, the cropping pattern of Indian farmers have undergone changes over the time—we can see them in following three phases:

Pre-Green Revolution period: In this phase we see Indian farmers going in for a cropping system (generally), which was primarily decided by the socio-cultural and economic factors—more or less they were closer to being *sustainable* as they had developed through the long process of the trial and error process of their forefathers. A combination of crops we see being grown by farmers across the country with judicious mixture of crops till the Green Revolution. This was a period of subsistence farming with high dependency of population for livelihood on it. The nature of the cropping pattern was too stubborn to change by incentives.

Green Revolution period: Under the spell of the New Agricultural Strategy (NAS), more popular as the Green Revolution (GR), since 1965 onwards, we see a *major shift* in the cropping pattern of Indian farmers. The main forces of change were economic, infrastructural and technological. Initiation of high yeilding varieties of seeds, financial supports of chemical and other inputs together with the provisions of minimum support price (MSP) gave major shift to the farmers' choices of crops. In GR regions we see a highly repetitive kind of cropping pattern with the 'wheat-rice' having predominance. In coming times, the GoI started announcing MSPs for many other crops, which had its own impact on the farmers' choices of crops in their cropping systems.

This period was primarily guided by the singular objective of attaining self-sufficiency in food, which may lead the nation to attain food security. By the late 1980s, India was able to manage self-sufficiecy in foodgrains. We see emergence of big farmers in the GR regions for whom at least farming did not remain subsitence —*commercial dimension* enters the Indian farm practices, for the first time.

This is the period when the traditional cropping pattern of India got exposed to new inputs of farming and geographical dimensions of crop selection were undermined. Soon (by 1996–97), the government came to know that the GR farm practices were ecologically damaging and unsustainable. The GoI officially adopts the idea of *sustainable* agriculture by 1997.

Reform period: Another wave of change in cropping pattern comes with the process of economic reforms commencing in 1991, which brings in new opprotunities together with the challenges in the area of farm sector:

- The issue of food security continued to give in pressure on policymakers as the foodgrains production was not able to

keep pace with the population growth rate. The situation becomes even more serious with Food Rights (NFSA) given to a large population of the country recently.

- Globalisation brought in new opportunities of farm exports together with the challenge of cheap production (need of farm mechanisation and commercial farming so that Indian farm products can compete in the global market) in wake of the agricultural provisions of the World Trade Organisation. It made India think of mobilising huge investments in the sector. India accepts agriculture as an industry (2000) giving green signal to *corporate* and *contract* farmings.
- Ecologically sustainable farming becomes the need of the hour due to ensuing danger of climate change and environment related constraints.
- The GoI proposes for the Second Green Revolution in 2002 with inclusion of the genetically modified foods (GMFs).

In wake of the above-cited factors, experts and the governments expect a major change coming in the cropping patterns of the country. Now, the issue is, as how to face up the emerging challenges together with making farm practices and cropping patterns sustainable—experts suggested the following steps (by late 1990s), which were discussed and almost accepted by the Planning Commission together with the Ministry of Agriculture:

(i) Putting in place the right kind of agricultural policy with the provisions of prize and punishment inclining farmers to go for the right kind of cropping pattern.

(ii) Evolving the right trade policy, which can protect Indian farm products from the negative global competition and enable to expand exports.

(iii) Bringing in proper labour laws, land leasing and acquisition policies to encourage the entry of Indian and foreign private sector in the agriculture sector of the country.

(iv) Keep pressurising the WTO so that a neutral and judicious regime of agricultural provisions are evolved by it accepting the realities of India's susbsistence farming and issues related with the high agriculture subsidies, which developed countries forward to their farm sector.

(v) Evolving the right environment of policy framework for the initiation of GMFs in farm sector and promotion to the non-GMF related reasearch and development in the country—by encouraging the corporate sector.

(vi) Factoring in the issue of environment and climate change in the domain of agricultural policy framework.

(vii) Emphasising the need of farmers' awareness and education for the changing times. For this the PRIs involvement will be crucial.

(viii) Attending to issues like plant protection, checking farm wastage, pest management, commercial production and commercial availability of the green inputs.

(ix) Evolving the right kind of credit and insurance policies for the farm sector at macro and micro levels.

(x) Immediate inclusion of other factos in the farm sector like, a national market for agricultural products, upstream and downstream requirements, proper supply chain management, logistics, agro-processing industries, storage, etc.

ANIMAL REARING

The economics of animal rearing plays a very vital role in the country. The agriculture sector in India is predominantly a mixed crop-livestock (animals, birds and fishes) farming system. Animal rearing has always remained an integral part of it. Animal rearing (which includes rearing of cows, camels, buffaloes, goats, pigs, ships, etc.), besides directly contributing to the national income and socio-economic development plays the following **vital functions** in the country:

(i) Supplements family income and generates gainful employment in the rural sector;
(ii) Particularly helps the landless labourers, small and marginal farmers and women (economic empowerment of women);
(iii) Provides cheap nutritional food;
(iv) Functions as the best insurance against drought, famine and other natural calamities;
(v) It is more *inclusive* in nature; and
(vi) Promotes the cause of *sustainable* agriculture.

The **significance** of this sector can be seen by the following facts:

(a) The livestock sector as a whole achieved an average growth rate of 4.8 per cent during the *11th Plan* which is *higher* than the farm sector growth (3.5 per cent) and the foodgrains growth (around 1 per cent).
(b) The livestock population of India is around 530 million. It accounts for about 26 per cent of the total agricultural, fishing and forestry sector.
(c) Meat production has a growth rate of 5.7 per cent with a total production of 4.8 million tonne (still this sector has huge demand-supply gap and scope of expansion is too much there).

Dairy Sector: India ranks first in the world in milk production with a production of around 133 million tonne and the per capita availabilty (pca) of 297 grams (world pca is 290 grams) by the end of 2014–15.

Some of the important GoI programmes/schemes for meeting the growing demand of milk:

- Intensive Dairy Development Programme.
- Strengthening Infrastructure for Quality and Clean Milk Production, Assistance to Cooperatives.
- Dairy Entrepreneurship Development Scheme.
- National Project for Cattle and Buffalo Breeding.

A new scheme, the *National Dairy Plan*, Phase I, has been launched in March 2012 with the following objectives:

- improving productivity of milch animals,
- strengthening and expanding village-level infrastructure for milk procurement, and
- providing producers greater access to the market in the dairy sector.

Pig Rearing Scheme: This scheme is aimed to assist farmers/landless labourers/co-operatives and the tribals particularly in North-Eastern states by raering pigs under stall fed condition for quality pork production and organised pork marketing in rural areas and semi-urban areas. The main objectives of the shceme are:

- Encouraging commercial rearing by adopting scientific methods and infrastructure creation;
- Production and supply of improved germ plasm;
- Organizing stakeholders to popularize scientific practices;
- Create supply chain for the meat industry;
- Encouraging the value addition for better income.

Adequate availability of *feed and fodder* for livestock is vital for increasing milk production and sustaining the ongoing genetic improvement programme. Green fodder shortage in the country is estimated at about 34 per cent. The central government has put in place a modified Centrally Sponsored Fodder and Feed Development Scheme since 2010 to supplement the efforts of the states to improve fodder production. Besides, the Accelerated Fodder Development Programme was launched as a component of the Rashtriya Krishi Vikas Yojana in 2011–12 to promote production of fodder.

Animal Health: With the improvement in the quality of livestock through launching of extensive cross-breeding programmes, the susceptibility to various diseases including exotic diseases has increased. In order to reduce morbidity and mortality, efforts are being made by the state/UT governments to provide better health care through Polyclinics/Veterinary Hospitals/Dispensaries/ First-Aid Centres including Mobile Veterinary Dispensaries. For the prevention of various diseases 27 veterinary vaccine production units are working with dominance of the public sector (20 are public sector and rest in private sector). The 'Livestock Health & Disease Control' is being run as a centrally sponsored scheme to assist the attempts of the states and UTs in the area.

Suggestions for further development of the sector:

- Developing progeny tested semen for artificial insemination.
- Expansion of fodder availability through innovative means.
- Facilities of animal health centres need to be upgraded and the disease control systems made more effective on the veterinary side.
- In the drylands and mountain ecosystems, livestock contribute anywhere between 50 to 75 per cent of total household income of the rural population. Support to these massive and highly diverse livestock populations in these regions is lacking.
- Raising the capability of the rural poor to conserve and manage their livestock resources, and enables them to derive sustainable incomes from these resources.
- Decentralisation and convergence of policy support for these options is crucial for diversification of livelihoods in small-holder farming.

FOOD MANAGEMENT

Managing enough food in the domestic market has been the prime focus of the governement since Independence. Meeting the physical target of food together with the challenge of enabling Indians to procure food for their consumption was also there. Over the year, we see the government devising various ways and means to handle the twin challenges. Once, the country joined the WTO, a new need was felt—producing surplus and competing with the world out there so that the benefits of globalisation could be reaped by the agriculture sector, too. This section mainly discusses the challenge of food.

MINIMUM SUPPORT PRICE

Minimum Support Price (MSP) is a form of market intervention by the GoI to insure agricultural producers against any sharp fall in farm prices —a guarantee price to save farmers from distress sale. The MSPs are announced at the beginning of the sowing season for certain crops on the basis of the recommendations of the Commission for Agricultural Costs and Prices (CACP, 1985). The major objectives are to support the farmers from distress sales and to procure food grains for public distribution. In case the market price for the

commodity falls below the announced minimum price due to bumper production and glut in the market, government agencies purchase the entire quantity offered by the farmers at the announced minimum price.

Commencing with 'wheat' for the 1066-67, currently the MSPs are announced for **24** commodities including seven cereals (paddy, wheat, barley, jowar, bajra, maize and ragi); five pulses (gram, arhar/tur, moong, urad and lentil); eight oilseeds (groundnut, rapeseed/mustard, toria, soyabean, sunflower seed, sesamum, safflower seed and nigerseed); copra, raw cotton, raw jute and virginia flu cured (VFC) tobacco. The MSPs are fixed at *incentive level*, to fulfil the following purposes:

(a) to induce more investment by the farmers in the farm sector,

(b) to motivate farmers to adopt improved crop production technologies, and

(c) to enhance production and thereby farmers income.

In the absence of such a guaranteed price, there is a concern that farmers may shift to other crops causing shortage in these commodities. The agricultural price policy in India emerged in the backdrop of *food scarcity* and *price fluctuations* provoked by *drought, floods* and *international prices* for exports and imports.[25]

Market Intervention Scheme

The Market Intervention Scheme (MIS) is similar to MSP which is implemented on the request of state governments for procurement of perishable and horticultural commodities in the event of fall in market prices. The scheme is implemented when there is at least 10 per cent increase in production or 10 per cent decrease in the ruling rates over the previous normal year. Proposal of MIS is approved on the specific request of State/UT governments, if the state/UT governments is ready to bear 50 per cent loss (25 per cent in case of North-Eastern states) incurred on its implementation.

Procurement Prices

In 1966–67, the GoI announced a 'procurement price' for wheat, too–a bit higher than its MSP (the purpose being security of food procurement for requirement of the PDS). The MSP was announced before sowing, while the procurement price was announced before harvesting—the purpose was encouraging the farmers to sell a bit more and get encouraged to produce more. But this increased price hardly served the purpose as a suitable incentive to farmers—it would have been better had it been announced before sowing and not after harvesting. That is why since the fiscal 1968–69 the government announced only the MSP, which is considered the effective procurement price, too.[26]

Issue Price

The price at which the GoI allows offtake of foodgrains from the FCI (the price at which the FCI sells its foodgrains). The FCI has been fetching huge losses in the form of food subsidies.[27] The foodgrains procured are transported to the godowns of the FCI located across the country (counted in the buffer stock). From here they head to the sale counters—to the TPDS or Open Market Sale. The transportaion, godowning, the cost of maintaining the FCI, carriage losses, etc., make the foodgrains costlier (the additional expenses other than the MSP is known as the 'economic cost of foodgrains'). To make the

25. **New Agricultural Strategy, 1965**; Reports of the **CACP** and **Ministry of Agriculture**, GoI, N. Delhi.
26. **New Agricultural Strategy, 1965**; the **CACP, 1967** and **Ministry of Agriculture**, GoI, N. Delhi.
27. **New Agricultural Strategy, 1965**; Reports of the **CACP** and **Ministry of Agriculture**, GoI, N. Delhi.

foodgrains affordable to the consumers, the issue prices for foodgrains are set lower than the total cost of procurement and distribution—the gap converts into the 'food subsidy'.

BUFFER STOCK

India has a policy of maintaing a minimum reserve of foodgrains (only for wheat and rice) so that food is available throughout the country at affordable prices round the year. The main supply from here goes to the TPDS (the PDS was restructured as the Targeted PDS in 1997) and at times goes for Open Market Sale to check the rising prices, if needed.

The Buffer Stocking norms (of 2005) was revised[28] by the government (by mid-2014) in the backdrop of increased requirement of foodgrains to run the TPDS in the last few years and with the coming into force of the National Food Security Act (NFSA). The new norms are as given below in the table:

REVISED BUFFER STOCK

As on	Existing since April, 2005 (in Million Tonnes)	Revised
1st April	21.2	21.04
1st July	31.9	41.12
1st Oct	21.2	30.77
1st Jan	25.0	21.41

As income levels of the BPL segment grows, in future, the buffer norms for the foodgrains are supposed to be revised downward. But the logic of maintaining such stocks will remain over there for the purpose of market intervention by the government.

DECENTRALIZED PROCUREMENT SCHEME

The decentralised procurement (DCP) scheme was operationalised by the GoI in 1997 (together with the Centre some states also procure foodgrains from the farmers, locally). Under this scheme, the designated states procure, store and also issue foodgrains under TPDS. The difference between the economic cost of the states and the central issue price (CIP) is passed on to the states by the GoI as subsidy. The decentralized system of procurement, helps to cover more farmers under the MSP operations, improves efficiency of the PDS, provides varieties of foodgrains more suited to local taste, and reduces the transportation costs of the FCI.[29]

The GoI urged ***all states*** to adopt the DCP scheme so that costs of distribution can be saved and outreach of price support mechanism to the farmers in hitherto weaker areas can be improved. To overcome the problem of gaps in the flow of information about procurement operations on day-to-day basis, an *Online Procurement Monitoring System (OPMS)* has been evolved for reporting and monitoring on a daily basis, procurement operations for wheat, paddy and coarse grains in the country.

Two decisions[30] of the GoI that will impact procurement and stocks of rice and wheat from are:

(i) To limit procurement from states that are declaring bonus over and above the MSP to the extent of targeted TPDS and other welfare schemes (OWS) requirements. In the case of non-DCP states declaring bonus, the FCI will not take part in MSP operations in those states.

28. **Economic Survey 2014-15**, MoF, GoI, N. Delhi, Vol. 2, p. 85.
29. **Economic Survey 2011-12**, MoF, GoI, N. Delhi.
30. **Economic Survey 2014-15**, MoF, GoI, N. Delhi, Vol. 2, p. 84.

(ii) To cap the percentage of levy on rice at 25 per cent.

STORAGE

The total capacity available for storage of foodgrains as by 2014 was 727 lakh MT, comprising covered godowns of 567 lakh MT capacity and cover and plinth (CAP) facilities of 160 lakh MT capacity. The existing warehousing facility is limited not only in terms of capacity, but also to certain crops. The stockholding capacity has not kept pace with the increase in production and demand for a long time. The challenges of storage have been outlined by the *Economic Survey 2014–15* in the following way:

(a) The CAP of 160 lakh MT capacity cannot be treated as scientific storage.

(b) Public agencies do not have warehouses for proper storage of even half of the wheat and rice procured by them.

(c) In the wake of persistent seasonal inflation in perishables like fruits and vegetables, there was no effective strategy to control inflation on a sustainable basis.

(d) Cold storage capacity for all type of food items is just 29 MT *(Planning Commission 2012).* The production of potato alone is about 35 MT.

(e) Cold storage facility is available for only 10 per cent of fruits and vegetables produced in India *(Planning Commission 2011).*

To bridge the gap between the requirement and availability of scientific storage capacity is the immediate need of the hour. For this it is advisable to promote the policies by which private sector investment can be attracted to it.

ECONOMIC COST OF FOODGRAINS

The economic cost of foodgrains consists of three components, namely the MSP including central bonus (the price paid to farmers), procurement incidentals, and the cost of distribution. The economic cost for both wheat and rice witnessed significant increase during the last few years due to increase in MSPs and proportionate increase in incidentals as well as other costs. As per the *Economic Survey 2014–15,* the economic costs of wheat and rice in 2014–15 are estimated to be over Rs. 28 and Rs. 20 per kg, respectively (they were around Rs. 20 and Rs 15 in 2010–11).

High economic cost necessitated a detailed review of the open-ended procurement policy, especially in states that offer high bonus on top of MSP and those that impose high taxes and statutory levies, as well as stocking and distribution policies. In this regard, the government set up a ***High Level Committee (HLC)*** in August 2014 (Shanta Kumar as its Chairman) to suggest inter-alia *restructuring* or *unbundling* of the FCI with a view to improve its operational efficiency and financial management.

OPEN MARKET SALE SCHEME

The FCI has been undertaking sale of wheat at predetermined prices (reserve prices) in the open market from time to time, known as the Open Market Sale Scheme (OMSS). This is aimed at serving the following *objectives:*

(a) to enhance market supply of foodgrains;

(b) to exercise a moderating influence on open market prices; and

(c) to offload surplus stocks.

Under the Open Market Sale Scheme (Domestic), during the year 2014–15, 100 lakh tonnes of wheat was been allocated for sale in

the domestic market. *Deviating from the earlier practice,* this year (i.e., 2015–16) the government has adopted a policy of differential prices to encourage sale of older stock first—sticking to the following policy stance:

(i) Keeping the reserve price above MSP, but reasonably below the acquisition cost or economic cost of wheat, so that the buyers remain attracted to purchase of wheat from the mandis during the harvest season and the market remains competitive.

ii) Maintaining that the market price in the lean season does not increase much and inflation remains under check.

Price Stabilisation Fund

The GoI, by late *March 2015,* launched the Price Stabilisation Fund (PSF) as a Central Sector Scheme to support market interventions for price control of perishable agri-hoticultural commodities. The cost to be borne between the centre and states in equal ratio (in case of the North Eastern states, the respective share will be 75:25). The scheme will commence with only two crops, viz., onion and potato.

FOOD SUBSIDY

Food security system of the government has been aimed at *twin objectives*:

(i) Provision of minimum nutritional support to the poor through subsidized foodgrains, and

(ii) ensuring price stability in different states.

In fulfilling its obligation towards distributive justice, the government incurs food subsidy. The programme covers over 65 million BPL households serviced through 4,50,000 fair price shops. While the economic cost of wheat and rice has continuously gone up, the issue price has been kept unchanged since 1 July 2002. On account of implementation of the NFSA, the Central Issue Price (CIP) has further gone down for the APL and BPL categories. The government, therefore, continues to provide large and growing amounts of subsidy on foodgrains for distribution under the TPDS/NFSA and other nutrition-based welfare schemes and open market operations. The food subsidy bill has increased substantially in the past few years putting severe strain on the public exchequer which is estimated to cross Rs. 1,20,000 crores by **2015–16** (from around Rs. 23,000 crores of 2005–06).

FARM SUBSIDIES

Farm subsidies form an integral part of the government's budget. In the case of developed countries, the agricultural or farm subsidies compose nearly 40 per cent of the total budgetary outlay while in India's case it is much lower (around 7.8 per cent of GDP) and of different nature.

Direct farm subsidies: These are the kinds of subsidies in which direct cash incentives are paid to the farmers in order to make their products more competitive in the global markets. The developed countries (USA and Europe) spend huge amounts of their annual budgets on the agriculture, farm and fisheries subsidies. Direct farm subsidies are helpful as they provide the right levels of purchasing power to the farmer and can significantly help in raising the standards of living of the rural poor. They also help in checking the misuse of public funds as they help in the proper identification of the beneficiaries.

Indirect farm subsidies: These are the farm subsidies which are provided in the form of cheaper credit facilities, farm loan waivers, reduction in irrigation and electricity bills, fertilizers, seeds and pesticides subsidy as well as the investments in agricultural

research, environmental assistance, farmer training, etc. These subsidies are also provided to make farm products more competitive in the global market.

The subsidies provided on the fertilizers as 'input' subsidies are in the form of *indirect* subsidies. But if the government does not incentivize the farmer by an effective cost reduction in prices of the fertilizers, but provides direct cash incentives after the produce, is known as a *direct* subsidy.

The World Trade Organization (WTO) has put some ceilings on the amount of direct and indirect subsidies being provided by the various developing and developed nations due to the fact that these subsidies *distort the free market forces* which have their own implications.

First thoughts are encouraging. A panel headed by Montek Singh Ahluwalia (the then Deputy Chairman, *Planning Commission)* recommended that the power ministry, instead of paying power-distribution companies, hand out electricity subsidies **directly** to farmers through a smart card linked to the unique identity number.

India spends about Rs. 1,60,000 crore every year or roughly 2 per cent of its GDP on subsidies, ***all indirectly***. For example, in fertilizers, which accounts for two-thirds of total subsidies, the government fixes a low selling price and compensates the producers by paying the difference between the selling price and the actual production costs (plus a pre-decided profit margin) as subsidy. *Important issues* related to farm subsidies are as given below:

(i) The indirect subsidy has been blamed for benefiting big farmers more than the small and medium farmers, for whom the subsidy is intended. This is because the bulk of the subsidised fertilizers is picked up by the rich farmers, because the small and marginal farmers account for just 37 per cent of the farm land.

(ii) Indirect subsidy has also discouraged improvements in production processes since manufacturers have no incentive to increase efficiency. This will also play a big part in bringing down India's overall subsidy bill. For instance, according to industry estimates, the money spent on poor farmers could potentially come down to Rs. 37,000 crore from the current Rs. 100,000 crore.

(iii) Another advantage of cash subsidies is that it will free up the distribution system and allow the people who receive the subsidy to choose where they buy their goods from. The complexity is not so much in the transfer of funds, as it is in the identification of the beneficiaries.

Other Countries: The idea of disbursing subsidies directly to the beneficiaries is becoming popular among the development thinkers and policymakers. It's already a part of policy in many parts of the world—predominantly, in Latin America where 16 countries have this practice, and also in other countries such as Jamaica, Philippines, Turkey and Indonesia.

The biggest and most cited of such programmes is Brazil's *Bolsa Familia*. It started in 2001, with a programme aimed at education. It expanded in 2003 to include a range of services like food and fuel, and now covers 2.6 million families in that country. The government *transfers cash* straight to a family, subject to conditions such as school attendance, nutritional monitoring, pre-natal and post-natal tests. By many measures, the programme is a success. Brazil's poverty levels dropped by 15 percentage points between 2003 and 2009, at least a sixth, thanks to Bolsa Familia (economic growth played a big part, too.) Millenium Development Goals initiative, which in 2000 sought to halve poverty by 2015, doesn't even mention cash transfers. But, Brazil achieved the goals 10 years ahead of the deadline. And the cost of these transfers has been 0.4 per cent of GDP.

The big question is not whether a direct cash transfer is the perfect solution, but whether it's an improvement over the existing systems. The evidence—its success in other parts of the world—and the poor performance of indirect subsidies so far would suggest so. Looking at it, the GoI has already started a pan-India scheme to disburse all forms of subsidies derectly, through the ***Direct Benefit Transfer (DBT)*** since 2015–16 onwards.

SUGAR SECTOR REFORMS

India is the largest consumer and second largest producer of sugar after Brazil. Sugar and sugarcane are notified as essential commodities under the Essential Commodities Act 1955. However, the Indian sugar sector suffers from policy inconsistency and unpredictability. The sugar industry in India is over-regulated and prone to *cyclicality* due to price interventions. Deregulation of the sugar industry has been widely debated for a long time. From a purely economic point of view, greater play of market forces would provide better prices and serve the interests of all stakeholders. The government should come into the picture only in situations where absolutely necessary. Export bans and controls could be replaced with small variable external tariffs to stabilize prices. A report on *'Regulation of the Sugar Sector in India: The Way Forward'* has been submitted by the Committee under the chairmanship of Dr. C. Rangarajan, Chairman of the Economic Advisory Council to the Prime Minister. The measures suggested[31] are as follows:

(i) phasing out cane reservation area

(ii) dispensing with minimum distance criteria

(iii) dispensing with the levy sugar system

(iv) states that want to provide sugar under the PDS may procure it from the market according to their requirement, fix the issue price and subsidise from their own budgets (till April 4, 2013, when the GoI 'decontrolled' the sugar industry from the burden of 'levy' to the tune of 10 per cent of their total production, there was an implicit cross-subsidy on account of the levy as sugar mills were under a transition). The report suggested some level of central support to help states meet the cost to be incurred on this account may be provided for a transitory period (which has been announced on April 4, 2013).

(v) dispensing with the regulated release mechanism (of non-levy) sugar

(vi) stable trade policy

(vii) no quantitative or movement restrictions on by-product like molasses and ethanol, and dispensing with compulsory jute packing.

(viii) a stable, predictable and consistent policy reforms to be brought about in a fiscally neutral manner and issues considered for implementation in a phased manner.

In the meanwhile, following on the path of ongoing *'factor market reforms'* the GoI decontrolled the sugar industry in *April 2013*—effective for the 'sugar year' September 2012–August 2013. It abolished the decades-old practice of regulating 'how much sugar a mill can sell in the open market' and the 'levy' system in which a company is forced to sell 10 per cent of the output at a loss to the FCI for supplies through the PDS (Public Distribution System)—they will be no more under the levy obligation. The *next move* of reform may be 'linking sugar and sugarcane prices'. To continue subsidised supply to the poor, states will now have to buy sugar at market rates and maintain the existing PDS sale price.

31. **Economic Survey 2012-13,** MoF, GoI, p. 177

RESTRUCTURING OF FCI

The GoI did set up a High Level Committee (Shanta Kumar as its Chairman) to suggest *restructuring* or *unbundling* of the Food Corporation of India (FCI) with a view to improve its *operational efficiency* and *financial management*. Some of the recommendations have already been implemented by the GoI by now. The **subject-wise** recommendations of the committee are as given below:

ON FCI

(i) The FCI should hand over all procurement operations of wheat, paddy and rice to states that have gained sufficient experience in this regard and have created reasonable infrastructure for procurement. The FCI will accept only the surplus (after deducting the needs of the states under the NFSA) from these state governments (not millers) to be moved to deficit states. The FCI should move on helping those states where farmers suffer from distress sales (prices below MSP), and which are dominated by small holdings.

(ii) Centre should make it clear to states that in case of any bonus being given by them on top of MSP, it will not accept grains under the central pool beyond the quantity needed by the state for its own TPDS and Other Welfare Schemes. This advice has already been notified by the GoI.

(iii) The statutory levies including commissions need to be brought down uniformly to 3 per cent, or at most 4 per cent of MSP, and this should be included in the MSP itself (states losing revenue due to this rationalisation of levies can be compensated through a diversification package for the next three-five years).

(iv) The Government of India must provide better price support operations for pulses and oilseeds and dovetail their MSP policy with trade policy so that their landed costs are not below their MSP.

(v) Cash transfers in TPDS should be gradually introduced, starting with large cities with more than 1 million population —extending it to grain surplus states and then giving deficit states for the option of cash or physical grain distribution.

(vi) The ***new face of the FCI*** will be akin to an agency for innovations in the *food management system* with the primary focus of creating competition in every segment of the foodgrain supply chain, from procurement to stocking to movement and finally distribution under the TPDS, so that overall costs of the system are substantially reduced and leakages plugged and it serves a larger number of farmers and consumers.

ON TPDS AND NFSA

(i) Given that leakages in the TPDS range from 40 to 50 per cent, the GoI should defer implementation of the NFSA in states that have not done end-to-end computerisation; have not put the list of beneficiaries online for anyone to verify; and have not set up vigilance committees to check pilferage from TPDS.

(ii) Coverage of population should be brought down to around 40 per cent.

(iii) BPL families and some even above that be given 7 kg/person.

(iv) On central issue prices (CIP), while Antyodya households can be given grains at Rs. 3/2/1/kg for the time being, but pricing for priority households must be linked to MSP.

On Stocking and Movement

(i) FCI should outsource its stocking operations to various agencies.

(ii) Covered and plinth (CAP) storage should be gradually phased out with no grain stocks remaining in CAP for more than 3 months.

(iii) Silo bag technology and conventional storages wherever possible should replace CAP.

On Buffer Stocking Operations and Liquidation Policy

(i) The Department of Food and Public Distribution (DFPD)/FCI have to work in tandem to liquidate stocks in Open Market Sale Scheme (OMSS) or in export markets, whenever stocks go beyond the buffer stock norms. A transparent liquidation policy is the need of hour, which should automatically kick-in when FCI is faced with surplus stocks than buffer norms.

(ii) Greater flexibility to FCI with business orientation to operate in OMSS and export markets is needed.

On Direct Subsidy to Farmers

(i) Farmers be given direct cash subsidy (of about Rs 7000/ha) and fertilizer sector can then be deregulated.

On end-to-end Computerization

(i) To go for total end-to-end computerisation of the entire *food management system,* starting from procurement from farmers, to stocking, movement, and finally distribution through the TPDS.

AGRICULTURE MARKETING

India's grimarket is presently regulated by the Agricultural Produce Market Committee (APMC) Act enacted by the state governments. There are about 2,477 principal regulated agrimarkets and 4,843 sub-market yards regulated by the respective APMCs in India. Thus, India has not one, not 29 (number of states) but thousands of agricultural markets. This Act notifies agricultural commodities produced in the region such as cereals, pulses, edible oilseed, fruits and vegetables and even chicken, goat, sheep, sugar, fish, etc., and provides that first sale in these commodities can be conducted only under the aegis of the APMC through the commission agents licensed by the APMCs set up under the Act.

The typical *amenities* available in or around the APMCs are: auction halls, weigh bridges, godowns, shops for retailers, canteens, roads, lights, drinking water, police station, post-office, bore-wells, warehouse, farmers amenity center, tanks, water treatment plant, soil-testing laboratory, toilet blocks, etc. Various taxes, fees/ charges and cess levied on the trades conducted in the *mandis* are also notified under the Act.

As per the *Economic Survey 2014–15,* the APMCs of the states levy multiples fees of substantial magnitude which are non-transparent and hence work as a source of political power. The functioning of the APMCs have always been a matter of debate among experts and policymakers alike—**major issues** being the following:

- They charge a market fee of buyers, and they charge a licensing fee from the commissioning agents who mediate between buyers and farmers.
- They also charge small licensing fees from a whole range of functionaries (warehousing agents, loading agents, etc.).

- In addition, commissioning agents charge commission fees on transactions between buyers and farmers.
- The levies and other market charges imposed by states vary widely. Statutory levies/mandi tax, VAT, etc., are a major source of market distortion.
- Such high taxes at the first level of trading have significant cascading effects on commodity prices, as the commodities passes through the supply chain. For rice, these charges can be as high as 14.5 per cent in Andhra Pradesh (excluding the state VAT) and close to 10 per cent in Odisha and Punjab.
- Even the model APMC Act (described below) treats the APMC as an arm of the state, and, the market fee, as the tax levied by the state, rather than fee charged for providing services. This is a crucial provision which acts as *a major impediment to creating national common market* in agricultural commodities. Removal of this provision will pave the way for creating competition and a national common market for agricultural commodities.
- Moreover, though the market fee is collected just like a tax, the revenue earned by the APMCs does not go to the state exchequer and hence does not require the approval of State legislature to utilise the funds so collected. Thus APMC operations are hidden from scrutiny.
- The rate of commission charged by the licensed commission agents is exorbitant, because, unlike direct taxes, which are levied on net income, the commission is charged on the entire value of the produce sold. The license fee charged from various market licensed operators is nominal, but the small number of licences granted creates a premium, which is believed to be paid in cash.
- There is a perception that the positions in the market committee (at the state level) and the market board – which supervises the market committee – are occupied by the politically influential persons. They enjoy a cosy relationship with the licensed commission agents who wield power by exercising monopoly power within the notified area, at times by forming cartels. The resistance to *reforming* APMCs is perceived to be emanating from these factors.

The scope of the *Essential Commodities Act, 1955* (EC Act) is much broader than the APMC Act. It empowers the central and state governments concurrently to control production, supply and distribution of certain commodities, including pricing, stock-holding and the period for which the stocks can be kept and to impose duties. The APMC Act on the other hand, controls only the first sale of the agricultural produce. Apart from food-stuffs which are covered under the APMC Act, the commodities covered under the EC Act generally are: drugs, fertilisers, and textiles and coal.

Model APMC Act

Since the State APMC Acts created fragment markets for agricultural commodities and curtailed the freedom of farmers to sell their produce other than through the commission agents and other functionaries licensed by the APMCs, the Ministry of Agriculture (GoI) developed a *Model APMC Act, 2003* and has been pursuing the state governments to modify their respective Acts along it. The Model APMC Act provides the following new things:

(i) Direct sale of farm produce by the farmer to contract farming sponsors;

(ii) Setting up 'Special markets' for 'specified agricultural commodities'—mostly perishables;

(iii) Permits private persons, farmers and consumers to establish new markets for agricultural produce in any area;

(iv) A single levy of market fee on the sale of notified agricultural commodities in any market area;

(v) Replaces licensing with registrations of market functionaries which would allow them to operate in one or more different market areas;

(vi) Establishment of consumers' and farmers' markets to facilitate direct sale of agricultural produce to consumers;

(vii) Creation of marketing infrastructure from the revenue earned by the APMC;

(viii) Provides some freedom to the farmers to sell their produce directly to the contract-sponsors or in the market set up by private individuals, consumers or producers;

(ix) Increases the competitiveness of the market of agri-produce by allowing common registration of market intermediaries.

Many of the states have partially adopted the provisions of model APMC Acts and amended their APMC Acts. Some of the states have not framed rules to implement the amended provisions, which indicate *hesitancy* on the part of state governments to liberalise the statutory compulsion on farmers to sell their produce through APMCs. Some states (such as Karnataka)[32] have however adopted changes to create greater competition within the state—popularly known as the ***Karnataka Model***.

Karnataka has integrated its 51 of the 155 main market yards and 354 sub-yards into a single licensing system. *Rashtriya e-market Services Ltd. (ReMS),* a joint venture created by the state government and NCDEX Spot Exchange, offers automated auction and post auction facilities (weighting, invoicing, market fee collection, accounting), assaying facilities in the markets, facilitate warehouse-based sale of produce, facilitate commodity funding, price dissemination by leveraging technology. The wider geographical scope afforded by breaking up fragmented markets has enabled private sector investment in marketing infrastructure.

The provisions of the Model APMC Act do not go far enough to create a national or even state level common market for agricultural commodities as it has several inadequacies. These ***inadequacies*** have been highlighted by the *Economic Survey 2014–15* in the following way:

- The model APMC Act retains the mandatory requirement of the buyers having to pay APMC charges even when the produce is sold directly outside the APMC area, say, to the contract sponsors or in a market set up by private individuals even though no facilities provided by the APMC is used.
- The relevant provision in the model APMC Act is, 'power to levy market fee' (single point levy)—"every market shall levy market fee on the sale or purchase of notified agricultural produce, whether brought from within the State or from outside the State into the market area."
- The model APMC Act bars the APMCs and commission agents from deducting the market fee/commission from the seller, but the incidence of these fees/

32. Other states like Maharshtra, Tamil Nadu and Andhra Pradesh did also go for reforms in their APMCs taking clues from the Model APMC Act – making these states also to have some synergy coming into their agriculture market.

commission falls on the farmers since buyers would discount their bids to the extent of the fees/commission charged by the APMC and the Commission agents.

- The model APMC Act provides for setting up of markets by private sector, but this provision is not adequate to create *competition* for APMCs even within the state, since the owner of the private market will have to collect the APMC fees/taxes, for and on behalf of the APMC, from the buyers/sellers in addition to the fee that he wants to charge for providing trading platform and other services, such as loading, unloading, grading, weighing etc.

The *Economic Survey 2014–15* goes to the extent of using Constitutional provisions to set up a common agrimarket—in a way, suggesting the Centre to use its power to override the states' power on the APMC as the subject falls in the Concurrent List. But this approach could be seen as heavyhanded on the part of the Centre and contrary to the new spirit of *cooperative federalism*.

The central government is closely working with state governments to re-orient states' APMC Acts to provide for establishment of private market yards/private markets. As per the *Economic Survey 2014–15*, some of the **recent initiatives** taken in this regard are as follows:

(i) A comprehensive advisory issued to states to go beyond the provisions of the Model Act and declare the entire state a *single market* with one licence valid across the entire state and removing all restrictions on movement of agricultural produce within the state.

(ii) To promote development of a *common national market* for agricultural commodities through ***e-platforms***, a central-sector scheme for Promotion of National Agricultural Market through Agri-Tech Infrastructure Fund (ATIF) has been lauched—to be implemented by 2016–17.

(iii) On the request of the central government, a number of state governments have exempted the marketing of fruits and vegetables from the purview of the APMC Act. The NCT of Delhi has put fruits and vegetables outside its APMC. The Small Farmers Agribusiness Consortium (SFAC) has taken the initiative for developing a ***Kisan Mandi*** in Delhi with a view to providing a platform to FPOs for direct sale of their produce to prospective buyers totally obviating or reducing unnecessary layers of intermediation in the process. The SFAC plan to scale their activities in other states based on the outcome of the experience of the Delhi kisan mandi.

AGRICULTURAL CREDIT

Three types[33] of loans are provided to Indian farmers to meet their financial requirements—

(i) Short-term loans
(ii) Medium-term loans
(iii) Long-term loans

SHORT-TERM LOANS

Short-term loans are provided for a period of less than 15 months to meet out expenses of routine farming and domestic consumptions. This type

33. Rakesh Mohan, ***'Agricultural Credit in India: Status, Issues and Future Agenda'***, from his lecture delivered at the **17th National Conference of Agricultural Marketing**, Indian Society of Agricultural Marketing, Hyderabad, February 5, 2004 [Rakesh Mohan was the then Deputy Governor, Reserve Bank of India]

of loan is demanded by farmers for purchasing seeds, fertilizers and for meeting out family requirements.

Medium-Term Loans

Medium-term loans are provided for a period of 15 months to 5 years to purchase agricultural equipment, animals and for land improvement.

Long-Term Loans

Long-term loans are provided for a period of more than 5 years. This type of loan is taken by the farmers to purchase land and expensive agricultural equipment and for repayment of old loans.

Sources of Agricultural Loans

The Indian farmer can acquire the above types of loans from two sources:

(i) Non-institutional sources like moneylenders, landlords, big businessmen, etc.[34]

(ii) Institutional sources like commercial banks, co-operative banks and government sources.

Policy on agriculture credit aims at progressive institutionalisation of credit agencies for providing credit to farmers for raising agricultural production and productivity. Agricultural credit is disbursed through a multi-agency network consisting of co-operatives, commercial banks and regional rural banks (RRBs).

COMMODITY FUTURES MARKET

By mid-2015, out of the 113 commodities notified for futures trading, 43 were actively traded in 4 national exchanges and 6 commodity-specific exchanges. Share of agricultural commodities in the total turnover was over 18 per cent in 2014–15 (up to December 2014), with food items (refined soya oil, soyabean, chana, coriander and rapeseed/ mustard seed) contributing over 50 per cent of it. The remaining (81.63 per cent) turnover was contributed by bullion, metals and energy contracts.

A *Committee* set up by the Ministry of Finance, which submitted its report in April 2014 has observed that hedging efficiency of the commodity futures markets is low. In order to ensure that forward markets in commodities are well regulated and the Indian commodity futures market is compliant with international regulatory requirements, the regulatory framework for the commodity futures market needs to be strengthened at the earliest. The GoI decided to merge the commodity market regulator, the Forward Market Commission (FMC) with the Security & Exchange Board of India (SEBI) in **2015–16** with enhanced and effective regulatory power given to it.

UPSTREAM & DOWNSTREAM REQUIREMENTS

'Upstream' and 'downstream' are business terms applicable to the production processes that exist within several industries. Upstream, downstream and midstream make up the stages of the production process for different industries.

Upstream: The upstream stage of the production process involves searching for and extracting raw materials—it does not do anything with the material itself, such as processing the materials. In upstream firms simply find and extract the raw material. Thus, any industry that relies on the extraction of raw materials commonly has an *upstream stage* in its production process. In a more general sense, upstream can also refer to any part of the production process relating to the extraction stages.

34. Known as the Unregulated Credit Market.

Downstream: The downstream stage in the production process involves processing the materials collected during the upstream stage into a finished product. It further includes the actual sale. End users will vary depending on the finished product. Regardless of the industry involved, the downstream process has direct contact with customers through the finished product.

Midstream: Several points in between the two points (the place where raw is extracted and till it reaches the final consumer as finished product) are taken as the midstream. It depends on the reference point as how many or which stage is considered as the midstream by an industry.

Whether an activity is upstream or downstream depends on the point of analysis in a supply chain. A manufacturer considers suppliers as upstream and customers as downstream. Within a manufacturer, control over activities in the supply chain is subject to a company's management. Even so, a manufacturing activity that occurs prior to another is considered an upstream activity. Control over activities outside the company is subject to inter-company negotiations, cooperation and technology. The firms involved in the chain of upstream and downstream processes keep their eyes on several other dimensions, such as *strategies, integration* and *improvement:*

(i) It is important to understand the *strategies* of supply chain partners. A supplier may have a strategy to grow and begin to perform manufacturing functions infringing on other supply chain member's markets. Understanding the incentives of suppliers, as well as customers, helps to plan for these types of changes. In order to remain a powerful player in a supply chain, a company can no longer afford to focus on its own business or those of its competitors, it must understand supply chain members business as if they were their own.

(ii) *Integration* of business processes throughout a supply chain depends on cooperation of members. For example, a manufacturer who decides to sole-source a component with one supplier can control and integrate with the supplier to streamline business processes. Technology can be implemented to make business processes between companies easier to perform. For example, a supplier can change from requiring a purchase order for every delivery to having an open purchase order that simply keeps track of shipments based on material requirements plans from the manufacturing resource planning software of a manufacturer. This type of integration becomes less likely when suppliers serve many manufacturers.

(iii) Manufacturers in a supply chain make 'make-or-buy' decisions that affect the chain. They do this based on cost and scheduling *improvements* available. Manufacturers may also begin using distributors to capture additional markets or decide to concentrate on larger customers whom they can serve directly. All of these types of potential improvements depend on understanding the motivations and incentives of the companies in a supply chain.

Industries, to have a smooth and uniterrupted fuctioning, depend heavily on the upstream and downstream requirements. In case of ***India***, we find several bottlenecks in both the processes:

(a) In case of the private sector, the downstream process seems better. But it is not so. Upto the level of 'wholesale' it is

somewhat organised, but the retail trading is quite fragmented. India's *retail business* remains least organised. Organised retail is yet to evolve in the country, thus, the levels of uncertainities, potential of market access, monitoring and regulation of retail market are too weak.

(b) Upstream processes are also not up-to-the-mark. From the stage where the wholesale comes into picture, things look better. But outsourcing the raw from the local producers is an uphill task in the country. Due to this the upstream segment of the economy has remained too weak and frgamented.

(c) The industrial and manufactured sectors have been managing their upstream and downstream requirements, but their heavy depenence on the unorganised sector is a challenging issue infront of India.

(d) In case of the agricultural products, the situation is even worse. Regulation of the agrimarkets by the APMCs of states has not allowed India to emrge with a common and single market. This has hampered not only the growth and business prospects of the businesses involved in this segment but it has also crippled the agricultural sector in a very serious way. It has taken the heaviest toll on the agriculture sector which still remains a non-remunerative profession.

(e) As India is to compete in the global market, it immediately needs to stregthen it upstream and downstream process. For this, India is advised to pick the best practices from around the world and integrate itself with the developed world with the better ways and the state-of-the-art tools and means.

SUPPLY CHAIN MANAGEMENT

A *supply chain* is a network of facilities and distribution options that performs the functions of procurement of materials, transformation of these materials into intermediate and finished products, and the distribution of these finished products to customers. Supply chains exist in both service and manufacturing organisations, although the complexity of the chain may vary greatly from industry to industry and firm to firm.

Traditionally, marketing, distribution, planning, manufacturing, and the purchasing organisations along the supply chain operated independently. These organisations have their own objectives and these are often conflicting. Marketing's objective of high customer service and maximum sales conflict with manufacturing and distribution goals. Many manufacturing operations are designed to maximise throughput and lower costs with little consideration for the impact on inventory levels and distribution capabilities. Purchasing contracts are often negotiated with very little information beyond historical buying patterns. The result of these factors is that there is not a single, integrated plan for the organisation—there were as many plans as businesses. Clearly, there is a need for a mechanism through which these different functions can be integrated together. Supply chain management is a strategy through which such an integration can be achieved.

Supply chain management is typically viewed to lie between fully vertically integrated firms, where the entire material flow is owned by a *single firm*, and those where each channel member operates independently. Therefore, coordination between the various players in the chain is key in its effective management. Supply chain management can be compared to a well-balanced and well-practiced 'relay team'—such a team is

more competitive when each player knows how to be positioned for the hand-off. The relationships are the strongest between players who directly pass the baton, but the entire team needs to make a coordinated effort to win the race.

Supply chain management, then, is the active management of supply chain activities to maximise customer value and achieve a sustainable competitive advantage. It represents a conscious effort by the supply chain firms to develop and run supply chains in the most effective and efficient ways possible. Supply chain activities cover everything:

(i) Product development,
(ii) Sourcing,
(iii) Production,
(iv) Logistics, and
(v) Information systems (for proper coordination).

The organisations that make up the supply chain are 'linked' together through *physical* flows and *information* flows. Physical flows involve the transformation, movement, and storage of goods and materials. They are the most visible piece of the supply chain. But just as important are information flows—information flows allow the various supply chain partners to coordinate their long-term plans, and to control the day-to-day flow of goods and material up and down the supply chain.

Upstream & downstream requirements and the supply chain management: Indian scenario & the issues of allowing FDI in it.

This segment of India has seen least organised development, even in the reforms period. Due to lack of proper 'market reforms' in the area of agricultural products (as APMCs of different states have failed to develop) which hampered so many aspects of it—storage, grading, packaging, etc. It is believed that this field needs huge investments from the corporate sector. The corporate sector has not been much attracted to this sector. Main factors for the unwillingness among the private sector to put in their money in it are, scarcity of capital, logistics, experience and non-conducive policy framework of the agriculture market. This is the reason why the GoI has allowed more freedom to Foreign Direct Investment in retail chain development. It is expected that the willing foreign firms will not only bringing the needed fund to the sector but with them India will get international experience and best practices.

To compete in the globalising world markets and to gain economic benefits out of globalisation, India needs the following features in its supply chain management:

(i) An organised retain sector
(ii) Proper levels of logistics
(iii) Fully updated data of raw materials, production, cropping pattern, etc.
(iv) International class packaging, care to wards phyto-sanitary aspects.

It is felt that the above-cited features will be easier to manage for the top global players as they have fund, experience and a willingness to expand their businesses in the growing regions of the world.

To strengthen and broad base the market, the Forward Markets Commission (FMC), which is ***the regulator*** for commodity futures trading under the provisions of the Forward Contracts (Regulation) Act 1952, has taken many initiatives such as:[35]

(i) Conducted awareness programmes in 2011, such as a media campaign under the ***Jago Grahak Jago Programme*** about

35. ***Economic Survey 2011-12,*** op. cit., p. 199.

the Dos and Don'ts of trading in the commodity futures market;

(ii) Police training programmes in the states of Madhya Pradesh, Chhattisgarh, Tamil Nadu and Delhi with regard to dabba trading / illegal trading;

(iii) A massive awareness and capacity-building programme for various stakeholder groups, with primary focus on farmers.

(iv) On the regulatory front, the FMC undertook measures for the development of the commodity futures market, which include ensuring more effective inspection of members of the exchanges on regular basis and in a comprehensive manner covering all aspects of the regulatory regime.

(v) Bringing out a guidance manual for improving audit practices, prescribing penalty structure for client code modification and for executing trade.

(vi) Granting exemptions for short hedge for soyabean/oil futures, issuing directives for segregation of client accounts.

FARM WASTE DEBATE

A recent study,[36] undertaken by the Central Institute of Post-Harvest Engineering and Technology (CIPHET), a government-run institute, has estimated the value of farm waste in India at Rs. 44,000 crore (at the prices of 2009), that is around 7 per cent of the total produce, which is much lower than the oft-stated 40 per cent level. Although cereals, such as wheat and rice, pulses and oil seeds accounted for around two-thirds of the wastage, the loss in case of fruits and vegetables was the highest at up to 18 per cent of the total produce.

Attending the causes of storage and processing facilities, something the GoI is emphasising, this level could come down significantly and can serve great purpose in helping the economy to fight the repeated price shocks of the past two years in case of fruits, vegetables and foodgrains to a great extent.

The losses take place in almost all stages of farming but ***the study*** looked at harvesting, collection, grading, cleaning, packaging, transportation and storage. If cultivation was also included the loss figure would be much higher. The GoI has said that availability of better technology and their adoption has brought about a reduction in losses.

IRRIGATION

The Planning Commission[37] classified irrigation projects/schemes in India on the following lines :

(i) *Major Irrigation Schemes*—those with cultivable command areas (CCA) of more than 10,000 hectares.

(ii) *Medium Irrigation Schemes*—those with cultivable command areas (CCA) between 2,000 and 10,000 hectares.

(iii) *Minor Irrigation Schemes*—those with cultivable command area (CCA) upto 2,000 hectares. Expansion of irrigation facilities, along with consolidation of the existing systems, has been the main part of the strategy for increasing production of foodgrains.

With a view to ensuring early completion of projects for providing irrigation benefits to the farmers, Rural Infrastructure Development Fund

36. ***Central Institute of Post-Harvest Engineering and Technology (CIPHET),*** ICAR, Ministry of Agriculture, GoI, Ludhiana, Study released in September, 2011.

37. ***Planning Commission***, GoI, N. Delhi, 1961.

(RIDF) has been in operation since 1995–96. The government launched the Accelerated Irrigation Benefits Programme (AIBP) in 1996–97 to give loan assistance to the states to help them complete some of the incomplete major/medium irrigation projects, which were in an advanced stage of completion.

NATIONAL FOOD SECURITY MISSION (NFSM)

The NFSM, launched in 2007, is a **crop development** scheme of the Government of India that aims at additional production of 10, 8 and 2 million tonnes of rice, wheat and pulses, respectively by the end of 2011–12. The mission interventions consist of:[38]

(i) seeds of improved variety,
(ii) soil ameliorants,
(iii) plant nutrients,
(iv) farm machines/implements, and
(v) plant protection measures

In addition, a special initiative under the name of the ***Accelerated Pulses Production Programme*** was initiated in 2010 to boost the production of pulses by active promotion of technologies in 1,000 clusters of 1,000 ha (hectare) each.

Considerable achievements under the NFSM have been recorded during the course of implementation of the programme such as new farm practices, distribution of seeds of high yielding varieties of rice, wheat, pulses, and hybrid rice, and treating area with soil ameliorants to restore soil fertility for higher productivity. Through targeted interventions, the mission has already achieved, a year in advance, 25 millions tonnes of additional production of foodgrains exceeding the target of 20 million tonnes of production set for the terminal year 2011–12, of the Eleventh Plan.

MACRO MANAGEMENT OF AGRICULTURE (MMA)

The MMA was revised in 2008 to improve its efficacy in supplementing/complementing the **efforts of the states** towards enhancement of agricultural production and productivity.[39] It also provides opportunity to draw upon agricultural development programmes out of ten sub-schemes relating to crop production and natural resource management, and give it the flexibility to use 20 per cent of resources for innovative components.

The revised MMA scheme has formula-based allocation criteria and provides assistance in the form of grants: loan to the states/UTs on 90:10 ratio basis, except in case of the north-eastern states where the central share is 100 per cent grant.

RASHTRIYA KRISHI VIKAS YOJANA (RKVY)

The RKVY was launched in 2007–08 for incentivising states to enhance public investment to achieve 4 per cent growth rate in agriculture and allied sectors during the Eleventh Plan.[40] The RKVY format permits taking up national priorities as sub-schemes, allowing the states flexibility in project selection and implementation. The sub-schemes include—

(i) Bringing Green Revolution to eastern region;
(ii) Integrated development of 60,000 pulses villages in rainfed areas;
(iii) Promotion of oil palm;
(iv) Initiative on vegetable clusters;
(v) Nutri-cereals;
(vi) National Mission for Protein Supplements;

38. ***Economic Survey 2011-12,*** op. cit., p. 190.
39. ***Economic Survey 2011-12,*** op. cit., p. 190.
40. ***Economic Survey 2011-12,*** op. cit., p. 190.

(vii) Accelerated Fodder Development Programme;
(viii) Rainfed Area Development Programme; and
(ix) Saffron Mission.

The RKVY links 50 per cent of central assistance to those states that have stepped up percentage of state plan expenditure on agriculture and allied sectors. States have indeed increased allocation to agriculture and allied sectors from 4.88 per cent of total state plan expenditure in 2006–07 to 6.04 per cent of in 2010–11 (as per the Revised Estimates, *Economic Survey 2011–12)*.

ISOPOM

The centrally sponsored ISOPOM (Integrated Scheme of Oilseeds, Pulses, Oil Palm, and Maize)[41] have been under implementation during the Eleventh Plan in 14 states for oilseeds and pulses, 15 for maize, and 9 for oil palm. The pulses component has been merged with the NFSM with effect from April 1, 2010. Oilseeds are raised mostly under rainfed conditions and are important for the livelihood of small and marginal farmers in the arid and semi-arid areas of the country.

NATIONAL HORTICULTURE MISSION(NHM)

The horticulture sector includes a wide range of crops, such as fruits, vegetables, roots and tuber crops, flowers, aromatic and medicinal plants, spices, and plantation crops, which facilitate diversification in agriculture. It has been recognised that growing horticulture crops is now an ideal option to improve livelihood security, enhance employment generation, attain food and nutritional security, and increase income through value addition. Over the years, there have been noticeable achievements and significant improvement in the production and productivity of various horticulture crops.

The NHM scheme was launched[42] during the Tenth Plan for **holistic development** of the horticulture sector, duly ensuring *forward* and *backward linkages* by adopting a *cluster approach,* with the active participation of all stakeholders. The supply of quality planting material through establishment of nurseries and tissue culture units, production and productivity improvement programmes through area expansion and rejuvenation, technology promotion, technology dissemination, human resource development, creation of infrastructure for post-harvest management and marketing in consonance with the comparative advantages of each state/region and their diverse agro-climatic conditions are the major programmes of the Mission. A major initiative has been taken during 2011–12 for enhancing the supply of good quality vegetables to metro cities under the *Vegetable Initiative in Urban Clusters (VIUC).*

NATIONAL BAMBOO MISSION (NBM)

The NBM, a centrally sponsored scheme of the Ministry of Agriculture for harnessing the potential of the bamboo crop in the country, is under implementation in 27 states. It envisages promoting *holistic growth of the bamboo sector* by adopting an area-based, regionally differentiated strategy to increase the area under bamboo cultivation and marketing.[43] Under the Mission, steps have been taken to increase the availability of quality planting material by supporting the setting up of new nurseries/tissue culture units and strengthening existing ones. To address forward integration, the Mission is taking steps

41. ***Economic Survey 2011-12,*** op. cit., p. 190-191.
42. ***Economic Survey 2011-12,*** op. cit., p. 191-192.
43. ***Economic Survey 2011-12,*** op. cit., p. 192.

to strengthen marketing of bamboo products, especially those related to handicraft items. Besides the Mission has provided financial assistance to different institutions/universities for twenty-three R&D projects aimed at higher productivity of bamboo. Agro-forestry trials comprising bamboo grown along with agricultural/horticultural crops and medicinal plants under different agro-climatic conditions in various states have been initiated.

NATIONAL AGRICULTURAL POLICY, 2000[44]

The Union Government has announced the new National Agricultural Policy in the Parliament on July 28, 2000. This policy has been planned under the provisions of the ***World Trade Organization*** so as to face the challenges of the agriculture sector. This policy gives emphasis on promoting agricultural exports after fulfilling domestic demand. The salient features[45] of this policy are:

(i) 4 per cent growth rate p.a. for the next two decades.

(ii) 4 per cent growth rate p.a. target to be achieved by 2005.

(iii) Land reforms to provide land to poor farmers.

(iv) Consolidation of holding in all states of the nation.

(v) Promoting private investments in agriculture.

(vi) Provide insurance umberalla for crops to farmers.

(vii) Promote bio-technology.

(viii) Promoting research for developing new varieties of crops and ensuring protection to the developed varieties.

AGRICULTURAL INSURANCE

There are various major crop insurance schemes under implementation in the country:

(i) *National Agricultural Insurance Scheme (NAIS):* The NAIS is a government-sponsored central-sector crop insurance scheme being implemented in the country since 1999–2000 season (the erstwhile *Comprehensive Crop Insurance Scheme-CCIS* of 1985 was merged into it) with the **objective** of providing financial support to farmers in the event of failure of crops as a result of *natural calamities, pests and diseases.* The Agriculture Insurance Company of India Ltd. (AICIL) is the implementing agency for the scheme. At present, the scheme is being implemented by 25 states and two UTs.[46]

(ii) *Modified NAIS (MNAIS):* With the aim of further improving crop insurance schemes, the MNAIS is under implementation on **pilot basis** in 50 districts in the country from rabi 2010–11 season. Some of the major improvements made in the MNAIS are[47]—

(a) *Actuarial premium* with *subsidy in premium* at different rates;

(b) All claims liability to be on the insurer;

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44. ***Economic Survey 2000–01,*** MoF, GoI, N. Delhi.
45. New Agriculture Policy has been described as "Rainbow Revolution" which includes the following revolutions:
Green (Food Grain Production), White (Milk), Yellow (Oil seeds), Blue (Fisheries), Red (Meat/Tomato), Golden (Fruits-Apple), Grey (Fertiliser), Black/Brown (Non-conventional Energy Sources), Silver (Eggs) and Round (Potato).
The above Rainbow Revolution also includes "Food Chain Revolution" to put a check on destroying foodgrains, vegetables and fruits.
46. ***Economic Survey 2011–12***, MoF, GoI, N. Delhi.
47. ***Economic Survey 2011–12,*** MoF, GoI, N. Delhi.

(c) Unit area of insurance reduced to village panchayat level for major crops;

(d) Indemnity for prevented/sowing/planting risk and for post-harvest losses due to cyclone;

(e) On account payment up to 25 per cent advance of likely claims as immediate relief;

(f) More proficient basis for calculation of threshold yield; and

(g) Allowing private sector insurers with adequate infrastructure.

Only upfront premium subsidy is shared by the central and state governments on 50:50 basis and claims are the liability of the insurance companies. The scheme has been notified by 17 states by now.

(iii) *Pilot Weather Based Crop Insurance Scheme (WBCIS):* Being implemented as a central-sector scheme from kharif 2007 season. The scheme[48] is intended to provide protection to farmers *against adverse weather incidence,* such as deficit and excess rainfall, high or low temperature, and humidity that are deemed to adversely impact crop production. This is based on actuarial rates of premium, but to make the scheme attractive, premium actually charged from farmers has been restricted to be at par with the NAIS.

(iv) *Krishi Shramik Suraksha Yojana:* The multi-benefit scheme[49] for the agricultural workers, commenced on July 1, 2001, provides life insurance protection, lump sum survival benefit and pension to those who are between the age of 18–50 years—functions on group-basis with minimum of 20 members. No new lives are added even under existing schemes at the time of renewal. Gram Panchayat acts as the nodal agency and with the help of NGO/SHG or any other agency which identify the agricultural workers.

(v) *Farm Income Insurance Scheme:* The scheme[50] commenced in January 2004 for providing insurance safeguards and economic security to farmers—run by the Ministry of Agriculture and Indian Agriculture Insurance Company Ltd. jointly:

(a) Provides ***'broader risk insurance'***

(b) Conceived to provide income protection to the farmers by integrating the mechanism of *insuring production* as well as *market risks*

(c) Farmer's income is protected by ensuring minimum guaranteed income.

(d) Subsidy in premium payment

(e) Available for all the states and compulsory for farmers availing crop loans.

NAIS will be withdrawn for the crops covered under it, but would continue to be applicable for other crops.

(vi) *Varsha Bima (Rainfall Insurance Scheme):* Introduced in 2004 south-west monsoon period—***covers*** all natural rainfal risks and provides[51] five different options suiting varied requirements of the farming community:

48. ***Economic Survey 2006–07,*** op. cit.
49. ***India 2010 & 2011,*** Pub. Division, N Delhi, P. 379.
50. ***Economic Survey 2004–05,*** MoF, GoI, N. Delhi.
51. ***India 2005,*** GoI, N. Delhi.

(a) Seasonal rainfall insurance based on aggregated rainfall from June to September
(b) Sowing failure insurance based on rainfall between June 15 and August 15
(c) Rainfall distribution insurance with the weightage assigned to different weeks between June and September
(d) Agronomic Index constructed on the basis of water requirements of crops
(e) A catastrophe option covering extremely adverse deviation of 50 per cent and above in rainfall during the season

This scheme ***covers*** all natural rainfall risks at the following stages:

(a) Failure of seed crop either in full or in parts due to natural risks
(b) Loss in expected raw seed yield
(c) Loss of seed crop after harvest
(d) At seed certification stage

RESEARCH AND EXTENSION

The Indian Council of Agricultural Research (ICAR) is engaged in developing new crop varieties with specific traits that improve yield and nutritional quality along with tolerance /resistance to various biotic and abiotic stresses. Besides, it matches crop production and protection technologies to target agro-ecologies. The adoption of improved varieties and crop management technologies has resulted in enhancement of production and productivity of cereals, pulses, and other field crops. The *Economic Survey 2014–15* outlines the issues and challenges in this regard in the following way:

(a) It is imperative to make Indian agricultural growth science-led by shedding 'technology fatigue'. There is a need of creating research institutions on the pattern of Indian Institutes of Technology (IIT) and Indian Institutes of Sciences (IIS). In 2015–16, the GoI aims to set up two institutes of excellence in Assam and Jharkhand to promote the cause.
(b) Greater investment in applied research, education, and extension will serve multiple aims in the sector—enhanced growth, cost cutting, increase in yield and productivity together with equipping the country for the Second Green Revolution.
(c) The latest NSSO Survey (70th Round, December 2013) indicates that about 59 per cent of farmers do not get much technical assistance and know-how from government-funded farm research institutes or extension services. So they have to rely on progressive farmers, media, and private commercial agents such as dealers of farm inputs like seeds, fertilizers, and pesticides for technical information.
(d) To ensure last-mile connectivity, extension services need to be geared up to address emerging technological and information needs. Effectiveness of the 'lab-to-farm' programme can be improved by leveraging information technology and **e-** (net-based) and **m-** (mobile-based) applications, participation of professional NGOs, etc.

The government took initiative in 2015 to set up the *Kisan TV* for disseminating realtime information to farmers regarding new farming techniques, water conservation, organic farming, etc., will partly make up for the existing adverse ratio of one extension worker for every 800 to 1,000 farmers and provide farmers a direct interface with agricultural experts.

Some of the *major existing schemes*[52] in this regard as given below:

(i) ***Mass media support*** to agriculture focusing on Doordarshan infrastructure and All India Radio (AIR) broadcasting agriculture-related information;

(ii) ***Kisan Call Centres*** (KCC) to provide agricultural information to the farming community through toll-free telephone lines;

(iii) ***Agri-clinic*** and ***agri-business*** centres by agriculture graduates to provide extension services to farmers on payment basis through setting up of economically viable self-employment ventures, and information dissemination through agri-fairs;

(iv) ***Extension education institutes*** at Nilokher (Haryana), Rajendra Nagar (Andhra Pradesh), Anand (Gujarat), and Jorhat (Assam) are operating at regional level to improve the skills and professional competence of extension field functionaries of agriculture and allied departments;

(v) There are ***model training courses*** on thrust areas of agriculture, horticulture, animal husbandry, and fisheries with the objective of improving the professional competence, upgrading the knowledge, and developing technical skills of subject matter specialists/extension workers of agriculture and allied departments; and

(vi) ***MANAGE,*** Hyderabad, an apex institute at the national level, provides training to middle and senior level officers of agriculture and allied departments of the states/UTs.[53]

(vii) The Support to State Extension Programme (SSEP) is being launched by the GoI since 2005–06 with the objective of making the extension system farmer-driven as well as accountable to farmers. For this, **ATMAs** (Agricultural Technology Management Agencies) has been set up at district level, which have active particiaption of farmers, farmers groups, NGOs and other stakeholders.

FARM MECHANIZATION

Agricultural mechanization is one of the main drivers of agricultural sector growth. Farm power availability and average foodgrain yield have a direct relationship. It increases productivity of land and labour by meeting timeliness of farm operations and increases work output per unit time. Besides its paramount contribution to the multiple cropping and diversification of agriculture, mechanisation also enables efficient utilisation of inputs such as seeds, fertilizers, and irrigation water. Following ***observations*** are quite relevant in this regard:

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52. Several volumes of **Economic Survey** and **India** upto 2015-16.

53. ***MANAGE*** was established in 1987, as the *National Centre for Management of Agricultural Extension* at Hyderabad, by the Ministry of Agriculture, Government of India as an autonomous Institute, from which its acronym *'MANAGE'* is derived. In recognition of its importance and expansion of activities all over the country, its status was elevated to that of a National Institute in 1992 and re-christened to its present name i.e., National Institute of Agricultural Extension Management.

MANAGE is the Indian response to challenges of agricultural extension in a rapidly growing and diverse agriculture sector. The policies of liberalization and globalization of the economy and the level of agricultural technology becoming more sophisticated and complex, called for major initiatives towards reorientation and modernisation of the agricultural extension system. Effective ways of managing the extension system needed to be evolved and extension organisations enabled to transform the existing set up through professional guidance and training of critical manpower. MANAGE is the response to this imperative need.

(i) Although India is one of the top countries in agricultural production, the current level of farm mechanisation, which varies across states, averages around 40 per cent as against more than 90 per cent in developed countries *(Economic Survey 2014–15)*.

(ii) The farm mechanisation in India has been growing at a rate of less than 5 per cent in last two decades*(Economic Survey 2014–15)*.

(iii) The economic benefit of adoption of improved implements is about Rs. 80,000 crore per annum, which is only a small fraction of the potential *(ICAR, 2015)*.

(iv) Farm mechnaisation has resulted in generating employment to rural youth and artisans for the production, operation, and maintenance of machines *(Economic Survey 2013–14)*.

(v) Due to significant and continuous reduction of agricultural workforce, higher levels of farm mechanisation are necessary for sustaining productivity and profitability *(Economic Survey 2013–14)*.

India faces mainly ***two main challenges*** in its drive towards farm mechanisation:

(i) Highly diverse agriculture with different soil and climatic zones, requiring customized farm machinery and equipment, and

(ii) Small land holdings with limited resources.

In the 12th Plan the GoI launched a dedicated *Sub-Mission on Agricultural Mechanisation* with focus on spreading farm mechanisation to small and marginal farmers and regions that have low farm power availability.

NATIONAL MISSION FOR SUSTAINABLE AGRICULTURE (NMSA)

The NMSA, launched in 2011–12, **aims** at enhancing food security and protection of resources such as land, water, biodiversity and genetic resources by developing strategies to make Indian agriculture more resilient to climate change.[54] The ***Economic Survey 2011–12*** discusses the *Impacts of Climate Change on Indian Agriculture* in the following points:

(i) Indian agriculture, with two-third rainfed area remains vulnerable to various vagaries of monsoon, besides facing occurrence of drought and flood in many parts of the country. Natural calamities such as drought and flood occur frequently in many parts of the country.

(ii) Climate change will aggravate these risks and may considerably affect food security through direct and indirect effects on crops, soils, livestock, fisheries and pests. Building climate resilience, therefore, is critical.

(a) Potential adaptation **strategies** to deal with the adverse impacts of climate change are :

(b) Developing cultivars tolerant to heat, moisture and salinity stresses;

(c) Modifying crop management practices; improving water management;

(d) Adopting new farm practices such as resource-conserving technologies;

(e) Crop diversification; improving pest management;

(f) Making available timely weather-based advisories;

54. ***Prime Minister's Council on Climate Change (PMCCC)*** approved the Mission in September 2010 and the Ministry of Agriculture initiated activities under the Mission in 2011-12.

(g) Crop insurance; and harnessing the indigenous technical knowledge of farmers.

The Indian Council of Agricultural Research has initiated a scheme on *National Initiative on Climate Resilient Agriculture (NICRA)*. The initiative has been planned as a multi-disciplinary, multi-institutional effort covering crops, livestock and fisheries, and focusing mainly on adaptation and mitigation of climate change in agriculture. It also has a component for demonstration of climate-coping technologies on farmers' fields in 100 most vulnerable districts. State-of-the-art infrastructure is being set up at key research institutes to undertake frontier research on climate change adaptation and mitigation.

SECOND GREEN REVOUTION

Use of all eco-friendly means in cultivation is the Second Green Revolution (SGR) or Evergreen Revoultion or Sustainable Agriculture. For experts[55] it includes the agricultural practices such as,

(i) replacing chemical fertilisers by bio-fertilizers;

(ii) in place of chemical pesticides using bio-pesticides;

(iii) conserving water, balanced cropping pattern, proper crop combinations, etc;

Such agricultural practices are popular in developed economies as *organic farming*.[56]

SECOND GREEN REVOLUTION IN INDIA

The Second Green Revolution in India is *a concept* as well as the name of *a programme*. It was suggested as an idea of sustainable agriculture in mid-1990s by agro-scientists as the ongoing GR was not based on sustainable agricultural practices. When the Indian President, Dr. Kalam suggested for the same, he attached much wider meaning to it. For him it consisted of, crop management, cost reduction, value addition, processing and marketing other than the green farming.

In January 2004, the Government of India announced a major agricultural programme named as the Second Green Revolution with an initial fund allocation of Rs. 50,000 crore. This programme was so exhaustive that it had hardly left any problem area of Indian agriculture untouched and had every potential of solving all long-standing problems. In a sense it was a complete agricultural policy based on the concept of sustainable development and well-equipped to fight the challenges posed by the WTO and capable enough to make Indian agriculture to emerge as a winner in the globalising economy. As there was a government change at the Centre, the complete details of the programme were not made available. The present government at the Centre has not been referring to this programme, but in practice it looks like promoting the same causes more vigorously. In the meantime, the President has been quoting the need for a second green revolution time and again.

SUMMING UP THE SECOND GREEN REVOLUTION

If we add up the ***different announcements*** by the governments time to time and the ***propositions of experts*** we may sum up the idea of the second green revolution in India with the help of its three broad coordinates:

(i) *Increasing Agricultural Production:* It includes four major things—

55. As per M.S. Swaminathan, Dr. A.P.S. Abdul Klam, P.S. Paroda, ICAR, etc.
56. This kind of farming had already commenced in the Euro-American economies by the 1980s. However, the concept gained popularity by the early 1970s in the wake of environmental pollution due to rapid industrialisation. ***The Brundtland Report on Sustainable Development*** (1987) gave the ultimate boost.

(a) Unlike the Green Revolution which was limited to only five foodgrains (wheat, rice, jowar, bajra, maize), the Second Green Revolution includes all agricultural products—cereals, cash crops, animal husbandry (dairy, goatry, piggery, poultry, etc.), fisheries, sericulture, etc. It is rightly called the ***Rainbow Revolution***, Naturally, it is the most ambitious idea in the agriculture sector of India ever formalised.

(b) It deals with suitable kinds of cropping pattern, crop diversification, crop management, plant protection, checking per-harvest losses of agricultureal products, as well as post-harvest, integrated pest management, soil conservation, etc.

(c) Initiation of sustainable practices in agriculture are all instrumental factors of sustainable agriculture to be utilised.

(d) One very important point should be noted here that India cannot afford to go for only green farming or organic farming in the name of sustainable agricultural development. As the replacement of chemical inputs by the organic ones has every chance of reducing production and with use of costlier inputs, the produce of such a farming will not be economically accessible by the vast poor population of India (already due to costlier outputs, of the GR masses lack the required purchasing capacity). That is why ***'cost cut'*** is an integral part of this revolution. And that is why agro-scientists have suggested to base our agriculture on ***biotechnology***. Use of biotechnology in agriculture does not only open new dimensions for it but it has every potential to cut costs of the agricultural products by doing miraculous and unthinkable kind of research and development. India is very much aware of this reality that without an active support of biotechnology, sustainable agricultural development will have only elitist value and nothing else.[57]

(ii) *Value Addition:* Indian agriculture has been lacking the aspect of value addition. In the Indian agriculture sector right from farmers to the traders there has been a tendency of deposing agricultural goods in its primary form. That is why the real potential of Indian agriculture to create gainful employment has never been tapped. This green revolution tries to go for it in a big way. In this direction there will be an increased emphasis upon agro-processing, beverages and drinks industries.

(iii) *Strengthening the Infrastructural/ Institutional Aspects:* The last coordinate

57. Some of the known potential which the agro-scientists are in the process of speedier implementation are—7 to 8 times potential of increasing productivity of the foodgrains; drought and flood resistant seed development; pest-resistant seeds; hybrid seeds like ***'pomato'***; new bio-fertilisers and bio-pesticides; etc., All these new technologies initiated into the agricultural practices will not only boost the production but cut the costs enabling India to have ***economic reach*** to food being with the eco-friendly methods of farming.

As the question of ***food security*** is a matter of immediate concern for countries like India and China, the onus of popularising the genetically modified foods (GMFs) remains on them. That is why we see these two countries allowing the use of the GMFs in recent years.

of the Second Green Revolution is related to the aspects of timely and adequate infrastructural/institutional support without which it cannot happen:

(a) We need to strenghen the ***credit delivery*** aspects for the agriculture sector—both at the micro and macro levels (for corporate farming).

(b) The ***storage facilities*** for agricultural products in India is among the weakest in the world. India does not have adequate capacity of dry godowns and cold storage. In the area of refrigerated storage, much needs to be done. A beginning has been made recently by the railways with the initiation of the refrigerated station wagons. Basically, private sector participation is considered very vital for the growth of this segment.

(c) The country lacks a suitable kind of ***transport connectivity*** for which super-highways and rural connectivity programmes are today the high priority areas for the government. The private sector is also being encouraged though at present it too seems to have a limited role in this area, especially in urban areas and at the micro level only.

(d) The development of ***telecommunication*** with all modern means are necessary pre-conditions for the timely development of the agriculture sector and for the empowerment of the farmer.

(e) The ***irrigation preparedness*** of India needs grassroots level approach (already part of the Bharat Nirman) and needs a foolproof systemic approach. It becomes specially important once the climate has started showing its vagaries more and more in recent times.

(f) Everything done till date in the area of developing, an adequate kind of ***marketing network*** for agricultural products has not been capable of delivering the same. And that is why the profession of agriculture has been failing to emerge as an economic and profitable area for the farmers. We need to restructure and strengthen it right from the grassroots level to the national level. Only then can we internationalise (***globalise***) our agriculture sector.

(g) If there has been any one area which has failed to have the proper care and support of insurance it has been the agriculture sector. Even after covering all agricultural activities and products under the agricultural insurance scheme (The National Agricultural Insurance Scheme, 1999) it has very low penetration basically due to lack of awareness among the farmers/beneficiaries. Now the government is trying hard to do the same which also depends upon suitable level of insurance sector reforms, state governments, care to the sector and awareness among the beneficiaries. At present India has insurance coverage for the crops, seeds. Now there is a proposal to cover even the marketing risk, too.

If we make some **statements** about the SGR, there must not seem any exaggeration in it:

(i) "The SGR is capable of solving the whole gamut of problems related to Indian food philosophy."

(ii) "The SGR will give agriculture & rural development the due it deserves."

(iii) "The SGR will make Indian agriculture face the challenges of the WTO and emerge as a net gainer in the process of globalisation."

(iv) "The SGR is the best route to make economic reforms reach the masses and benefit those who consider it anti-poor, anti-agriculture and anti-rural areas."

(v) "The SGR is the best way to let people feel that economic reform has a *human face* and very much essential for rich and poor, alike."

(vi) "The SGR is, undoubtedly the best and the ultimate as well as a complete agriculture policy of India."

In recent times, the governmental approach has gone for a complete change in favour of the agriculture sector and the SGR. It is clearly visible from the streamlining of the New Agricultural Policy (2000), the Union Budget, Foreign Trade Policy, the Credit and Monetary Policy what would be the future requirements of the SGR.

Impact of Second Green Revolution

The Second Green Revolution has every prospect of revolutionising the agriculture sector of India with multi-dimensional positive impact on agriculture in particular and the economy, in general:

(i) As agricultural production will increase, India will be safe from ***food security*** concern. This will provide India ***physical access*** to food.

(ii) Every Indian will have ***economic access*** to food because of increase in production and cost cut due to genetically modified foods (GMFs) will make food cheaper.

(iii) As this is a sustainable kind of agriculture revolution, India will also be able to make its agriculture sector ecologically safe—the achievement of ***ecological access*** will become possible.

(iv) The surplus agricultural produce will enter the world market and agriculture sector will be able to tap the ***benefits of globalisation*** thus, farmers, rural areas and agri-business will be able to feel the benefits of economic reforms and globalisation.

(v) It will create ***gainful employment*** sources in the agriculture sector on which more than 58 per cent of the population depends for its livelihood. It will serve the purposes of poverty alleviation, bridging economic inequality, boosting rural development, solving the curse of unemployment, etc.

(vi) It will eliminate hunger and malnutrition from India.

(vii) India won't be an example of '***market failure***'—its market will succeed by increasing the purchasing capacity of the population.

(viii) Living standard of the population will improve and development has to show up. Thus, India's rank on the human development index (HDI) will improve for sure.

Other than the above-given points, there will be numerous related positive effects on the economy as a whole and on the agriculture sector in particular.

Second Green Revolution Strategy was adopted in the Eleventh Plan.[58] The urgent need for taking agriculture to a higher trajectory of four per cent annual growth can be met only with improvement in the scale as well as quality of agricultural reforms undertaken by the various

58. ***Economic Survey 2006–07,*** op. cit.

states and agencies at various levels. These reforms must aim at efficient use of resources and conservation of soil, water and ecology on a sustainable basis, and in a holistic framework. Such a holistic framework must incorporate financing of rural infrastructure such as water, roads and power.

The approach paper to the Eleventh Five Year Plan has highlighted such a holistic framework and suggested the following strategies to raise agricultural output:

(i) Doubling the rate of growth of irrigated area;

(ii) Improving water management, rain water harvesting and watershed development;

(iii) Reclaiming degraded land and focusing on soil quality;

(iv) Bridging the knowledge gap through effective extension;

(v) Diversifying into high value outputs, fruits, vegetables, flowers, herbs and spices, medicinal plants, bamboo, bio-diesel, but with adequate measures to ensure food security;

(vi) Promoting animal husbandry and fishery;

(vii) Providing easy access to credit at affordable rates;

(viii) Improving the incentive structure and functioning of markets; and

(ix) Refocusing on land reforms issues.

The National Commission on Farmers has already laid the foundation for such a framework.[59] Programme formulation as well as their implementation in the states must be based on unique regional contexts incorporating agro-climatic conditions; and availability of appropriate research and development (R&D) backed by timely and adequate extension and finance.

SECOND PUSH TO AGRICULTURE

The post-Green Revolution programme launched by the Government of Punjab in 2004, includes introduction of new technology in agriculture (green farming techniques, use of biotechnology, etc., encompassing the idea of *sustainable development*) besides crop diversification, promotion dairy and bee-keeping, floriculture, horticulture, modernising agriculture markets and value addition.[60]

WTO AND THE INDIAN AGRICULTURE: PROSPECTS AND CHALLENGES

With the operationalisation of the provisions of the World Trade Organization (WTO), the process of globalisation commenced in the major parts of the world—the non-member countries, in the coming few years, also started negotiating for entry into the club. There has always been an air of confusion among the members and the non-members of the WTO in assessing the pros and cons of globalisation on the health of their economies. The sector which has created the highest number of deliberations in the WTO as well as views and counterviews has been agriculture—an area of utmost concern for the developed and the developing worlds alike. India is no exception to it, better say it has been among the few countries in the world spear-heading the campaign against the biased provisions of the WTO concerning agriculture.

India was skeptical about the issue even before joining the organisation, but once it became a part of it, it started assessing the situation objectively and moved towards crisis mitigation. Globalisation as such opened unlimited prospects for the economies, but at the same time brought several challenges too. Yes, the challenges were different

59. ***India 2007,*** (op. cit.) might be seen for details.
60. Ministry of Agriculture, Government of Punjab, June 2004, Chandigadh.

in nature for the developed and the developing countries. We need to enquire the prospects and the challenges brought by the WTO for Indian agriculture.

Had the agriculture of the leading and politically vocal developing economies not be of subsistence level, the course of the world would have been completely different. It is the biggest hurdle in the process of globalisation and the success of the World Trade Organization. Yes, the process of converting the sector into an industry has already started in most of the leading developing economies amidst tough resistance from the farmers, political parties and the NGOs alike.

The Prospects

The oldest and the first document regarding the impact of the implementation of the provisions of the WTO, Uruguay Round (1995–2005) was prepared jointly by the World Bank, the GATT[61] and the OECD[62]. According to the joint document, the WTO provisions were supposed to have the following positive impacts on the world trade:

(i) By 2005 there will be an addition of $745 billion in the world merchandise trade.[63]

(ii) The ***GATT Secretariat*** provided a full break-up of the above-projected trade increase in the following way:

(a) The clothing sector to have a share of 60 per cent.

(b) The agricultural, forestry and fisheries products to have a share of 20 per cent.

(c) The processed food, beverages and drinks to have a share of 19 per cent.

It means that due to the implementation of the WTO provisions, there will be only ***one per cent*** increase in the trade of all other goods excluding the above-cited sectors. It was a highly inflated view and became a matter of debate around the world. But the areas which were projected to have very high increase in their trade were not mere projections either. Member countries went home and started going for their own studies, estimations and projections—India being no exception. We must see the assessment of India:

(i) The products which were projected to have the maximum increase in their trade, India had a traditional great export potential in them. It means the WTO has a great prospect for agriculture in store as maximum goods fell in the agriculture sector. Assuming that India's share in the world exports improves from 0.5 per cent to 1.0 per cent, and India is able to take advantage of the opportunities that are created, the trade gains may conservatively be placed at $2.7 billion extra exports per year. A more generous estimate will range from $3.5 to $7 billion worth extra exports.[64]

(ii) The NCAER (National Council for Applied Economic Research) survey of

61. General Agreement on Trade and Tariff (GATT) was a multi-lateral arrangement (not an ***organisation*** like WTO whose deliberations are binding on the member countries) promoting multi-lateral world trade. Now the GATT has been replaced by the WTO (***since Jan. 1995***).

62. ***Organisation for Economic Cooperation and Development*** (OECD) was set up as a world body of the developed economies from the Euro-American region which today includes countries from Asia, too (such as Japan, S. Korea). The first idea of 'globalisation' was proposed by the OECD in the early 1980s at one of its Annual Meet (***at Brussels***).

63. Merchandise trade does not include services.

64. Economic Survey 1994–95, MoF, GoI, N. Delhi.

the WTO on the Indian economy is cited as the best document in this area. The survey[65] had all important things to say on this issue:

(a) The exports of agricultural products will be boosted by the WTO accepted regime.

(b) Only the foodgrains trade that too of wheat and rice were projected to be around $270 billion.

(c) The survey also pointed out that almsot 80–90 per cent of the increased supply of foodgrains to the world is going to originate from only two countries China and India as they are having the scope for increasing production.

(d) But the survey painted a very wretched picture about the preparedness of Indian agriculture sector to exploit the opportunities. It concluded China to be far better than India is this matter.

(e) It suggested almost every form of preparedness for the agriculture sector (at a glance we may have been on the Second Green Revolution in India—basically the revolution is modelled on the findings and suggestions of the survey).

(f) Lastly, the survey ended at a high note of caution and concern that if India fails in its preparations to make agriculture come out as a winner in the WTO regime the economy will emerge as the biggest importer of agricultural products. At the same time the cheaper agri-imports might devastate Indian agricultural structure and the import-dependence may ruin the prospects of a better life for millions of poor Indians.

(g) Even if India does not want to tap the opportunities of the globalising world it has to gear up in the agriculture sector since the world market will hardly be able to fulfil the agri-goods demands of India by 2025. It means, it is only India which can meet its own agri-goods demand in the future.

There is no doubt that the WTO has brought problably ***the last opportunity*** to make our masses have better income and standard of living via better income coming from agriculture. But provided we go for the right kind of preparation at the right time. There are enough prospects, undoubtedly.

THE CHALLENGES[66]

If the WTO brings high prospects for Indian agriculture, it also brings in some hard-boiled challenges in front of it. These could be seen as individual challenges of the similar economies as well as joint challenges of such economies. The ***first*** category of challenges pertains to the area of relavent preparations, investment and restructuring of agriculture. And the ***second*** category of challenges are nothing less than a revision in the very agricultural provisions of the WTO itself (around which today revolves the success and faliure of the organisation itself). We may take a look at the challenges before the Indian agriculture:

65. ***NCAER Survey*** headed by its chairman Rakesh Mohan, GoI, 1994.

66. The challenges and their possible remedies discussed in this sub-topic are based on some of the finest and timely debates and articles which appeared in many renowned journals and newspapers between the period 1994–2007. For better understanding of the readers only the consensual as well as the less-complex parts have been provided here.

(i) *Self-sufficiency of Food:* Due to inflow of cheaper foodgrains from the world it would not remain economically viable in India to produce them and farmers might incline in favour of the profitable agri-products. This will make India heavily dependent upon the world market for its food supplies, marring its achievement of food self-sufficiency. This will have serious political and ethical outcomes for India.[67]

(ii) *Price Stability:* Dependence on the world market for the supply of agricultural products and specially for foodgrains will never be safe for India. As the international market for the products is highly speculative and full of variations (due to natural factors) the price stability will be always in danger—fluctuations hamper the producers and consumers of agri-goods in India. It would be very tough to fight *dumping* of surplus agri-goods from other countries.

(iii) *Cropping Pattern:* The cropping pattern of agriculture might take a very imbalanced shape, which will be highly detrimental to the ecology at large[68] as the farmers will always be in favour of going for the crops and commodities which have comparative price advantage.

(iv) *Weaker Sections:* The benefits of globalisation may not be neutral to areas, crops and the people. There will never prevail a certainty as to which area/region or crops or the people are going to benefit from globalisation in which year. At the same time globalisation is a process where profits can be made, but it is a market-based concept. Those who are unable to produce due to lack of capital, investment and entrepreneurship will have no gains from it. They will be net consumers or buyers. Since India has a vast population of the weaker sections (as other third world countries have) this population will neither be able to increase its income nor be able to purchase the agri-goods having no price stability.

It means that the weaker sections of India might miss this chance of growth and development. We need to make the benefits of globalisation reach these people, too. This could be done by a timely and society-orientied public policy which is a big challenge.[69]

(v) *WTO Commitments:* There are certain time-bound obligatory commitments of India towards the provisions of the WTO in the area of agriculture, which are highly detrimental to the people and

67. Almost 50 per cent of the Indian population spends 75 per cent of its total income on the purchase of foodgrains—this is why their standard of life and nutrition depends on the indigenously grown food in a great way. Once the self-sufficiency is lost their lives will depend upon the ***diplomatic uncertainties*** of its regular supply. It will have serious political outcomes for the political scenario of India. Similarly, irregular supply of the foodgrains will create a high ethical dilemma, too.

68. Farmers might go for highly repetitive kind of cropping pattern creating problems for soil fertility, water crisis, etc. This will have highly adverse effects on the agriculture insurance companies, too.

69. The primary examples of corporate and contract farming have given enough hints that economically weaker sections of society have meagre chances of benefitting from the globalisation of agriculture—with major profits going to the corporate houses. Naturally, the governments (centre and states) will need to come up with highly effective policies which could take care of the economic interests of the masses.

The policies may focus on areas such as ***healthcare, education, insurance, housing, social security,*** etc. Already the governments have started emphasising the delivery and performance of the ***social sector*** but in the future, more focused and accountable programmes in the sector will be required.

the economy. We may see this challenge from two angles—

(a) According to the agricultural provisions, the total subsidies forwarded by the government to the sector must not cross 10 per cent of the total agricultural outputs. At the same time, exemptions to farmers are to be withdrawn—hampering the public distribution system badly. India's subsidies are still far below this limit, but commitments pose a threat to the sovereign decision making.

(b) The subsidies (with different names) to agriculture, which are forwarded by the developed countries are highly detrimental to Indian agriculture and they are very high, too.[70]

None of the above-given challenges are easy to fight. These are not to be fought by India alone, but almost all developing countries are to face it. Once the WTO comes into operation, many experts from India and abroad have provided ways to fight these challenges, which may be summed up in the following way—

(i) To fight the challenges related to self-sufficiency in food, the price stability and the cropping pattern a judicious mix of suitable kind of agricultural and trade policies will be the need of the hour. To the extent agricultural policy is concerned, India has a limited level of freedom. But the WTO regime does not allow the member countries to impose higher tarrif or tarrif itself to ward off cheaper agri-goods from entering the economy—this is the main reason behind the above challenges. It means it is essential to modify, change or revise the provisions of the WTO.

Similarly, the issue of agricultural subsidies (*the Boxes*) need to be equitably defined so that they do not look biased. Here also the provisions of the WTO need revision.

To fight out this typical challenge, experts suggested that the ***WTO is not God-given***. Its provisions may go in for change if concerted efforts are made by the member countries in this direction. Like-minded nations who face the same kind of crises should come together and go for a joint effort, from inside the WTO, for the revisions or relaxations in its provisions. Morality related and ethical issues might be used as eye-openers and a handy tool to have the attention of the developed nations and the WTO alike.

Prima facie this suggestion looked as a preach easier said than done. Post-1995 saw a polarisation of like-minded countries inside the WTO that finally culminated into failure of the ***Seatle Round*** of the WTO deliberations. The most powerful country in the world failed to convene a meeting that too in its most distant region (the Alaska)—a moral triumph of the poor over the rich. This incidence while indicating a possible failure of the WTO itself, boosted the morale of the developing countries to go for stronger groupings and even sub-groupings under the WTO.

After the Doha Round the USA had hinted to forget multilateralism and indicated its intentions towards bilateralism. The European Union had the same intentions, but it did not show it as openly as the USA. The year 2002 came as a watershed period for the WTO when the EU in its new diplomatic move announced to hear the agriculture-related issues of the developing

70. Some of the developed economies are still forwarding subsidies to the agricultural areas to the tune of 180–220 per cent! Again, the justification for such high subsidies have been provided by defining agriculture subsidies according to their ease—highly blurring and confusing.

nations. The USA announced the intentions few days after the EU announcement—just few days before the ***Cancun Meet*** of the WTO. The Hongkong deliberation of the WTO, though it did not give anything concrete to the develolping world, provided enough hope, there is no doubt in it. The real picture emerges in the next meet for which the different pressure groups had serious deliberations on alternatives of bargaining power.

The second level suggestion to India was in the area of preparedness for the WTO regime. India was required to set new and internationally best standards in the area of production by boosting areas such as—research and development, biotechnology, information technology, health and phytosanitary matters. This will make Indian goods and services compete in the international market.[71]

WTO AND AGRICULTURAL SUBSIDIES[72]

AMS

The subsidies provided by the government to the agricultural sector (i.e., domestic support) is termed by the WTO as Aggregate Measure of Support (AMS).[73] It is calculated in terms of *product* and *input* subsidies. The WTO argues that the product subsidies like minimum support prices and input subsidies (non-product) like credit, fertilizers, irrigation and power will cut production cost of farming and will give undue advantage to such countries in their access to the world market—such subsidies are called to cause ***'distortions'*** to the world trade. Such subsidies are not permitted in one sense as they have a minimum permissible limit *de minimis* under the provisions which is 5 per cent and 10 per cent of their total agricultural output in the case of developed and developing countries, respectively.

THE BOXES

The agricultural subsidies, in the WTO terminology have in general been identified by 'boxes' which have been given the colours of the traffic lights—*green* (means permitted), *amber* (means slow down, i.e., to be reduced) and *red* (means forbidden).

In the agriculture sector, as usual, things are more complicated. The WTO provisions on agriculture has nothing like *red box* subsidies, although subsidies exceeding the reduction commitment levels is prohibited in the *'amber box'*. The *'blue box'* subsidies are tied to programmes that limit the level of production. There is also a provision of some exemptions for the developing countries sometimes called the 'S & D box'.[74]

We may see them individually though they are very much connected in their applied form. The objective meaning of each one of them becomes clear, once one has gone through all of them.

AMBER BOX

All subsidies which are supposed to distort production and trade fall into the amber box, i.e., all agricultural subsidies except those which fall into the blue and green boxes.[75] These include government policies of ***minimum support prices***

71. Because even the agriculture related provisions are modified the global market will always run after the agri-products which are the best—pricewise, qualitywise, etc.
72. A simplified and 'easy-to-understand' analysis done on the basis of the documents of the ***Information and Media Relations Division*** of the World Trade Organisation Secretariat, Geneva, Switzerland, October, 2007.
73. Defined in ***Article 1*** and ***Annexures 3 & 4,*** Agreement on Agriculture (AoA), WTO, 1994.
74. ***Article 6.2, AoA***, WTO, 1994.
75. ***Article 6, AoA***, WTO, 1994.

(as MSP in India) for agricultural products or any help directly related to production quantities (as power, fertilizers, pesticides, irrigation, etc).

Under the WTO provisions, these subsidies are subject to reduction commitment to their minimum level—to 5 per cent and 10 per cent for the developed and the developing countries, respectively, of their total value of agricultural outputs, per annum accordingly. It means, the subsidies ***directly related*** to production promotion above the allowed level (which fall in either the blue or green box) must be reduced by the countries to the prescribed levels.

In the current negotiations, various proposals deal with issues like deciding the amount by which such subsidies should be reduced further, and whether to set product-specific subsidies or to continue with the present practice of the *'aggregate'* method.

Blue Box

This is the *amber box with conditions*. The conditions are designed to reduce distortions. Any subsidy that would normally be in the amber box, is placed in the blue box if it requires farmers to go for a certain production level.[76] These subsidies are nothing but certain direct payments (i.e., direct set-aside payments) made to farmers by the government in the form of assistance programmes to encourage agriculture, rural development, etc.

At present there are no limits on spending on subsidies in the blue box. In the current negotiations, some countries want to keep blue box as is because they see it as a crucial means of moving away from distorting the amber box subsidies without causing too much hardship. Others want to set limits or reduction commitments on it while some advocate moving these subsidies into the amber box.

Green Box

The agricultural subsidies which cause minimal or no distortions to trade are put under the green box.[77] They must not involve price support.

This box basically includes all forms of government expenses, which are not targeted at a particular product, and all direct income support programmes to farmers, which are not related to current levels of production or prices. This is a ***very wide box*** and includes all government subsidies like—public storage for food security, pest and disease control, research and extension, and some direct payments to farmers that do not stimulate production like restructuring of agriculture, environmental protection, regional development, crop and income insurance, etc.

The green box subsidies are allowed without limits provided they comply with the policy-specific criteria.[78] It means, this box is exempt from the calculation under subsidies under the WTO provisions because the subsidies under it are not meant to promote production thus do not distort trade. That is why this box is called *'production-neutral box'*. But the facts tell a different story.[79]

In the current negotiations, some countries argue that some of the subsidies forwarded under this box (by the developed economies) do seriously distort trade (opposed to the view of minimal

76. ***Article 6***, ***Para 5*** AoA, WTO, 1994.
77. ***Annexure 2, AoA***, and ***Para 1*** AoA, WTO, 1994.
78. ***Annexure 2, AoA***, AoA, WTO, 1994.
79. Basically, a large part of this box is used by the farmers in the USA and the European Union as basic investments in agriculture. India as well as other like-minded countries have this view and want this box to be brought under the AMS i.e. under the reduction commitments. The USA at the Hongkong Ministerial meet (December 2005) announced to abolish such subsidies in the next 12 year commencing 2008. The EU also proposed to reduce its 'trade distorting subsidies' by 70 per cent. None of them used the name green box which shows some internal vagueness.

distortion as used by Annexure 2)— it is the view of the developing countries. These countries have raised their fingers on the direct payments[80] given by the developed countries to their farmers via programmes like income insurance and income-safety schemes,[81] environmental protection, [82] etc. Some other countries take the opposite view and argue that the current criteria are adequate, and advocate to make it more flexible (so that it could be increased) to take better care of non-trade concerns such as environmental protection and animal welfare.

S&D Box

Other than the above-discussed highly controversial boxes of agricultural subsidies, the WTO provisions have defined yet another box, i.e., the Social and Development Box (S & D Box) allows the developing countries for some subsidies to the agriculture sector under certain conditions. These conditions revolve around ***human development issues*** such as poverty, minimum social welfare, health support, etc., specially for the segment of population living below the poverty line. Developing countries can forward such subsidies to the extent of less than 5 per cent of their total agricultural output.[83]

Export Subsidies

For export subsidy the WTO has provisions in two categories:

(i) Reduction in the total budgetary support on export subsidies, and
(ii) Reduction in the total quantity of exports covered by the subsidy.

Higher reduction commitment for the developed countries and lower for the developing countries are the provisions. But the developed nations forward such an inflated support to their agricultural exports that even after the committed reductions it will be highly price distorting against the agri-exports of the developing countries. It is therefore opposed by the developing countries.

Sanitary and Phytosanitary Measures

The provisions of the WTO allow member countries to set their own health and safety standards provided they are justified on scientific grounds and do not result in arbitrary or unjustified barrier to trade. The provisions encourage use of international standards and also include certain special and differential treatment in favour of developing countries.[84]

Though this provision has realised the scope of unjustified kind of health and phytosanitory measures on the developing countries, the developed nations have been beautifully able to do so by validating their health and related rules on scientific grounds. Such instances have distorted trade in favour of these countries and the developing countries' agriculture has been the real loser. The developing countries accuse such measures as the non-tarrif barriers used by the developed nations to block goods from the developing nations.

NAMA

The Non-Agricultural Products Market Access (NAMA) is a part of the WTO provisions which deals with the idea of encouraging market reach

80. ***Para 5, Green Box, AoA,*** WTO, 1994.
81. ***Para 7, Green Box, AoA,*** WTO, 1994.
82. Para 8, **Green Box, *AoA,*** WTO, 1994.
83. ***Article 6.2, AoA,*** WTO, 1994.
84. ***Article 14, AoA,*** WTO, 1994.

to the non-agricultural goods of the member countries.[85] But the encouragement was objected/ opposed by the developing countries, especially pointing to the non-tariff barriers enforced by the developed countries. At the Doha Ministerial Conference (November 2001), ministers agreed to start negotiations to further liberalise trade of non-agricultural products. By early 2002, a Negotiating Group on NAMA was created. The members at the meet decided to go for tariff reductions on non-agricultural products adopting the **Swiss Formula.** The negotiations are still in the process—updated position may be seen in detail in Chapter 16.

One major concern that the members took note was of the small and vulnerable economies for whom a flexibility was committed while going for tariff reductions. For India, market access is not an issue of tariffs alone, but it means elimination of tariff peaks and tariff escalation in the markets of the developed countries. It will also end the abuse of anti-dumping laws and remove non-tariff barriers (NTBs) used to block goods from developing countries.

SWISS FORMULA

A variety of alternative methods are possible in the process of tariff reductions—some are more common than others. Some are based on *formulas.* But one thing should be kept in mind that whatever formula be agreed upon it does not have value unless it is properly implemented. Even after a formula or combination of formulas has been agreed upon, the final outcome of tariff reductions may depend on the bargaining capacity between countries.

The **Swiss Formula**[86] belongs to the classification of formulas known as having harmonising impact. Since such a formula prescribes a higher/steeper cut on higher tariffs and lower cuts on lower tariffs it is seen to harmonise the rates by bringing the final rates becoming closer and bridging the gap.

The formula was proposed by Switzerland in the Tokyo round negotiations of GATT (1973–79). But Switzerland opposes using this method in the current agriculture negotiations—it prefers the **Uruguay Round formula.**

The Uruguay Round (1986–94) negotiations in agriculture produced an agreement for developed countries to cut tariffs on agricultural products by an average of 36 per cent over six years (6 per cent per year) with a minimum tariff cut of 15 per cent on each product for the period. It was a version of *flat rate* method of tariff reductions.[87]

NATIONAL FOOD SECURITY ACT

The National Food Security Act was enacted by the Ministry of Consumer Affairs, Food and Public Distribution by end-December 2013. India's most ambitious and world's largest social welfare programme provides legal right to about 82 crore people for subsidised foodgrains—a historic initiative towards ensuring food and nutritional security. Major highlights of the programme are as given below:

(i) It will cover upto 75 per cent rural and 50 per cent urban population (around two thirds of the total popultion) with uniform entitlement of 5 kg foodgrains per month at highly subsidised prices

85. As per the provisions of the WTO ***fishes, fisheries products*** and ***forest products*** don't fall under agriculture and have been classified as the non-agricultural products.
86. ***"Formula Approaches to Tariff Negotiations"*** (Revised), WTO, Oct. 2007.
87. ***Uruguay Round of GATT,*** 1994.

of Rs. 3, Rs. 2 and Rs. 1 per kg for rice, wheat and coarse grains, respectively. The *poorest of poor* households continue to receive 35 kg foodgrains per household per month under the *Antyodaya Anna Yojna* at the same subsidised prices.

(ii) It provisions for special focus on nutritional support to women and children—*pregnant* women and *lactating* mothers, besides being entitled to nutritious meals as per the prescribed nutritional norms will also receive maternity benefit of at least of Rs. 6,000. *Children* in the age group of 6 months to 14 years will be entitled to take home ration or hot cooked food as per prescribed nutritional norms.

(iii) Eldest woman of eighteen years of age or above will be head of the household for issue of ration card, and if not available, the eldest male member is to be the head of the household.

(iv) For effective implementation, the Act also contains provisions for **reforms** in PDS through *doorstep delivery* of foodgrains, application of information and communication technology (ICT) including end-to-end computerisation, leveraging *'Aadhaar'* for identification of beneficiaries, diversification of commodities under TPDS, etc.

(v) The Act provisions state and district level **redressal mechanism** with designated officers. The states will be allowed to use the existing machinery for District Grievance Redressal Officer (DGRO), State Food Commission, if they so desire, to save expenditure on establishment of new redressal set up. It also provides for **penalty** on public servants or authority, if found guilty of failing to comply with the relief recommended by the DGRO.

(vi) Provisions have also been made for disclosure of records relating to PDS, **social audits** and setting up of Vigilance Committees in order to ensure transparency and accountability.

The work of identification of eligible households is left to the states/UTs, which may frame their own criteria or use Social Economic and Caste Census (SECC) data, if they so desire. The central government will provide funds to states/UTs in case of *short supply* of food grains from the central pool. In case of non-supply of food grains or meals to entitled persons, the concerned state/UT governments will be required to provide such food security allowance as may be prescribed by the central government to the beneficiaries. In order to address the concern of the states regarding additional financial burden, The central government will provide assistance to the states towards cost of intra-state transportation, handling of foodgrains and FPS dealers' margin, for which norms will be developed. This will ensure timely transportation and efficient handling of foodgrains.

While enacting the Act, the Ministry estimated an annual foodgrains requirement of 61.23 MT, which will accrue estimated food subsidy of Rs.1,24,724 crore. Meanwhile, a High Level Committee (headed by Shanta Kumar), by early 2015, suggested the GoI to revise the covergare population under the Act from 67 to 40 per cent. The recommendation was severely criticised by the experts and the political parties in the country. The government is yet to take the final call on the issue.

FOOD PROCESSING

Indian food processing industry (FPI)[88] has not grown with the pace which we see in the developed countries—there has been certain reasons for it:

88. The analyses are based on several volumes of **Economic Survey, India** and the relevant documents of the **Government of India** between the period 2005-15.

(a) India has a lower urban population (around 30 per cent of the population).

(b) Whatever urban population India has it does not have the *typical* urban food habits. As majority of it is second or third generation in the urban areas they still continue with the non-urban/rural food habits detrimental to the consumption of the agro-precessed items.

(c) In recent times, there has come enough awareness among the population across the country regarding the chemicals which are used in the agro-processing industries—creating a general tendency to avoid such food articles (much damage has been done to the industry by the 'fast foods', adulteration in food items such as sweets, milk, etc.).

(d) A wave across the world towards comsuming more 'which comes on plants' than 'what is produced in plants'. A similar wave of 'slow food' has gained popularity across Europe and other parts of the world originating from France.

Moreover, India's agro-processing policy today guided by the following **drivers**:

(i) As urban population rises and urban food habits evolve, there will be increased demand for processed foods as it happened across the urbanising developed world. The economy has already started having an informed and increased demand in such food items as 'dietary habits' are in the process of shift (NSSO, 2014).

(ii) External dimension to it was also accepted by the government by mid-1990s. As per a joint GATT-OECD study, processed food are supposed to account for around 19 per cent of the increased trade after the provisions of the WTO are implemented.

(iii) A very high percentage of food items which have short shelf life get wasted in India. It does not look good for a country which is crippled by the short-supply of food and high rate of hunger.

Importance: While increased productivity is an essential component of a vibrant agricultural sector, improved post-harvest handling and processing is essential to ensure value addition, reduction in wastage and to make good quality products reach the markets. Too often, even when the yields are high, producers lose income due to poor post-harvest practices.

Aim: Food processing aims to make food more *digestible, nutritious* and *extend the shelf life*. Due to the seasonal variations high levels of wastage or shortages can arise if adequate measures are not taken to preserve and store the food. Food processing covers all the processes that food items go through from the *farm to the consumers' plate*. It includes basic cleaning, grading and packaging as in case of fruits and vegetables and also alteration of the raw material to a stage just before the final preparation. Value addition processes to make 'ready-to eat' food like bakery products, instant foods, flavored and health drinks, etc., are also included in this *definition*.

Food processing *offers* an opportunity for the creation of sustainable livelihoods and economic development for the rural communities. Food processing has come a long way in the last few decades. The everchanging lifestyles, food habits and tastes of customers globally have altered the dynamics of the industry. Food processing benefits all the sections of the society:

(i) *Farmers* get better returns, higher yield, and lower the risks drastically;

(ii) *Consumers* get access to a greater variety, better prices and new products;

(iii) *Economy* gets benefit via creation of new business opportunities, while the workforce gets employment.

With a huge production base, India can easily become one of the leading food suppliers to the world while at the same time serving the vast growing domestic market of over a billion people. India's large market size with growing incomes and changing life styles also creates incredible market opportunities for food producers, food processors, machinery makers, food technologists and service providers in this sector.

Growth in the food processing sector is also expected to open up a lot of opportunities for players having strong linkages in the agri-value chain. Significant investment opportunities are yet to be tapped in the areas of *supply chain management, cold storages, financing, retailing* and *exports*.

Historically, agriculture and FPI have been plagued by factors such as:

(i) Low public investment,

(ii) Poor infrastructure,

(iii) Inadequate credit availability, and

(iv) High levels of fragmentation.

Rules & Regulations: Rules and regulations regarding the industry is as given below:

(a) Most food processing enterprises have been exempted from industrial licensing under the Industries (Development and Regulation) Act, 1951 with the exception of beer and alcoholic drinks, and items reserved for the small scale sector.

(b) For foreign investment, automatic approval is given even up to 100 per cent equity for a majority of processed foods.

(c) For manufacture of items reserved for MSEs, FDI is permissible under automatic route up to 24 per cent.

Attractive **packaging** makes the product more appealing to consumers who are therefore willing to pay more if the product offered is of good quality and easy to use. The policy initiatives of the government also include assistance for opening up of mega food park, cold chain and development of agri-export zones, skill development and R&D activities. Apart from the various schemes from the central government, various state governments are implementing their own food processing promotion policies and schemes.

Contributions: The sector contributes around 10 per cent of GDP in agriculture and manufacturing sector. During the last 5 years, FPI sector has been growing at an average annual growth rate (AAGR) of around 6 per cent as compared to around 4 per cent in agriculture and 7 per cent in manufacturing.

Infrastructure Development: The Ministry of Food Processing Industries (MoFPI) has been implementing a scheme for the creation of modern enabling infrastructure which includes mega food parks scheme, scheme for cold chain, value addition and preservation infrastructure and the scheme for construction and modernisation of abattoirs.

Mega Food Parks Scheme (MFPS): The Mega Food Parks Scheme *aims* to accelerate the growth of the food processing industry in the country by facilitating establishment of strong food processing infrastructure backed by an efficient supply chain. Under this scheme, capital grant of 50 per cent of the project cost is provided in general areas and 75 per cent in difficult and ITDP (Integrated Tribal Development Programme) notified areas (with a ceiling of Rs 50 crore). Each Mega Food Park takes about 30–36 months to be completed.

Cold Chain, Value Addition and Preservation: The Scheme for Cold Chain, Value Addition, and Preservation Infrastructure was approved in 2008 with an *objective* to provide integrated and complete cold chain, value addition and preservation infrastructure facilities without

any break, for perishables from the farm gate to the consumer. The assistance under the scheme includes financial assistance (grant-in-aid) of 50 per cent of the total cost of plant and machinery and technical civil works in general areas and 75 per cent for the North Eastern region and difficult areas (subject to a maximum of Rs. 10 crore).

Modernisation of Abattoirs: The Ministry has approved 10 projects in first phase which are at various stages of progress. Two projects have been completed. A proposal for up-scaling the scheme is under consideration.

Technology Upgradation: Under the Scheme for Technology Upgradation, Establishment, Modernisation of FPIs, financial assistance is provided in the form of 'grants-in-aid' for the setting up of new food processing units as well as technological upgradation and expansion of existing units in the country. The GoI extends financial assistance in the form of grant-in-aid to entrepreneurs at 25 per cent of the cost of Plant & Machinery and Technical Civil Works subject to a maximum of Rs. 50 lakhs in general areas or 33.33 per cent subject to a maximum of Rs. 75 lakhs in difficult terrains. The Scheme has now been transferred to the states with the launching of the National Mission on Food Processing (NMFP) in the 12th Plan.

Quality Assurance, Codex Standards and R & D and Promotional Activities: In the global market today, quality and food safety gives a competitive edge which is an important factor for the enterprises producing processed foods and providing services. Apart from domestic standards for food products, processes and management practices, Codex prescribes international standards for safety and quality of food as well as codes of good manufacturing practices, which are accepted worldwide. Further, equal emphasis is required to be accorded to R&D activities for the development of innovative products, cost effective processes and efficient technologies for the food processing sector. The scheme for Food Safety Codex and R&D has been successful in making a dent in this area in the country.

Human Resource Development: The human resource development is very critical for sustained growth in the sector. Extensive training and entrepreneurship development is given top priority:

(i) Creation of infrastructural facilities for running degree/diploma courses in food processing
(ii) Entrepreneurship Development Programmes (EDP)
(iii) Setting up of Food Processing Training Centres (FPTC)
(iv) Training at recognised national/state-level institutes, etc., sponsored by MoFPI or other training programme

Strengthening of the Indian Institute of Crop Processing Technology (IICPT): Indian Institute of Crop Processing Technology (IICPT) formerly known as Paddy Processing Research Centre (PPRC), Thanjavur is an autonomous organisation under the administrative control of MoFPI. It has been in existence for the last three decades. As other commodities such as millets, pulses and oil seeds are gaining importance, it was decided in 2001 to expand the mandate of this Institute to include the above commodities also. The institute is being upgraded into a national level institute now.

National Meat and Poultry Processing Board (NMPPB): The GoI established the National Meat and Poultry Processing Board 2009. The Board is an autonomous body and was initially funded by the GoI for 2 years and is be managed by the industry itself. This industry-driven institution has been launched to work as a ***National Hub*** for addressing all key issues related to the meat and poultry processing sector for its systematic and proper development. The Board serves as a

single window service provider for producers, manufacturers and exporters of meat and meat products, for promoting the meat industry as a whole.

Indian Grape Processing Board: The GoI, in 2009, gave its approval for the establishment of the Indian Grape Processing Board (IGPB) at Pune, Maharashtra which is close to the principal grape growing and processing areas in the country. The functions and objectives of the IGPB are:

(a) To focus on R&D, extension, quality upgradation, market research, information, domestic and international promotion of *Indian wine*.

(b) To foster sustainable development of Indian wine industry.

(c) To formulate a vision and action plan for the growth of Indian wine sector including R&D for quality upgradation in new technologies.

During three years of its existence, the Board has focused on the promotion of ***Wines of India*** in the domestic as well as international market by participating in important and relevant exhibitions, fairs, consumer awareness and training programmes, undertaking advocacy work with the various state governments/central ministries on various issues related to taxes/levies and promotion aspects. The Board is going to implement a traceability programme "wine-net" for standards and quality in wine sector.

National Institute of Food Technology, Entrepreneurship & Management (NIFTEM): For developing a vibrant food processing sector, India needs not only world-class food technologists to undertake R&D in frontier areas, develop new products, processes, technologies and machineries, set food standards and protocol testing, but also business leaders and managers well versed with the requisite mix of technologies, management and entrepreneurship who can exploit major opportunities in the expanding global food trade.

In the emerging global scenario, there is a need for setting up of an institution of global excellence, which could cater to the needs of the booming food processing sector, various stakeholders such as entrepreneurs, industry, exporters, policymakers, government and other research institutions. NIFTEM was conceived by MoFPI to create an international *Center of Excellence* in the field of Food Sciences & Food Technology. NIFTEM will grow into an apex world class institute to promote cooperation and networking among existing institutions both within the country and various international bodies. The institute will offer high quality educational, research and management programme specific to the food industry, provide referral advise on food standards, disseminate knowledge on the food sector and provide business incubation facility. It is situated (2006) at Kundli, Sonipat (Haryana).

National Mission on Food Processing (NMFP): India enjoys a 'competitive advantage' in food processing sector given its huge production base of a number of agricultural, dairy, fishing and horticultural items. To ensure that this sector gets the stimulus it deserves, the MoFPI has been implementing a number of schemes for infrastructure development, technology upgradation and modernisation, human resources development and R&D in this sector. In the context of the *12th Plan*, it is felt that there is a need to decentralise the implementation of schemes through involvement of the states/UTs for better outreach, supervision, monitoring and ensuring job creation. Accordingly, National Mission on Food Processing (NMFP) was launched as a centrally sponsored scheme in 2012. The NMFP contemplates establishment of a National Mission as well as corresponding Missions at the state and district levels.

The Challenges: The most important challenges among others in the sector include avoidance of

the significant 'wastage' at every level and in value addition. High food inflation, high post-harvest wastage particularly in fruits and vegetables, low level of processing, etc., are the main challenges in the food processing sector. Addressing these core concerns by reducing wastage of food, increasing shelf life and enhancing value of agricultural produce are some of the objectives of the food processing industry. In terms of employment, the contribution of the sector is significant. Presently, the total number of *persons employed* in the food processing sector is about 17 lakh. The National Manufacturing Policy, 2011 seeks to give special attention to food processing industries to ensure job creation. To promote industrial growth along with the objective of inclusive growth the food processing sector will get higher attention from the government.

OUTLOOK FOR THE FUTURE

So that the FPI expands as per the expectations emphasis is needed on the following fronts:

(i) Given the need for *wastage reduction*, *value addition* and the *high employment* potential of the sector, there is a need to substantially step up the allocations given the importance of the sector in terms of its contribution to the economy.

(ii) There is also a need for greater *involvement of state* governments for better outreach, supervision and monitoring (keeping this in view, government has already launched centrally sponsored National Mission on Food Processing).

(iii) There is a need for greater emphasis on creation of infrastructure with full participation of state governments and *private sector*. The main infrastructure schemes for setting up food parks and cold chains are at present 'closed ended'. This should be 'open ended' permitting the Ministry to fund all the viable projects proposals received under these schemes rather than limiting the number of projects.

(iv) The credit dimension of the sector is also a vital issue.

With the idea of 'Team India' under the NITI Aayog, it is believed that a new synergy will come to the food processing industry. The nature of industry requires active participation from not only the concerned states, but the loacal bodies, too. Experts believe that the emerging emphasis by the government on the issue of 'ease of doing business' will be of great help to the sector.

CURRENT AGRICULTURAL SCENARIO

The agriculture sector has remained the least reformed area in the reform era. There has been several socio-economic reasons behind it. In the meantime, the sector still plays a big role in the proper functioning of the economic system even if it contributes just around 14 per cent to the national income. As per the *Economic Survey 2014–15*, the outlook and challenges regarding the sector are as given below:

1. The inflation is not expected to rise significantly from the current levels as—
   (i) The oil prices are expected to remain low in the coming months on account of weak global demand and increased supplies.
   (ii) Global commodity prices have generally been declining and are expected to remain weak in 2015 due to low demand and comfortable supply.
   (iii) Factors like high rural wages, higher level of MSP, and rise in input cost have been instrumental for higher inflation in the last few years. At present, growth of all these have been slowed down considerably and this

could result in keeping *food inflation* within limits.

2. Agriculture and food sector needs huge investment in research, education, extension, irrigation, fertilizers, and laboratories to test soil, water and commodities, warehousing, coldstorage.
3. Rationalisation of subsidies and better targeting of beneficiaries would generate part of the resources for public investment.
4. There are wide differences in the yields within states. Even the best of the states have much lower yield in different crops when compared to the best in the world. This provides ample opportunity to increase production by bridging the yield-gap to the extent feasible within the climatic zone.
5. The focus of public expenditure for agriculture so far has been on provision of subsidies (public expenditure in agriculture is only one-fourth of expenditure towards food and fertilizer subsidies) and it is time it shifted towards investments to boost productivity.
6. Recommendations of the Shanta Kumar Committee provide useful suggestions for the future road-map of food-policy. Every effort should be made to bring states on board for creating national common market for agricultural commodities.

CHAPTER

9

INDUSTRY & INFRASTRUCTURE

- Introduction
- Review of Industrial Policies upto 1986
- New Industirial Policy, 1991
- Disinvestment
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- New Steps to Boost Industry
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- State Discoms
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*In China I was greatly attracted to the Industrial Co-operatives–the Indusco movement–and it seems to me that some such movement is peculiarly suited to India. It would fit in with the Indian background, give a democratic basis to small industry, and develop the co-operative habit. It could be made to complement big industry. It must be remembered that, however rapid might be the development of heavy industry in India, a vast field will remain open to small and cottage industries. Even in the Soviet Russia owner-producer co-operatives have played an important part in industrial growth.**

* *As Jawaharlal Nehru writes in* ***The Discovery of India****, Oxford University Press, 6th Impression (1st Edition 1946, Oxford, London), N. Delhi, 1994, p. 406.*

INTRODUCTION

Many of the western economies have already written their success stories of industrialisation leading to accelerated growth and development by the time India became an independent economy. Independent India needed to rejuvenate its economy from a completely dilapidated state. The country had many tasks in front of it—the abject mass poverty, shortage of foodgrains, healthcare, etc., calling for immediate attention. The other areas of attention included industry, infrastructure, science and technology and higher education, to name a few. All these areas of development required heavy capital investment as they had been severly avoided by the colonial ruler for the last 150 years or so. Increasing the growth of the economy and that too with a faster pace was the urgent need of the economy. Looking at the pros and cons of the available options, India decided the industrial sector to be the 'prime moving force' (PMF) of the economy—the logical choice for a faster growth (a fully established idea at that time, all over the world). The secondary sector will lead the economy, was well-decided in the 1930s itself by the dominant political forces among the freedom fighters.

As the government of the time had decided upon an active role for the governments in the economy, naturally, the industrial sector was to have a dominant state role—the expansion of the government-owned companies (i.e., the PSUs) to glorious heights. In many ways the development of the Indian economy has been the development of the government sector. Once this idea of state's role in the economy went for a radical change in the early 1990s with the process of economic reforms, the hangover or the drag of it is still visible on the economy. The industrial policies which the governments announced from time to time basically moulded the very nature and structure of the economy. Any discussion on the Indian economy must start with a survey of the industrial policies of the country. Here we have a brief review of the various industrial policies of India till date.

REVIEW OF INDUSTRIAL POLICIES UPTO 1986

For a better understanding of the Indian economy, it is advisable to look into the various industrial polices. The official stances keep changing with every upcoming industrial policy. Understanding these policies become even more important to understand the finer aspects of the reform process which the country will commence by the early 1990s. Here, a brief review of India's industrial policies are being dicussed to serve the purpose.

INDUSTRIAL POLICY RESOLUTION, 1948

Announced on April 8, 1948 this was not only the first industrial policy statement of India, but it decided the model of the economic system (i.e., the mixed economy), too. Thus, it was the *first* economic policy of the country. The major highlights of the policy are given below:

(i) India will be a mixed economy.[1]

(ii) Some of the important industries were put under the ***Central List*** such as coal, power, railways, civil aviation, arms and ammunition, defence, etc.

(iii) Some other industries (usually of medium category) were put under a ***State List*** such as paper, medicines, textiles, cycles, rickshaws, two-wheelers, etc.

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1. Here this should be noted that India will be a planned economy, was well-decided before this industrial policy which articulated for an ***active role*** of the state in the economy. The main objective of planning pointed out at this time was ***poverty alleviation*** by a judicious exploitation of the resources of the country. Only 'mixed economy' did fit such a wish (***Conference of State Industry Ministers, 1938***).

(iv) Rest of the industries (not covered by either the central or the state lists) were left open for private sector investment—with many of them having the provision of compulsory licencing.

(v) There was a 10 year period for review of the policy.

Industrial Policy Resolution, 1956

The government was encouraged by the impact of the industrial policy of 1948 and it was only after eight years that the new and more crystallised policies were announced for the Indian industries. The new industrial policy of 1956 had the following major provisions:

1. Reservation of Industries

A clear-cut classification of industries (also known as the **Reservation of Industries**) were affected with three schedules:

(i) Schedule A

This schedule had 17 industrial areas in which the Centre was given complete monopoly. The industries set up under this provision were known as the Central Public Sector Undertakings (CPSUs) later getting popularity as 'PSUs'. Though the number of industries were only 17, the number of PSUs set up by the Government of India went to 254 by 1991. These included those industrial units too which were taken over by the government between 1960 to 1980 under the ***nationalisation*** drives.[2] These industries belonged to Schedules B and C (other than Schedule A).

(ii) Schedule B

There were 12 industrial areas put under this schedule in which the state governments were supposed to take up the initiatives with a more expansive follow up by the private sector. This schedule also carried the provisions of compulsory licencing. It should be noted here that neither the states nor the private sector had monopolies in these industries unlike Schedule A, which provided monopoly to the Centre.[3]

(iii) Schedule C

All industrial areas left out of Schedules A and B were put under this in which the private enterprises had the provisions to set up industries. Many of them had the provisions of licencing and have ***necessarily*** to fit into the framework of the social and economic policy of the state and were subject to control and regulation in terms of the Industries Development and Regulation (IDR) Act and other relevant legislations.[4]

The above classification of industries had an in-built bias in favour of government-owned companies (i.e., the CPSUs) which went according to the ideas of the planning process, too. Thus, expansion of the public sector became almost a directive principle of economic policy and the PSUs did expand in the coming times.[5]

It was this industrial policy in which the then PM Pandit Jawaharlal Nehru had termed the PSUs the ***'temples of modern India'***, symbolically pointing to their importance.[6] There was a time soon after Independence when the PSUs were

2. The nationalisation of industrial units allowed the government to enter the unreserved areas which consequently increased its industrial presence. Though the nationalisation was provided a highly rational official reason of ***greater public benefit,*** the private sector always doubted it and took it as an insecurity and major unseen future hurdle in the expansion of private industries in the country.
3. The Central Government had always the option to set up an industry in any of these 12 industrial areas. This happened in the coming years via two methods—first, the *nationalisation* and second, the *joint sector*.
4. Industrial Policy Resolution, 1956 (30 October).
5. V. M. Dandekar, ***Forty Years After Independence*** in Bim
6. The statement we get in the ***Second Five Year Plan (1956–61),*** too.

regarded as the principal instrument for raising savings and growth in the economy.[7] The rapid expansion of PSUs accounted for more than half of the GDP of the economy by 1988–89.[8]

2. Provision of Licencing

One of the most important developments of independent India, the provision of compulsory licencing for industries, was cemented in this policy. All the schedule B industries and a number of schedule C industries came under this proivision. This provision established the so-called ***'Licence-Quota-Permit'*** regime (***raj***) in the economy.[9]

3. Expansion of the Public Sector

Expansion of the public sector was pledged for the accelerated industrialisation and growth in the economy—glorification of government companies did start with this policy. The emphasis was on heavy industries.

4. Regional Disparity

To tackle the widening **regional disparity,** the policy committed to set up the upcoming PSUs in the comparatively backward and underdeveloped regions/areas in the economy.[10]

5. Emphasis on Small Industries

There was emphasis on small industries as well as the khadi and village industries.

6. Agricultural Sector

The agricultural sector was pledged as a priority.

IMPORTANCE

This is considered as the most important industrial policy of India by the experts as it decided not only the industrial expansion but structured the very nature and scope of the economy till 1991 with minor modifications. All the industrial policies were nothing but minor modifications in it except the new industrial policy of 1991 which affected deeper and structural changes in it with which India started a wider process of economic reforms.

INDUSTRIAL POLICY STATEMENT, 1969

This was basically a licencing policy which aimed at solving the shortcomings of the licencing policy started by the Industrial Policy of 1956. The experts and industrialists (new comers) complained that the industrial licencing policy was serving just the opposite purpose for which it was mooted. Inspired by the socialistic ideals and nationalistic feelings the licencing policy had the following reasons:

(i) exploitation of resources for the development of all;

(ii) priority of resource exploitation for the industries;

(iii) price-control of the goods produced by the licenced industries;

(iv) checking concentration of economic power;

(v) channelising investment into desired direction (according to the planning process).

In practice, the licencing policy was not serving the above-given purpose properly. A powerful

7. Bimal Jalan, ***India's Economic Policy,*** Penguin Books, N. Delhi, 1992, p. 23.
8. V.M., Dandekar, **'Forty years After Independence'**, p. 64.
9. These industries which were set up after procuring ***'licences'*** from the government had fixed upper limits of their production known as ***'quota'*** and they needed to procure timely 'permit' (i.e., permission) for the supply of, raw materials—that is why such a name was given to the whole system.
10. Such a commitment went completely against the *'theory of industrial location'*.

industrial house was always able to procure fresh licences at the cost of a new budding entrepreneur. The price regulation policy via licencing was aimed at helping the public by providing cheaper goods, but it indirectly served the private licenced industries ultimately (as central subsidies were given to the private companies from where it was to benefit the poor in the form of cheaper goods). Similarly, the older and well-established industrial houses were capable of creating hurdles for the newer ones with the help of different kinds of trade practices forcing the latter to agree for sell-outs and takeovers. A number of committees were set up by the government to look into the matter and suggest remedies.[11] The committees on industrial licencing policy review pointed out several shortcomings of the policy, but it also accepted the useful role of industrial licencing.[12] Finally, it was in 1969 that the new industrial licencing policy was announced which affected the following major changes in the area:

(i) The Monopolistic and Restrictive Trade Practices (MRTP) Act was passed. The Act intended to regulate the trading and commercial practices of the firms and checking monopoly and concentration of economic power.

(ii) The firms with assets of Rs. 25 crore or more were put under obligation of taking permission from the Government of India before any expansion, greenfield venture and takeover of other firms (as per the MRTP Act). Such firms came to be known as the ***'MRTP Companies'***. The upper limit (known as the ***'MRTP limit'***) for such companies was revised upward to Rs. 50 crore in 1980 and Rs. 100 crore in 1985.[13]

(iii) For the redressal of the prohibited and restricted practices of trade, the government did set up an ***MRTP Commission***.

Industrial Policy Statement, 1973

The Industrial Policy Statement of 1973 introduced some new thinking into the economy with major ones being as follows:

(i) A new classificatory term i.e., ***core industries*** was created. The industries which were of fundamental importance for the development of industries were put in this category such as iron and steel, cement, coal, crude oil, oil refining and electricity. In the future, these industries came to be known as ***basic industries, infrastructure industries*** in the country.

(ii) Out of the six core industries defined by the policy, the private sector may apply for licences for the industries which were not a part of schedule A of the Industrial Policy, 1956.[14] The private firms eligible to apply for such licences were supposed to have their total assets at Rs. 20 crore or more.

(iii) Some industries were put under the ***reserved list*** in which only the small or medium industries could be set up.[15]

11. There were four specific committees set up on this issue, namely ***Swaminathan Committee (1964), Mahalanobis Committee (1964), R.K. Hazari Committee (1967)*** and ***S. Dutt Committee (1969).*** The Administrative Reform Commission (1969) also pointed out the short comings of the industrial licencing policy perpetuated since 1956.
12. ***Dutt Committee,*** 1969.
13. The upward revision was logical as it was hindering the organic growth of such companies—neither the capacity addition was possible nor an investment for technological upgrading.
14. Out of the six core industries only the cement and iron & steel industries were open for the private investment with the rest fully ***reserved*** for the central public sector investment.
15. This is considered a follow up to such suggestions forwarded by the ***Industrial Licensing Policy Inquiry Committee*** (S. Dutt, Chairman), Government of India, N. Delhi, 1969.

(iv) The concept of ***'joint sector'*** was developed which allowed partnership among the Centre, state and the private sector while setting up some industries. The governments had the discretionary power to exit such ventures in future. Here, the government wanted to promote the private sector with state support.

(v) The Government of India had been facing the foreign exchange crunch during that time. To regulate foreign exchange the Foreign Exchange Regulation Act (FERA) was passed in 1973.[16] Experts have called it a ***'draconian'*** Act which hampered the growth and modernisation of Indian industries.

(vi) A limited permission of foreign investment was given with the multinational corporations (MNCs) being allowed to set up their subsidiaries in the country.[17]

Industrial Policy Statement, 1977

The Industrial Policy Statement of 1977 was chalked out by a different political set up from the past with a different political fervour—the dominant voice in the government was having an anti-Indira stance with an inclination towards the Gandhian-socialistic views towards the economy. We see such elements in this policy statement:

(i) Foreign investment in the ***unnecessary areas*** were prohibited (opposite to the IPS of 1973 which promoted foreign investment via technology transfer in the areas of lack of capital or technology). In practice, there was a complete 'no' to foreign investment.[18]

(ii) Emphasis on village industries with a redefinition of the small and cottage industries.

(iii) Decentralised industrialisation was given attention with the objective of linking the masses to the process of industrialisation. The District Industries Centres (DICs) were set to promote the expansion of small and cottage industries at a mass scale.

(iv) Democratic decentralisation got emphasised and the khadi and village industries were restructured.

(v) Serious attention was given on the level of production and the prices of essential commodities of everyday use.

Industrial Policy Resolution, 1980

The year 1980 saw the return of the same political party at the Centre. The new government revised the Industrial Policy of 1977 with few exceptions in the Industrial Policy Resolution, 1980. The major initiatives of the policy were as given below:

(i) Foreign investment via the technology transfer route was allowed again (similar to the provisions of the IPS, 1973).

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16. The FERA got executed on January 1, 1974. The private sector in the country always complained against this act and doubted its official intentions.

17. This limited permission was restricted to the areas where there was a need of foreign capital. Such MNCs entered the Indian economy with the help of a partner from India—the partner being the major one with 74 per cent shares in the subsidiaries set up by the MNCs. The MNCs invested via ***technology transfer route.*** Basically, this was an attempt to make up the loss being incurred by the FERA. This was the period when most of the MNCs had the chances to enter India. Once economic reforms started by 1991, many of them increased their holdings in the Indian subsidiaries with the Indian partner getting the minority shares or a total exit.

18. The permission of working was withdrawn in the case of already functioning soft drink MNC the ***Coca Cola***. The ongoing process of entry to the computer giant ***IBM*** and automobile major ***Chrysller*** was soon called off. These instances played a highly negative role when India invited the foreign direct investment in the reform era post-1991.

(ii) The 'MRTP Limit' was revised upward to Rs. 50 crore to promote setting of bigger companies.
(iii) The DICs were continued with.
(iv) Industrial licencing was simplified.
(v) Overall liberal attitude followed towards the expansion of private industries.

INDUSTRIAL POLICY RESOLUTION, 1985 & 1986

The industrial policy resolutions announced by the governments in 1985 and 1986 were very much similar in nature and the latter tried to promote the initiative of the former. The main highlights of the policies are:

(i) Foreign investment was further simplified with more industrial areas being open for their entries. The dominant method of foreign investment remained as in the past, i.e., ***technology transfer,*** but now the equity holding of the MNCs in the Indian subsidiaries could be upto 49 per cent with the Indian partner holding the rest of the 51 per cent shares.
(ii) The *'MRTP Limit'* was revised upward to Rs. 100 crore—promoting the idea of bigger companies.
(iii) The provision of industrial licencing was simplified. Compulsory licencing now remained for 64 industries only.[19]
(iv) High level attention on the sunrise industries such as telecommunication, computerisation and electronics.
(v) Modernisation and the profitability aspects of public sector undertakings were emphasised.
(vi) Industries based on imported raw materials got a boost.[20]
(vii) Under the overall regime of FERA, some relaxations concerning the use of foreign exchange was permitted so that essential technology could be assimilated into Indian industries and international standard could be achieved.
(viii) The agriculture sector was attended with a new scientific approach with many *technology missions* being launched by the government.

These industrial policies were mooted out by the government when the developed world was pushing for the formation of the WTO and a new world economic order looked like a reality. Once the world had become one market, only bigger industrial firms could have managed to cater to such a big market. Side by side sorting out the historical hurdles to industrial expansion perpetuated by the past industrial policies, these new industrial policy resolutions were basically a preparation for the *globalised* future world.

These industrial provisions were attempted at liberalising the economy without any slogan of 'economic reforms'. The government of the time

19. A total number of 95 industries had the compulsions of licencing till then. These industries belonged to Schedules B and C of the Industrial Policy Resolution, 1956.
20. This was similar to the policy being followed by Gorbachev in the USSR with the similar fiscal results—a severe balance of payment (BoP) crisis by end 1980s and the early 1990s (Rosser & Rosser, ***Comparative Economics in A Transforming World,*** PHI & MIT Press, N. Delhi, 2004, pp. 469–75).

had the mood and willingness of going for the kind of economic reforms which India pursued post-1991 but it lacked the required political support.[21]

The industrial policies conjoined with the overall micro-economic policy followed by the government had one major loophole that it was more dependent on foreign capital with a big part being costlier ones. Once the economy could not meet industrial performance, it became tough for India to service the external borrowings—the external events (the Gulf war, 1990–91) vitiated the situation, too. Finally, by the end of 1980s India was in the grip of a severe balance of payment crisis with higher rate of inflation (over 13 per cent) and higher fiscal deficit (over 8 per cent).[22] The deep crisis put the economy in a financial crunch, which made India opt for a new way of economic management in the coming times.

NEW INDUSTIRIAL POLICY, 1991

It were the industrial policies of past which had shaped the nature and structure of the Indian economy. The need of the hour was to change the nature and structure of the economy by early 1990s. The GoI decided to change the very nature of the industrial policy which will automatically lead to change in the nature and scope of the economy. And here came the New Industrial Policy of 1991.

With this policy the government kickstarted the very process of reform in the economy, that is why the policy is taken *more as a process than a policy.*

Background: India was faced with severe balance of payment crisis by June 1991. Basically, in early 1990s, there were inter-connected set of events, which were growing unfavourable for the Indian economy:

(i) Due to the Gulf War (1990–91), the higher oil prices were fastly[23] depleting India's foreign reserves.

(ii) Sharp decline in the private remittances from the overseas Indian workers in the wake of the Gulf War[24], specially from the Gulf region.

(iii) Inflation peaking at nearly 17 per cent.[25]

(iv) The gross fiscal deficit of the Central Government reaching 8.4 per cent of the GDP.[26]

(v) By the month of June 1991, India's foreign exchange had declined to just ***two weeks*** of import coverage.[27]

India's near miss with a serious balance of payments crisis was the proximate cause that started India's market liberalisation measures in 1991 followed by a gradualist approach.[28] As the reforms were induced by the crisis of the BoP, the initial phase focussed on macroeconomic

21. The ***Seventh Five Year Plan (1985–90)*** as well as the ***Sixth Five Year Plan (1980–85)*** had already suggested the government to re-define the role of the state in the economy and permit the private sector into those areas of industries where the presence of the government was non-essential, etc. But such a radical approach might not be digested by the country as it was like 'rolling back' the state. This is why the government of the time looks not going for full-scale economic reforms or vocal moves of liberalisation.
22. Vijay Joshi and I.M.D. Little, ***India's Economic Reforms, 1991–2001,*** OUP: Clarendon Press, London, 1996, p. 17.
23. ***Economic Survey, 1990–91 & 1991–92,*** GOI, N. Delhi.
24. Sach, Varshney and Bajpai, op.cit., p. 2.
25. ***'Economic Reforms: Two Years After and the Task Ahead',*** Discussion Paper, Department of Economic Affairs, GoI, N. Delhi, 1993, p. 6.
26. Ibid.
27. Bimal Jalan, ***India's Economic Crisis: The Way Ahead,*** OUP, Delhi, 1991, p. 2–12.
28. Sach, Varshney and Bajpai, op.cit., p. 2.

stabilisation while the reforms of industrial policy, trade and exchange rate policies, foreign investment policy, financial and tax reforms as well as public sector reforms did also follow soon.

The financial support India recieved from the IMF to fight out the BoP crisis of 1990–91 were having a tag of conditions to be fulfilled by India. These IMF conditionalities required the Indian economy to go for a structural re-adjustment. As the nature and scope of the economy were moulded by the various industrial policies India did follow till date, any desired change in the economic structure had to be induced with the help of another industrial policy. The new industrial policy, announced by the government on July 23, 1991 had initiated a bigger process of economic reforms in the country, seriously motivated towards the structural readjustment naturally obliged to 'fulfil' IMF conditionalities.[29] The major highlights of the policy are as follows:

1. De-reservation of the Industries

The industries which were reserved for the Central Government by the IPR, 1956, were cut down to only eight. In coming years many other industries were also opened for private sector investment. At present there are only two industries which are fully or partially reserved for the Central Government:

(i) Atomic energy and nuclear research and related activities, i.e., mining, use, management, fuel fabrication, export-import, waste management, etc., of radioactive minerals (none of the nuclear powers in the world have allowed the entry private sector in these activities, thus no such attempts look logical in India, too).

(ii) Railways (many of the functions related to the railways have been allowed private entry, but still the private sector cannot enter the sector as a full-fledged railway service provider).

2. De-licencing of the Industries

The number of industries put under the compulsory provision of licencing (belonging to Schedules B and C as per the IPR, 1956) were cut down to only 18. Reforms regarding the area were further followed and presently there are only ***five industries***[30] which carry the burden of compulsory licencing:

(i) Aero space and defence related electronics
(ii) Gun powder, industrial explosives and detonating fuse
(iii) Dangerous chemicals
(iv) Tobacco, cigarette and related products
(v) Alcoholic drinks

3. Abolition of the MRTP Limit

The MRTP limit was Rs. 100 crore so that the mergers, acquisitions and takeovers of the

29. Rakesh Mohan, ***Industrial Policy and Controls*** in the Bimal Jalan edited, ***The Indian Economy: Problems & Prospects,*** op.cit., p. 92–123.

30. In 1985–86 there were just 64 industries under the compulsory licencing provision. By the fiscal 2015–16 the number remained five (**India-2015**, Pub. Div., GoI, N. Delhi). Though the numbers are still six, all these six industries have many internal areas which today carry no obligation of licencing. As for example, the electronic industry was under this provision and entrepreneurs needed licences to produce radio, tv, tape-recorder, etc., what to ask of mobile phones, computers, DVDs and i-pods. Now only those electronic goods carry licencing provision which are related to either the aero-space or the defence sectors—thus we see a great number of electronic industries freed from the licencing provision the item 'electronics' still remains under it. Similarly while 'drug & pharma' still belong to the licenced industries, dozens of drugs and pharmaceuticals have been made free of it. The six industries have gone for high-level internal de-licencing since the reforms started.

industries could become possible. In 2002, a competition Act was passed which has replaced the MRTP Act. In place of the MRTP commission, the Competition Commission has started functioning (though there are still some hitches regarding the compositional form of the latter and its real functions and jurisdictions).

4. Promotion to Foreign Investment

Functioning as a typical closed economy, the Indian economy had never shown any good faith towards foreign capital. The new industrial policy was a pathbreaking step in this regard. Not only the draconian FERA was committed to be diluted, but the government went to encourage foreign investment (FI) in both its forms—direct and indirect. The direct form of FI was called as the foreign direct investment (FDI) under which the MNCs were allowed to set up their firms in India in the different sectors varying from 26 per cent to 100 per cent ownership with them—***Enron*** and ***Coke*** being the flag-bearers. The FDI started in 1991 itself. The indirect form of foreign investment (i.e., in the assets owned by the Indian firms in equity capital) was called the ***portfolio investment scheme*** (PIS) in the country, which formally commenced in 1994.[31] Under the PIS the ***foreign institutional investors*** (FIIs) having good track record are allowed to invest in the Indian security/stock market. The FIIs need to register themselves as a stock broker with SEBI. It means India has not allowed ***individual foreign investment*** in the security market still, only ***institutional investment*** has been allowed till now.[32]

5. FERA Replaced by FEMA

The government committed in 1991 to itself to replace the draconian FERA with a highly liberal FEMA, which same into effected in the year 2000–01 with a sun-set clause of two years.[33]

6. Location of Industries

Related provisions were simplified by the policy which was highly cumbersome and had time-consuming process. Now, the industries were classified into 'polluting' and 'non-polluting' categories and a highly simple provision deciding their location was announced:

(i) Non-polluting industries might be set up anywhere.

(ii) Polluting industries to be set up at least 25 kms away from the million cities.

7. Compulsion of Phased production Abolished

With the compulsion of phased production abolished, now the private firms could go for producing as many goods and models

31. ***Economic Survey, 1994–95,*** GoI, N. Delhi.
32. It becomes very complex and tough to regulate the individual foreign investment in the share market though it is an easier way of attracting foreign exchange. It should be noted that the South East Asian economies which faced financial crisis in 1996–97 all had allowed individual foreign investment in their share market. As the Indian security market was learning the art of regulation in its nascent phase, the government decided not to allow such foreign investment. The logic was vindicated after the S.E. Asian currency crisis when India had almost no shocks ***(Economic Survey, 1996–97,*** GoI, N. Delhi***).***
33. The delayed action by the government in the foreign exchange liberalisation was due to the delayed comfort the economy felt regarding the availability of foreign exchange.

simultaneously.[34] Now the capacity and capital of industries could be utilised to their optimum level.

8. Compulsion to Convert Loans into Shares Abolished

The policy of nationalisation started by the Government of India in the late 1960s was based on the sound logic of ***greater public benefit*** and had its origin in the idea of ***welfare state***—it was criticised by the victims and the experts alike. In the early 1970s, the GoI came with a new idea of it. The major banks of the country were now fully nationalised (14 in number by that time), which had to mobilise resources for the purpose of planned development of India. The private companies who had borrowed capital from these banks (when the banks were privately owned) now wanted their loans to be paid back. The government came with a novel provision for the companies who were unable to repay their loans (most of them were like it)—they could opt to convert their loan amounts into equity shares and hand them over to the banks. The private companies which opted this route (this was a compulsory option) ultimately became a government-owned company as the banks were owned by the GoI—this was an ***indirect*** route to nationalise private firms. Such a compulsion which hampered the growth and development of the Indian industries was withdrawn by the government in 1991.[35]

The picture presented by the New Industrial Policy of 1991 was taken by many experts, the opposition in the Parliament and even the public figures as well as the business and industry of the country as a ***'rolling back'*** of the state. The glorious role given to the state by the Nehruvian economy seemed completely toppled down. Any one idea the new policy challenged was an emphatic good bye to the 'control regime' perpetuated till now by the government. There was a coalition of interests of politicians, bureaucrats, multinationals as well as the domestic industrial and business houses whose interests were sheltered and by the control regime.[36] Thus, a memorandum to the government requesting not to dismantle the control regime by the major industrial houses of India as well as arrival of the '*Swadeshi Jagaran Manch*' were not illogical. But the governments continued with the reform programme with politically permissible pace and a time came when the same industrial houses requested the government (2002) to expedite the process of reform. Now the Indian industry and business class has been able to understand the economics of 'openness' and a different kind of

34. This was another hurdle which the private sector industries have been complaining about. As the industrial products were completely new to the Indian market and its consumers alike, the government followed this policy with the logic to provide enough time so that the products become domesticised i.e.,development of awareness about the product and its servicing, maintenance, etc. As for example, the MNC subsidiary Phillips India was allowed to produce a highly simple radio ***Commandar*** and ***Jawan*** models for comparatively longer periods of time then they were allowed to come up with the smaller fashionable radio sets or two-in-ones and three-in-ones. Such provisions hampered their full capacity utilisation as well as achieving the economy of scale had also been tougher. The new industrial policy of 1991 did away with such impediments. By that time, the Indian consumer as well as the market was fully aware of the modern industrial goods.
35. Combined with nationalisation, this ***indirect route*** to nationalisation failed to provide the confidence among the entrepreneurs that the industrial units they are intending to set up will be owned by them. This discouraged entrepreneurship in India while taking risk. The abolition of this compulsion was an indirect indication by the government of no more direct or indirect nationalisation in future. This has served the purpose, there is no doubt in it.
36. This nexus of the interests of the vested groups to the control regime of the economy has been beautifully elaborated by Rakesh Mohan in **'Industrial Policy and Controls'** in the Bimal Jalan edited ***The Indian Economy: Problems & Prospects,*** pp. 92–123. He also points out that the control system perpetuating the academic and intellectual ideological leanings negated the very need for re-examination of the system. The 'planners' and the 'bureaucrats' were able to preserve their powers via the control regime did everything to maintain the status quo, Rakesh Mohan further adds.

the mixed economy. But the process of reforms have still to go miles before its real benefits start reaching the masses and development together with reform could be made a mass movement.

This is why experts have suggested that only assuming that reforms will benefit the masses will not be enough to make it happen politically, but the governments, the administrative agencies and the economists all need to link it positively to ***mass welfare***—it might require to create a popular climate and form the political coalitions in favour of the argument that privatisation and accordingly restructured labour laws are basically aimed at creating jobs, better job prospects, alleviating poverty, enriching education and providing healthcare to the masses.[37] In the coming times, the government went from one to another generations of the reforms, setting new targets and every time trying to make reforms socio-politically possible.

Reforms with the human face was one such attempt of the United Progressive Alliance in 2003 when it formed the government at the Centre. It was believed that the 'India Shining' slogan of the outgoing government (i.e., the NDA) was correct, but remained localised in its effects to the urban middle class only.[38] The new government seemed taking lessons from the past and tried to make India shine for the rural masses, too. Its one programme, the ***Bharat Nirman*** (a rural infrastructure focused programme), could be seen as a political attempt to make it happen.[39]

Only the coming times will tell as to what extent the government has been able to educate the masses (better say the voters who vote!) the needful logic of the reforms.

DISINVESTMENT

Disinvestment is a process of selling government equities in public sector enterprises. Disinvestment in India is seen connected to three major inter-related areas, namely—

(i) A tool of public sector reforms[40]

(ii) A part of the economic reforms started in mid-1991. It has to be done as a complementary part of the ***'de-reservation of industries'***.[41]

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37. First of the series of such suggestions came from **Sach, Varshney and Bajpai** (eds.) ***India in the Era of Economic Reforms,*** p. 24).
38. It should be noted that ***'reform with the human face'*** was not a new slogan or call given by the UPA Government but this was the same slogan with which the reform programme was launched by the Rao-Manmohan Government in 1991—it has only been 're-called back' by the new government with a new committment to live it up.
39. Point should be noted that **Bharat Niraman** has been the only time-bound programme of infrastructure building in rural areas which is supposed to be completed within four years (the time left out of the total term of the Government when the programme was launched). The UPA naturally, tries to make it a political statement and a point for the next General Elections—development becoming an issue of real politics Let's see what happens.
40. Pub. Div., ***India 1991,*** GoI, N. Delhi.
41. The de-reservation of industries had allowed the private sector to enter the areas hitherto reserved for the Central Government. It means in the coming times in the unreserved areas the PSUs were going to face the international class competitiveness posed by the new private companies. To face up the challenges the existing PSUs needed new kind of technological, managerial and marketing strategies (similar to the private companies). For all such preparations there was a requirement of huge capital. The government thought to partly fund the required capital out of the proceeds of disinvestment of the PSUs. In this way disinvestment should be viewed in India as a way of increasing investment in the divested PSUs (which we see taking place in the cases of BALCO, VSNL, etc.).

(iii) Initially motivated by the need to raise resources for budgetary allocations.[42]

The approach towards public sector reforms in India has been much more cautious than that of the other developing countries. India did not follow the radical solution to it—under which outright privatisation of commercially viable PSUs is done and the unviable ones are completely closed.[43] There was an emphasis on increasing functional autonomy of public sector organisations to improve their efficiency in the 1980s in India as part of the public sector reforms. Once the process of economic reforms started in the early 1990s, disinvestment became a part of the public sector reforms. The C. Rangarajan Commission on Disinvestment of the Public sector Enterprises (1991) went on to suggest the government on the issue in a highly commendable and systematic way, taking empirical notes from the experiences of disinvestment around the world. The government started the process of disinvestment in 1991 itself. In 1997 the goverment did set up a Disinvestment Commission to advice upon the various aspects of the disinvestment process. The financial year 1999–2000 saw a serious attempt by the government to make disinvestment a political process to expedite the process of disinvestment in the country—first a Disinvestment Department and later a full-fledged Ministry of Disinvestment was set up.[44] The new government (UPA) dismantled the Ministry of Disinvestment and today only the Department of Disinvestment is taking care of the matter, working under the Ministry of Finance.

Types of Disinvestment

Since the process of disinvestment was started in India (1991), its consisted of ***two official types.*** A brief discussion on them is given below:

(i) Token Disinvestment

Disinvestment started in India with a high political caution—in a symbolic way known as the ***'token' disinvestment.*** The general policy was to sell the shares of the PSUs maximum upto the 49 per cent (i.e., maintaining government ownership of the companies). But in practice, shares were sold to the tune of 5–10 per cent only. This phase of disinvestment though brought some extra funds to the government (which were used to fill up the fiscal deficit considering the proceeds as the 'capital receipts') it could not initiate any new element to the PSUs, which could enhance their efficiency. It remained the major criticism of this type of disinvestment, and experts around the world started suggesting the government to go for it in the way that the ownership could be transferred from the government to the private

42. Right since 1991 when disinvestment began, the total governments have been using the disinvestment proceeds to fulfil the fiscal deficits in every budget at least up to 2000–01. From 2000–01 to 2002–03 some of the proceeds went for some social sector works or labourer's security. After 2003 India has a National Investment Fund to which the proceeds of disinvestment automatically flow and is not supposed as a ***capital receipt*** of the Union Government. This idea of Indian experiment with disinvestment was articulated by ***Sach, Varshney and Bajpai, India in the Era of Economic Reforms*** p. 62–63.

43. As was done by **Margaret Thatcher** in the UK in the mid-1980s. Her brand of privatisation was driven by the conviction that government control makes PSUs inherently less efficient and privatisation therefore improves its economic efficiency and is good for the consumers. However, this idea has been rejected around the world on the empirical bases. ***A PSUs could also have comparable economic efficiency even being under full government control.*** This was followed by Mrs. Thatcher (1979–90) forcefully in Great Britain conjoined with the supply-side economics as was done by Ronald Reagan (1981–89) in the United States as discussed by **Samuelson and Nordhaus** in ***Economics,*** p. 703.

44. A highly experienced person from the media world, Arun Shourie remained the Minister for the whole term of the NDA government. Some highly accelerated and successful disinvestments were done during this period but not without controversies.

sector. The other hot issue raised by the experts was related to the question of using the *proceeds* of disinvestment.

(ii) Strategic Disinvestment

In order to make disinvestment a process by which efficiency of the PSUs could be enhanced and the government could de-burden itself of the activities in which the private sector has developed better efficiency (so that the government could concentrate on the areas which have no attraction for the private sector such as social sector support for the poor masses), the government initiated the process of strategic disinvestment. The government classifying the PSUs into ***'strategic'*** and ***'non strategic'*** announced in March 1999 that it will generally reduce its stake (share holding) in the ***'non-strategic'*** public sector enterprises (PSEs) to 26 per cent or below if necessary and in the ***'strategic'*** PSEs (i.e., arms and ammunition; atomic energy and related activities; and railways) it will retain its majority holding.[45] There was a major shift in the disinvestment policy from selling small lots of share in the profit-making PSUs (i.e., token disinvestment) to the strategic sale with change in management control both in profit and loss-making enterprises. The essence of the strategic disinvestment was—

(i) The minimum shares to be divested will be 51 per cent, and

(ii) the wholesale sale of shares will be done to a ***'strategic partner'*** having international class experience and expertise in the sector.

This form of disinvestment commenced with the Modern Food Industries Ltd. (MFIL). The second PSUs was the BALCO which invited every kind of criticism from the opposition political parties, the Government of Chattisgarh and experts, alike. The other PSUs were CMC Ltd, HTL, IBPL, VSNL, ITDC (13 hotels), Hotel Corporation of India Ltd. (3 hotels), Paradeep Phosphate Ltd (PPL), HZL, IPCL, MUL and Lagan Jute Manufacturing Company Ltd. (LJMC)—a total number of 13 public sector enterprises, were part of the ***'strategic sale'*** or ***'strategic disinvestment'*** of the PSEs.[46] The new government at the Centre did put this policy of strategic disinvestment on the hold practically and came up with a new policy in place.

CURRENT DISINVESTMENT POLICY ■

The present disinvestment policy[47] was articulated by the UPA-II under its restructured Common Minimum Prgramme (CMP) in 2009 which is based on the ***main ideology*** that:

(i) Citizens have every right to own part of the shares of Public Sector Undertakings

(ii) Public Sector Undertakings are the wealth of the nation and this wealth should rest in the hands of the people, and

(iii) While pursuing disinvestment, the government has to retain majority shareholding, i.e., at least 51 per cent and management control of the PSUs.

The ***action plan*** for disinvestment in profit making government companies is:

(i) Already listed profitable PSUs (not meeting mandatory shareholding of 10 per cent) are to be made compliant by 'Offer for Sale' by government or by the PSUs through issue of fresh shares or a combination of both;

(ii) Unlisted PSUs with no accumulated losses and having earned net profit in three preceding consecutive years are to be listed;

45. ***Concept Classification of the PSEs,*** Government of India, 16.03.1999.
46. ***India 2003***, Pub. Div., GoI, N. Delhi.
47. Ministry of Finance, ***Disinvestment Policy Announcement,*** Deptt. of Disinvestment, GoI, N. Delhi, Nov. 5, 2009.

(iii) Follow-on public offers would be considered taking into consideration the needs for capital investment of PSUs, on a case-by-case basis, and government could simultaneously or independently offer a portion of its equity shareholding;

(iv) In all cases of disinvestment, the government would retain at least 51 per cent equity and the management control;

(v) All cases of disinvestment are to be decided on a case-by-case basis; and

(vi) The Department of Disinvestment is to identify PSUs in consultation with respective administrative ministries and submit proposal to government in cases requiring Offer for Sale of Government equity.

Proceeds of Disinvestment: Debate Concerning the Use

In the very next year of disinvestment, there started a debate in the country concerning the suitable use of the proceeds of disinvestment (i.e., accruing to the government out of the sale of the shares in the PSUs). The debate has by now evolved to a certain stage coming off basically in three phases:

Phase I: This phase could be considered from 1991–2000 in which whatever money the governments received out of disinvestment were used for fulfilling the budgetary requirements (better say bridging the gap of fiscal deficit).[48]

Phase II: This phase which has a very short span (2000–03) saw two new developments. *First,* the government started a practice of using the proceeds not only for fulfilling the need of fiscal deficit but used the money for some other good purposes, such as—re-investment in the PSEs, pre-payment of public debt and on the social sector. *Second,* by the early 2000–01 a broad concensus emerged on the issue of the proposal by the then Finance Minister.[49] The proposal regarding the use of the proceeds of disinvestment was as given below:

Some portions of the disinvestment proceeds should be used:

(i) in the divested PSU itself for upgrading purposes

(ii) in the turn-around of the other PSUs

(iii) in the public debt repayment/pre-payment

(iv) in the social infrastructure (education, healthcare, etc.)

(v) in the rehabilitation of the labour-force (of the divested PSUs) and

(vi) in fulfilling the budgetary requirements.

Phase III: The current policy regarding the use of the disinvestment proceeds are as given below:

1. **National Investment Fund:** In January 2005, the Government of India decided to constitute a 'National Investment Fund' (NIF)[50] which has the following ***salient features*:**

   (a) The proceeds from disinvestment will be channelised into the NIF, which is to be maintained outside the Consolidated Fund of India.

   (b) The corpus of the National Investment Fund will be of a permanent nature.

   (c) The Fund will be professionally managed, to provide sustainable

48. Various issues of ***Economic Survey,*** GOI, N. Delhi.

49. It was proposed by Yashwant Sinha and thus got popularity as the ***'Yashwant Formula'*** of using disinvestment proceeds. Being his personal proposal, the Government of the time was not officially bound to it. However, the idea got support inside and outside of the Parliament and looked having an impact on the government's thinking about the issue.

50. Ministry of Finance, Deptt. of Disinvestment, GoI, N. Delhi, ***Disinvestment Policy Announcement,*** Jan. 27, 2005.

returns without depleting the corpus, by selected Public Sector Mutual Funds *(they are, UTI Asset Management Company Ltd.; SBI Funds Management Company Pvt. Ltd.; LIC Mutual Fund Asset Management Company Ltd.)*.

(d) 75 per cent of the annual income of the Fund will be used to finance selected social sector schemes, which promote education, health and employment. The residual 25 per cent of the annual income of the Fund will be used to meet the capital investment requirements of profitable and revivable PSUs that yield adequate returns, in order to enlarge their capital base to finance expansion/diversification.

The income from the NIF investments was utilised on selected social sector schemes, namely the Jawaharlal Nehru National Urban Renewal Mission (JNNURM), Accelerated Irrigation Benefits Programme (AIBP), Rajiv Gandhi Gramin Vidyutikaran Yojana (RGGVY), Accelerated Power Development and Reform Programme, Indira Awas Yojana and National Rural Employment Guarantee Scheme (NREGS).

2. **Restructuring of NIF:** In November 2009, the governement approved a change in the policy on utilisation of disinvestment proceeds. In view of the difficult situation caused by the global slowdown of 2008–09 and a severe drought in 2009–10, a *one-time exemption* was accorded to disinvestment proceeds being deposited into NIF—to be operational for the fiscals 2009–12, which was furhter extended to 2012–13, in view of the persistent difficult condition of the economy. All disinvestment proceeds *(in place of the income accruing out of the investment of the NIF corpus)* obtained during the three year period were to be used for selected social sector schemes.

In January 2013, the government approved **restructuring** of the NIF and decided that the disinvestment proceeds with effect from the fiscal year 2013–14 will be credited to the existing *'Public Account'* under the head NIF and they would remain there until withdrawn/invested for the approved purpose. It was decided that the NIF would be utilised for the following purposes:

(a) Subscribing to the shares being issued by the CPSE including PSBs and public sector insurance companies, on *rights basis* so as to ensure 51 per cent government ownership in them.

(b) *Preferential allotment* of shares of the CPSE to promoters, so that government shareholding does not go down below 51 per cent in all cases where the CPSE is going to raise fresh equity to meet its Capex [51] programme.

(c) *Recapitalisation* of public sector banks and public sector insurance companies.

(d) Investment by Government in RRBs, IIFCL, NABARD, Exim Bank;

51. The Prime Minister's Office has been monitoring the CAPEX (Capital Expenditure) programme and investment plans of selected Central Public Sector Enterprises (CPSEs) since 2012-13. The purpose of this exercise was to enhance investment in the economy, utilizing the substantial cash surpluses that are available with some of the CPSEs to drive economic growth.

(e) Equity infusion in various metro projects;
(f) Investment in Bhartiya Nabhikiya Vidyut Nigam Limited and Uranium Corporation of India Ltd.;
(g) Investment in Indian Railways towards capital expenditure.

The allocations out of the NIF will be decided in the government budget. For the financial year 2013–14 the government approved allocations from the NIF towards spending on recapitalisation of public sector banks and capital expenditure of the Indian Railways.

INVESTMENT CHALLENGE

As per the recent informations released[52] by the GoI, the concerns and policies regarding the investment scenario in the industrial sector is as given below:

Gross Capital Formation (GCF): Investment and capacity additions are critical for sustained industrial growth data clearly indicate a moderation in the growth of GCF in industry—the rate of growth of GCF in four broad sectors of the industry comprising mining, manufacturing, electricity and construction, averaged 10.9 per cent during **2004–11**, almost the same as the rate of growth of GCF in the economy as a whole. The micro, small, and medium enterprises segment had ***the lowest*** medium-term growth of only 0.8 per cent during this period. The share of GCF in industry as a per cent of the overall GCF, after peaking to a level of **54.9** per cent in 2007–8, moderated to **48.3** per cent in 2010–11.

Investment Intentions: While GCF indicates actualisation of investment, investment intentions indicated in the *Industrial Entrepreneur Memorandums* (IEMs) filed are lead indicators of likely investment flow to industry and of entrepreneurs' perception. The investment intentions also provide the sectoral preferences of investors and shifts in these preferences over time. During 2001–10, overall investment indicated in the IEMs filed increased at an average annual rate of 38.7 per cent.

Foreign Direct Investment (FDI): FDI, being a *non-debt capital flow*, is a leading source of external financing, especially for the developing economies. It not only brings in capital and technical know-how but also increases the competitiveness of the economy. Overall it supplements domestic investment, much required for sustaining the high growth rate of the country. Since 2000, significant changes have been made in the FDI policy regime by the government to ensure that India becomes an increasingly attractive and investor-friendly destination.

The current phase of FDI policy is characterised by ***three broad entry options*** for foreign direct investors :

(i) In few sectors, FDI is not permitted (negative list);
(ii) in another small category of sectors, foreign investment is permitted only till a specified level of foreign equity participation; and
(iii) the third category, comprising all the other sectors, is where foreign investment up to 100 per cent of equity participation is allowed. The third category has two subsets:
  (a) one consisting of sectors where automatic approval is granted for FDI (often foreign equity participation less than 100 per cent) and
  (b) the other consisting of sectors where prior approval from the Foreign

52. ***Ministry of Finance,*** GoI, March 16, 2012, N. Delhi & the ***Economic Survey 2011-12,*** op.cit.

Investment Approval Board (FIAB) is required.

Cumulative amount of FDI inflows from April 2000 to December 2011 stood at US$ 240.06 billion, out of which FDI *equity inflows* amounted to US$ 157.97 billion. FDI inflows declined globally in 2009 and 2010. While India was able to largely insulate itself from the decline in global inflows in 2009–10, FDI flows moderated in 2010–11.

Services (financial and non-financial), telecom, construction, drugs & pharmaceuticals, metallurgical industries and power were the sectors that attracted maximum (around 84 per cent) FDI during 2011–12. Cabinet cleared 100 per cent FDI in single brand retail and 5 per cent FDI in multi-brand retail. The decision regarding multi-brand retail is suspended till the consensus is developed through consultation among various stakeholders.

NEW STEPS TO BOOST MANUFACTURING

The GoI has taken several specific initiatives to strengthen industry, particularly the manufacturing sector. The Twelfth Plan document lays down broad strategies for spurring industrial growth and recommends sector specific measures covering micro, small, medium and large industries in the formal as well as informal sectors. Some of the major initiatives that can change the manufacturing landscape of India are as follows: [53]

NATIONAL MANUFACTURING POLICY (NMP)

It was approved by the government in October 2011. The major objectives of the policy are:

(i) Enhancing the share of manufacturing in gross domestic product (GDP) to 25 per cent and creating an additional 100 million additional jobs over a decade or so.

(ii) providing special focus to industries that are employment intensive, those producing capital goods, those having strategic significance, small and medium enterprises, and public sector enterprises besides industries where India enjoys a competitive advantage.

(iii) Promotion of clusters and aggregation, especially through the creation of National Investment and Manufacturing Zones (NIMZs).

(iv) Out of twelve NIMZs so far announced, eight are along the DMIC. Besides, four other NIMZs have been given in-principle approval —

   (a) Nagpur in Maharashtra,
   (b) Tumkur in Karnataka,
   (c) Chittoor district in Andhra Pradesh, and
   (d) Medak district in Andhra Pradesh.

DMIC PROJECT

The industrial development initiatives under DMIC (Delhi-Mumbai Industrial Corridor)[54] project presently cover *eight* industrial cities that are proposed to be developed along the railway corridor. The master planning for the investment regions and industrial areas taken up initially to be developed as *new cities* in Gujarat, Madhya Pradesh, Haryana, Rajasthan and Maharashtra have been completed and master planning in Uttar Pradesh has started. The state governments have initiated the process of obtaining land for the new industrial regions/areas as well as for the early bird projects. For five industrial cities EIA (Environmental Impact Assessment) studies have been initiated.

53. ***Economic Survey 2012-13,*** *op.cit., p. 203.*
54. *For a detailed discussion see* ***Chapter - 21****, p.21.12.*

FDI POLICY

Following the policy reform process, the FDI policy is being progressively liberalised on an ongoing basis in order to allow FDI in more industries under the automatic route. Some recent changes in FDI policy, besides consolidation of the policy into a single document include FDI in multi-brand retail trading up to 51 per cent subject to specified conditions; increasing FDI limit to 100 per cent in single-brand retail trading; FDI up to 49 percent in civil aviation and power exchanges; FDI up to 49 percent in the broadcasting sector under the automatic route and FDI above 49 percent and up to 74 percent under the government route both for teleports and mobile TV.

THE E-BIZ PROJECT

The government has announced the setting up of ***Invest India***—a joint-venture company between the Department of Industrial Policy and Promotion and FICCI, as a *not-for-profit*, single window facilitator, for prospective overseas investors and to act as a structured mechanism to attract investment. In addition, the government has initiated implementation of the e-Biz Project, a mission mode project under the NeGP (National e-Governance Plan) for promoting an *online single window* at the national level for business users. The objectives of setting up of the **e-Biz** portal are to provide a number of services to business users, covering the entire life cycle of their operation. The project aims at enhancing India's business competitiveness through a service oriented, event-driven **G2B** (Government to Business) interaction.

NEW STEPS TO BOOST INDUSTRY

The new government at the Centre has been in repair-damage mode for instilling confidence among the business community and boosting industrial growth. The emphasis of the government is on rapidly improving 'ease of doing business' and launching fresh initiatives like *Make in India* and *Digital India*, creating a National Industrial Corridors Authority (NICA), streamlining environment and forest clearances and labour reforms. Some of the **major steps**[55] taken by the government in this regard are as given below:

(i) Ease of Doing Business: India's ranking in the *'Doing Business-2015'* (a World Bank annual report) is very low, at 142nd. To improve India's ranking, reforms are being undertaken in areas such as starting a business, dealing with construction permits, registration of property, power supply, paying taxes, enforcing contracts, and resolving insolvency. The *important recent measures* taken in this regard are:

(a) liberalisation of licensing and deregulation of a large number of defence products,

(b) extending the validity of licencses to provide enough time to licencees to procure land and obtain the necessary clearances/approvals from authorities,

(c) adoption of a checklist with specific time-lines for processing all applications filed by foreign investors in cases relating to retail and the export-oriented unit (EoU),

(d) automation of processes for registration with the Employees Provident Fund Organization and Employees State Insurance Corporation,

(e) processing of environment and forest clearances online,

55. ***Economic Survey 2014–15***, MoF, GoI, N. Delhi, Vol. 2, p.91.

(f) reducing the number of documents for exports,

(g) adoption of best practices by states in granting clearances and ensuring compliance through peer evaluation, self-certification, etc.

(ii) Make in India: This programme is aimed to facilitate investment, foster innovation, enhance skill development, protect intellectual property, and build best-in-class manufacturing infrastructure –

(a) Information on *twenty-five* sectors has been provided on a web portal along with details of FDI policy, National Manufacturing Policy, intellectual property rights, and the Delhi-Mumbai Industrial Corridor and other National Industrial Corridors.

(b) An Investor Facilitation Cell has been created in 'Invest India' to guide, assist, and handhold investors.

(iii) E-Biz Project: Under this, sveral new steps have been taken by now –

(a) Government to Business (G2B) portal is being set up to serve as a one-stop shop for delivery of services to the investors and address the needs of the business and industry from inception through the entire life cycle of the business.

(b) The process of applying for industrial licence (IL) and industrial entrepreneur memorandum (IEM) has been made online and this service is now available to entrepreneur on 24x7 basis at the E-Biz website.

(c) Other services of the central government are also being integrated.

(iv) Skill Development: A new Ministry of Skill Development and Entrepreneurship has been set up to promote skill and entrepreneurial activities. New steps taken are:

(a) Common norms for skill training across central ministries/departments are being evolved.

(b) *Thirty-one* industry/employer-led Sector Skill Councils (SSCs) are now operational and these have been aligned with the *twenty-five* sectors of 'Make in India'.

(c) To create a common standard for skills training and certification in the country efforts are on to align the National Council for Vocational Training (NCVT), school boards, and the University Grants Commission (UGC).

(v) Streamlining Environment and Forest Clearances: New steps in this regard are–

(a) A process for online submission of applications for environment, coastal regulation zone (CRZ), and forest clearances has been started.

(b) The decision-making process has been decentralised by strengthening federalism.

(c) To ensure industrial and education growth, the requirement of environment clearance has been done away with for projects for construction of industrial sheds which house plant and machinery, educational institutions and hostels.

(vi) Labour-sector Reforms: New steps regarding labour reforms are:

(a) 'Shram Suvidha' portal has been launched for online registration of units, filing of self-certified, simplified, single online return by units, introduction of a transparent labour inspection scheme via

computerized system as per risk-based criteria, uploading of inspection reports within seventy-two hours and timely redressal of grievances.

(b) Universal Account Number (UAN) has been launched facilitating portable, hassle-free, and universally accessible Provident Fund accounts for employees.

(c) The Apprentices Act, 1961 has been amended so as to make it flexible and attractive to youth and industry.

(d) 'Apprentice Protsahan Yojana' has been launched to support micro small and medium enterprises (MSMEs) in the manufacturing sector in engaging apprentices.

MAKE IN INDIA

'Make in India' campaign is aimed at the revival of the manufacturing sector. The objective is laudable but it faces huge challenges, too. Indian manufacturing has been stagnant at low levels, especially when compared with the East Asian successes.[56]

Out of the two sectors, *services* and *manufacturing*, which has got the potential to play the transformational role in case of India, the services sector, contributing over 60 per cent to the GDP in the last decade, makes this even more contemporary debate. Studies and the growth theory suggest that ***transformational sectors***[57] should be assessed in light of their *underlying characteristics* and not just in terms of the traditional manufacturing-services distinction. There are **five** such important characteristics in the sector:

(i) High *levels* of productivity (for income increase).

(ii) Rapid rate of *growth* of productivity (on both external and domestic fronts—interanational and domestic convergence, respectively).

(iii) Ability to *attract resources* (to spread the benefits to the rest of the economy).

(iv) *Alignment* with country's resources (human resources remain typically unskilled).

(v) *Tradability* of the sector (it determines whether the sector can expand without running into demand constraints).

As per the *Economic Survey 2014–15*, the **comparative advantage** of India in *manufacturing* and *sevices* can be seen in the following way:

(i) The formal segment (registered) of manufacturing in India has some traits of 'transformational sector' (such as high productivity and rapid growth in productivity). But non-formal segment can not be such a sector. Thus, 'formalisation' should be encouraged.

(ii) Some sub-sectors in services (such as telecommunications and finance) are highly productive and dynamic (like formal manufacturing sector). But these sectors have not been able to attract large amounts of *unskilled labour*, limiting the

56. The recent upward revisions to the level of manufacturing share in GDP are to some extent statistical rather than real. Moreover, even the revised data do not change the pattern of trend decline in this share. What has happened is the statistical opposite of the technological change which **Jagdish Bhagwati** [*"Splintering and Disembodiment of Services and Developing Nations"*, 1984, The World Economy, 7(2)] referred to as 'splintering' services from goods.

57. The sector which can play the lead role in bringing the largest number of benefits to the economy is known as the **'transformational sector'**. These benefits could be of various kinds – employment opprtunities, growth and income enhancing propects, trdae promotion, poverty alleviation synergy, transition of labour force from one to another sector (in case of India from agriculture to industry or services, etc.

benefits of their dynamism (this unlike the formal manufacturing). These services are skill-intensive sectors while India has more unskilled labour. Construction is one service sector which is *unskilled labour-intensive*, but it is fairly dynamic. However, construction is not a tradable sector, which limits its potential to be a transformational sector.

(iii) One policy conclusion is that efforts should be made to improve the conditions for labour-intensive manufacturing with rapid skill upgradation. This is need of the hour as skill-intensive sectors are dynamic sectors in India and sustaining their dynamism will require skilled labour—otherwise even these sectors could become uncompetitive. It means, to make the 'Make in India' happen, India will first need to make 'Skill India' happen.

India needs to use the right tools (means) to make the 'Make in India' happen. As per the *Survey,* these 'means' are as given below (in decreasing order of their effectiveness and increasing order of controversy):

(i) To attract enough investment from the private sector (domestic as well as foreign) improvement in *business environment* is needed. For this, India needs to take the following steps:
   (a) Regulatory simplification,
   (b) Less onerous tax structure,
   (c) Building infrastructure,
   (d) Reforming labour laws, and
   (e) Enabling connectivity.

   The above-given measures, aimed at improving the 'ease of doing business' would reduce the cost of doing business, increase profitability, and hence encourage the private sector to increase investments. These measures would not just benefit manufacturing, but all sectors of the economy.

(ii) The next category of means could be loosely called—'industrial policy'. Under this, the major required steps, for the promotion of manufacturing, are—
   (a) Providing subsidies,
   (b) Lowering the cost of capital, and
   (c) Creating special economic zones (SEZs)

   The above-given measures should be taken for all manufacturing industries to have the right benifit coming to the economy.

(iii) The next category of tools are related to the is the 'tradability' factor of the manufacturing sector. The normal tools applied by India might be called 'protectionist'—
   (a) Higher custom on imported manufactured goods,
   (b) Imposing the compulsions of local procurement on the foreign companies,
   (c) Providing export-related incentives to domestic manufacturing.

But such policy actions go against India's external obligations under the WTO and also undermine its credentials of openness.

Indian Scenario & the Right Way

India has been depending more on the last two of the above-given 'means', which have been counterproductive to the manufacturing sector in general—resulting into an environment of *negative protection* to it. Together with improving the 'business environment' (which is difficult and a long-term process), India needs to impart a competitive edge to its manufacturing industry by tweaking its tax regime without compromising

on its external obligations. The policy steps in this regard should be—

(a) Eliminating the exemptions in the countervailing duty (CVD) and special additional duties (SAD) on imports.

Tax theory accepts neutrality of incentives between domestic production and imports. This requires that all domestic indirect taxes also be levied on imports. So, if a country levies a sales tax, value added tax (VAT), or excise or GST on domestic sales/production, it should also be levied on imports. India's current indirect tax system, however, acts sometimes to favour foreign production over domestically produced goods.

(b) Enacting a well-designed GST preferably with one, internationally competitive rate and with narrowly defined exemptions.

In one stroke the penalties on domestic manufacturing would be eliminated because the GST (central and state) would automatically be levied on imports to ensure neutrality of incentives. In effect, India would be promoting domestic manufacturing without becoming protectionist and without violating any of its international trade obligations under the World Trade Organization (WTO) or under Free Trade Agreements (FTAs).

INDIAN INFRASTRUCTURE

AN INTRODUCTION

Infrastructure is the 'lifeline' of an economy as protein is the lifeline of the human body. Whichever sector be the prime moving force of an economy, i.e., primary, secondary or tertiary, suitable level of infrastructure presence is a pre-requisite for growth and development. This is why the Government in India has always given priority to the developmental aspects of the sector. But the level of preparedness and performance had been always less than required by the economy. Which sector are called the infrastructure? ***Basically, the goods and services usually requiring higher investment, considered essential for the proper functioning of an economy is called the infrastructure of an economy.***[58] Such sector might be as many as required by a particular economy such as power, transportation, communication, water supply, sewerage, housing, urban amenities, etc.

There are three sectors which are considered as the infrastructure universally around the world namely power, transportation and communication. Since, infrastructure benefits the whole economy, it has been often argued by the economists that the sector should be funded by the government by means of taxation, partly not wholly.

Indian infrastructure sector is clearly overstrained and has suffered from underinvestment in the post-reforms period.[59] Infrastructure bottlenecks are always constraint in achieving a higher growth for the economy. India needs massive investment, both from the public and private sectors, to overcome infrastructure bottlenecks. Investments by the public and private sectors are not alternatives, but complimentary to each other as the required investment is very high. Public investment in the sector depends upon the ability to raise resources (capital) in the public sector and this in turn depends upon the ability to collect the user charges from the consumers. To make this happen following ***three*** factors are extremely important:

58. ***Oxford Dictionary of Business***, N. Delhi, 2004.
59. ***India Infrastructure Report, 1994.*** GOI., New Delhi.

(i) Reform of the power sector,
(ii) Introduction of road user charges (either directly via tolls or indirectly via a cess on petrol diesel), and
(iii) Rationalisation of railway fares.

Experts[60] have suggested for expanding public investment in the sector supplemented duly by a vigorous effort of attracting private investment (domestic as well as foreign). Creating the conducive environment to attract private investment in infrastructure should include:

(i) Simplification and transparency in the clearance procedures;
(ii) Unbundling an infrastructure project so that the private sector may go for only those unbundled segment of the project whose they are able to bear; and
(iii) Providing credible and independent regulatory framework so that the private players get fair treatment.

OFFICIAL IDEOLOGY

Putting in place the quality and efficient infrastructure services is essential to realise the full potential of the growth impulses surging through the Indian economy. There is now a widespread consensus[61] (now clearly accepted by the Planning Commission) that exclusive dependence on the government for the provision of all infrastructure services introduces difficulties concerning adequate scale of investment, technical efficiency, proper enforcement of user charges, and competitive market structure. At the same time, complete reliance on private production, particularly without appropriate regulation, is also not likely to produce optimal outcomes.[62] India, while stepping up public investment in infrastructure, has been actively engaged in finding the appropriate policy framework, which gives the private sector adequate confidence and incentives to invest on a massive scale, but simultaneously preserves adequate checks and balances through transparency, competition and regulation.

The Eleventh Plan[63] emphasised the need for removing infrastructure bottlenecks for sustained growth—proposed an investment of US$500 billion in infrastructure sectors through a mix of public and private sectors to reduce deficits in identified infrastructure sectors. As a percentage of the gross domestic product (GDP), investment in infrastructure was expected to increase to around 9 per cent. For the first time the contribution of the private sector in total investment in infrastructure was targeted to exceed 30 per cent. Total investment in infrastructure during the Eleventh Plan is estimated to increase to more than 8 per cent of the GDP in the terminal year of the Plan, which was higher by 2.47 percentage points as compared to the Tenth Plan. The private sector is expected to be contributing nearly 36 per cent of this investment.

An analysis[64] of the creation of infrastructure in physical terms indicates that while the achievements in some sectors have been remarkable during the Eleventh Plan as compared to the previous FiveYear Plans, there have been slippages in some sectors. The success in garnering private-sector investment in infrastructure through the public-private partnership (PPP) route during the

60. One of such major suggestion was forwarded by ***Jeffrey D. Sach, Ashutosh Varshney*** and ***Nirupam Bajpai*** (Eds), ***India in the Era of Economic Reforms,*** OUP, N. Delhi, 1999, p. 79.
61. ***Economic Survey, 2006–07,*** GoI, N. Delhi.
62. ***India Infrastructure Report 2007,*** GoI, N. Delhi.
63. Planning Commission, ***Mid Term Appraisal of the 11th Pan,*** GoI, N. Delhi, released October 2011.
64. ***Planning Commission,*** while announcing the *Approach for the 12th Plan,* N. Delhi.

Plan has ***laid solid foundation*** for a substantial step up in private-sector funding in coming years. PPPs are expected to augment resource availability as well as improve the efficiency of infrastructure service delivery.

The Planning Commission[65], in its aproach paper has projected an investment of over Rs. 45 lakh crore (for about US $1 trilion) during the **Twelfth Plan (2012–17).** It is projected that at least 50 per cent of this investment will come from the private sector as against the 36 per cent anticipated in the Eleventh Plan and public sector investment will need to increase to over Rs. 22.5 lakh crore as against an expenditure of Rs. 13.1 lakh crore during the Eleventh Plan. Financing infrastructure will, therefore, be a big challenge in the coming years and will equire some innovative ideas and new models of financing.

Sectoral Situation & Initiatives[66]

Power Deficit: The deficit in power supply in terms of peak availability and total energy availability declined during the Eleventh Five Year Plan. While the energy deficit decreased from 9.6 per cent in the terminal year of the Tenth Plan (2006–07) to 7.9 per cent during April–December 2011, peak deficit declined from 13.8 per cent in 2006–07 to 10.6 per cent during the current financial year (up to December 2011). *Capacity addition* during the Eleventh Plan is, therefore, expected to be about 50,000 to 52,000 MW.

Ultra Mega Power Projects (UMPPs) Initiative for development of coal-based super critical UMPPs, each of about 4,000 MW capacity, under Case II bidding route. *National Grid* helps to even out supply-demand mismatches. The existing inter-regional transmission capacity of 23,800 MW connects the northern, western, eastern, and north-eastern regions in a synchronous mode operating at the same frequency and the southern region asynchronously operating in the same mode. This has enabled inter-regional energy exchanges of about 39,275 million units (MUs) during April–November 2011, thus contributing to better utilisation of generation capacity and an improved power supply position. Proposals are under way for synchronous integration of the southern region with other regions.

Competition in the electricity sector has been augmented by having an ***open access*** system allowing a buyer to choose his supplier and a seller to choose his buyer. Open access at inter-state transmission level is now fully functional. The facilitative framework created by the Central Electricity Regulatory Commission (CERC) in this regard has provided the desired regulatory certainty for developers in terms of market access, and also payment security against default. *Central Transmission Utility (CTU)* which is responsible for granting connectivity, medium-term open access, and long-term access, has received 141 applications for connectivity involving generation capacity of 1,52,850 MW.

Trading of Electricity is enabled through electricity traders and power exchanges. Power trading helps generation resource optimisation by facilitating trade and flow of power across the country with varied geography, climatic conditions, and natural resource endowments. It has helped in sale of surplus power available with distributing utilities and captive power plants on one hand and purchase of power by deficit utilities to meet sudden surges in demand. Short-term markets also provide generators with an alternative

65. Planning Commission, ***Approach to the 12th Plan,*** GoI, N. Delhi.
66. Analyses on the sectoral situations in the infrastructure sector of India and the new initiatives taken by the GoI in recent times are based on the governments documents – ***Economic Survey 2011-12***, pp. 251-276; ***Approach Paper to the 12th Plan, Mid Term Appraisal of the 11th Plan;*** various ***Papers/*****Documents** published by the ***Planning Commission;*** and different ***Releases*** by the concerned ***Central Ministries of the GoI.***

to sell power other than through long-term power purchase agreements (PPAs). The CERC grants inter-state trading licences.

National Electricity Fund (Interest Subsidy Scheme) has been approved to provide interest subsidy (Rs. 8,466 crore) on loan to the state power utilities, both in the public and private sectors, to improve the **distribution network**. The preconditions for eligibility to avail of interest subsidy are linked to the reforms in the power sector and the amount of interest subsidy is linked to the progress achieved in reforms.

AT&C Losses: Due to lack of adequate investment on 'transmission and distribution' (T&D) works, the T&D losses have been consistently on the higher side, and reached to the level of 32.86 Per cent in the year 2000-01. The reduction of these losses was essential to bring economic viability to the state utilities (SEBs). As the T&D loss was not able to capture all the losses in the network, concept of *Aggregate Technical and Commercial (AT&C)* loss was introduced. AT&C loss captures technical as well as commercial losses in the network and is a true indicator of total losses in the system.

High technical losses in the system are primarily ***due to*** inadequate investments over the years for system improvement works, which has resulted in unplanned extensions of the distribution lines, overloading of the system elements like transformers and conductors, and lack of adequate reactive power support.

The commercial losses are mainly due to:

(i) low metering efficiency

(ii) theft, and

(iii) pilferages

This may be eliminated by improving metering efficiency, proper energy accounting & auditing and improved billing & collection efficiency. Fixing of accountability of the personnel/feeder managers may help considerably in reduction of AT&C loss.

With the initiative of the Government of India and of the states, the ***Accelerated Power Development & Reform Programme*** (APDRP) was launched in 2001, for the strengthening of sub–transmission and distribution network and reduction in AT&C losses. The main objective of the programme was to bring AT&C losses below 15 per cent in five years in urban and in high-density areas, the loss as a percentage of turnover was reduced from 33 per cent in 2000–01 to 16.60 per cent in 2005–06.

The APDRP programme has been *restructured*. The restructured APDRP (R-APDRP) was launched in July 2008 as a central sector scheme for the Eleventh Plan (in order that reliable and verifiable baseline data of revenue and enegry in APDRP Project areas is attained over an IT platform and that AT& C loss reduction is achieved on a sustained basis).

In December 2014, the APDRP was subsumed into the new launched Integrated Power Development Scheme (IPDS) with some new features.

Development of Multi-functional Complex (MFC): A new concept of development of MFCs with *budget hotels* was introduced in the *Rail Budget 2009–10,* so that important facilities may be available to rail users in a separate complex in the vicinity of the circulating area on station—a total of 198 stations have been identified by now.

In a major move to give further impetus to ***railways' modernisation*** plans, an Expert Group has been constituted under the Chairmanship of Shri Sam Pitroda to recommend ways and means of meeting the challenges of economic growth, the aspirations of the common man, the needs of changing technology, and the expanding market, while at the same time ensuring adequate focus on

addressing the social and strategic requirements of the country consistent with Indian Railways' national aspirations. The terms of reference of the group involve outlining strategies for modernisation of railways with focus on track, signalling, rolling stock, stations and terminals upgradation; using ICT for improving efficiency and safety; augmenting existing capacities of railways through indigenous development; reviewing projects; and addressing PPP issues. The Expert Group is expected to submit its report by March 2012.

In order ***to attract private capital*** for accelerated construction of fixed rail infrastructure, GoI has formulated PPP investment models. A comprehensive draft policy is under consideration which would replace the existing Railways Infrastructure for Industry Initiative (**R3i**) and Railways Policy for Connectivity to Coal and Iron Ore Mines (**R2CI**) policies for private investments in rail connectivity projects.

National Highways Development Project (NHDP): About 22 per cent of the total length of National Highways (NHs) is single lane/ intermediate lane, about 53 per cent is two lane standard, and the balance 25 per cent is four lane standard or more.

Financing of the NHDP: A part of the **fuel cess** imposed on petrol and diesel is allocated to the NHAI for funding the implementation of the NHDP. The NHAI leverages the cess flow to borrow additional funds from the debt market. Till date, such borrowings have been limited to funds raised through 54 EC (capital gains tax exemption) bonds and the short-term overdraft facility. Government has also taken loans for financing projects under the NHDP from the World Bank (US$ 1,965 million), Asian Development Bank (US$ 1,605 million) and Japan Bank for International Cooperation (32,060 million yen) which are passed on to the NHAI partly in the form of grants and partly as loan. The NHAI has also availed a direct loan of US$ 149.78 million from the ADB for the Manor Expressway Project.

Special Accelerated Road Development Programme for North-East region (SARDP-NE) aims at improving road connectivity to state capitals, district headquarters, and remote places of the north-east region. Development of roads in Left Wing Extremism *(LWE)*-affected areas in the states of Andhra Pradesh, Bihar, Chhattisgarh, Jharkhand, Madhya Pradesh, Maharashtra, Odisha, and Uttar Pradesh is continuing; Prime Minister's Reconstruction Plan *(PMRP)* for Jammu and Kashmir, launched in November 2004.

Pradhan Mantri Gram Sadak Yojna (PMGSY): Launched to provide single all-weather road connectivity to eligible unconnected habitations having population of 500 persons and above in plain areas and 250 persons and above in hill states, tribal (Schedule V) areas, desert (as identified in the Desert Development Programme) areas, and LWE-affected districts as identified by the Ministry of Home Affairs. Rural roads has also been identified as one of the ***six components*** of Bharat Nirman which has the goal of providing all-weather road connectivity to all villages with a population of 1,000 (500 in the case of hilly or tribal areas).

The Eleventh Plan had envisaged accelerated efforts to bring the NH network up to a ***minimum two-lane*** standard by the end of the **Twelfth Plan** and for removing existing deficiencies. In order to make a visible impact, the work would be taken up for upgradation on a corridor concept. These corridors would include strengthening (in adjoining reaches) in addition to widening to two-lane/two-lane with paved shoulder standards in order to have better facility over long continuous stretches.

Civil Aviation: Airport infrastructure development continues to be a matter of concern. Upgradation of many airports, including construction of new terminals, upgradation in 18 non-metro airports, for improving air navigation services the Airport Authority of India (AAI) installing the new ATS automation system. In order to address issues concerning viability of the civil aviation sector, particularly the airline industry, a Working Group was constituted on 12, December 2011 under the chairmanship of the Secretary civil aviation. Their major recommendations were:

- (i) state governments should rationalise the value added tax (VAT) on aviation turbine fuel (ATF),
- (ii) foreign airlines be permitted to invest in domestic airlines undertakings,
- (iii) direct import of ATF by airlines for their own consumption be allowed,
- (iv) airlines should be asked to prepare their turnaround plans,
- (v) fare structure should be reviewed by airlines to cover the cost of their operations.
- (vi) an economic regulatory framework suggested with regard to excessive/ predatory pricing by 31, May 2012.

Maritime Agenda 2010–20: The **objective** of the Maritime Agenda 2010–20 is not only creating more capacity but setting up ports on a par with the best international ports in terms of performance:

- (i) A target of 3,130 MT port capacity has been set for the year 2020. More than 50 per cent of this capacity is to be created in the non-major ports as the traffic handled by these ports is expected to increase to 1,280 MT.
- (ii) This enlarged scale of operation is expected to reduce transaction costs considerably and make Indian ports *globally competitive.*
- (iii) Proposed investment in major and non-major ports by 2020 is expected to be around Rs. 2,96,000 crore.
- (iv) Most of the investment to come from the private sector including FDI (up to 100 per cent under the automatic route is permitted for construction and maintenance of ports), around 96 per cent, private sector to fund most of the projects through PPP or on 'build operate transfer' (BOT) or 'build operate own transfer' (BOOT) basis.
- (v) Private-sector participation will not only increase investment in the ports infrastructure, it is expected to improve operations of the ports through the induction of the latest technology and better management practices.
- (vi) Public funds will be mainly deployed for common use infrastructure facilities like deepening of port channels, rail and road connectivity from ports to hinterland, etc.

Urban Infrastructure: Jawaharlal Nehru National Urban Renewal Mission (JNNURM) has been launched by the Ministry of Urban Development for a seven-year period (i.e., up to March 2012) to encourage cities to initiate steps to bring about improvements in a phased manner in existing civic service levels. The components under the sub-mission Urban Infrastructure and Governance (UIG) include urban renewal, water supply (including desalination plants), sanitation, sewerage and solid waste management, urban transport, development of heritage areas, and preservation of water bodies.

The UIDSSMT *(Urban Infrastructure Development Scheme for Small and Medium Towns)* is a ***sub-component*** of the JNNURM for development of infrastructure facilities in all towns and cities other than the 65 mission cities covered under UIG (Urban Infrastructure and

Governance) sub-mission of the JNNURM. For obtaining assistance under the UIDSSMT, states and urban local bodies (ULBs) need to sign MoAs committing to implementation of the reforms.

Under the pilot scheme, *Urban Infrastructure Development in Satellite Towns around Seven Mega-Cities,* launched in 2011–12 to contribute towards amelioration of basic services in these towns. For the north-eastern region, the *North Eastern Region Urban Development Programme* was launched in November 2009 with Asian Development Bank (ADB) assistance. The project aims to assist the states of Tripura, Mizoram, Sikkim, Meghalaya, and Nagaland to address challenges of urban development in their capital cities.

Urban Transport is one of the key elements of urban infrastructure. As compared to private modes of transport, public transport is energy efficient and less polluting. The public transport system helps improve urban-rural linkages and access of rural/semi-urban population in the periphery to city centres for the purposes of work without proliferation of slums within and around cities. National Urban Transport Policy (NUTP), 2006 **aims** to ensure accessible, safe, affordable, quick, comfortable, reliable, and sustainable mobility for all—under which several projects of 'bus rapid transit system' (BRTSs) and 'Metro Rail Projects' have been sanctioned by May 2012.

Financing Infrastructure: Net bank credit to infrastructure had a healthy growth of 48.4 per cent per annum during 2006–11 but it turned negative 2011–12 and was around 61 per cent of 2010–11—power and telecom sectors saw significant reduction. FDI inflows registered 23.6 per cent growth in 2011–12 with power (43.6 per cent), non-conventional energy (338 per cent) and telecommunications (499 per cent) the preferred sectors for foreign investors—the sectors, however, failed to share the buoyancy in FDI inflows.

ENERGY PRICING

The economic role of rational energy pricing can hardly be under-estimated. Rational energy prices provide the right signals to both the producers and consumers, and lead to a demand-supply match, providing incentives for reducing consumption on the one hand and stimulating production on the other. Aligning domestic energy prices with the global prices, especially when large imports are involved, may be an ideal option as misalignment could pose both micro and macroeconomic problems.

At the microeconomic level, underpricing of energy to the consumer not only reduces the incentive for being energy efficient, it also creates fiscal imbalances. Leakages and inappropriate use may be the other implications. Underpricing to the producer reduces both his incentive and ability to invest in the sector and increases reliance on imports. Over the years, India's energy prices have become misaligned and are now much lower than global prices for many products. The extent of misalignment is substantial, leading to *large untargeted subsidies*. Several initiatives have been taken by the GoI for rationalising the energy prices in different sectors—

(i) The Integrated Energy Policy has outlined the broad contours of the pricing system for coal. The *pricing of coal* is done now on gross calorific value (GCV) basis with effect from 31, January 2012, replacing the earlier system of pricing on the basis of useful heat value (UHV), which takes into account the heat trapped in ash content also, besides the heat value of carbon content. The revision in the GCV is likely to increase the prices of domestic coal to some extent, but this is a desirable adjustment because domestic thermal coal, adjusted for quality differences, continues to be underpriced.

(ii) In case of petroleum products pricing, the government dismantled the Administered Pricing Mechanism in 2002. This decision, however, was not fully implemented and domestic pass through of global price increases remained low for petrol, diesel, kerosene and LPG—in June 2010, the government announced that the *price of petrol was fully deregulated* and the oil companies were free to fix it periodically.

(iii) In *January 2013*, the government announced the new roadmap providing for a gradual price increase for reducing *diesel under-recoveries*.

(iv) Admissibility of subsidised number of liquefied petroleum gas (LPG) cylinders and prices of LPG have also recently been revised. Pricing of gas is presently done under the New Exploration Licensing Policy (NELP). The government provides the operator freedom to sell the gas produced from the NELP blocks at a market-determined price, subject to the approval of pricing formula. The government is reviewing pricing under the PSC (price sharing contract) to clarify the extent to which producers will have the freedom to market the gas.

DEDICATED FREIGHT CORRIDOR

The Eastern and Western Dedicated Freight Corridors (DFC) are a mega-rail transport project being undertaken to increase transportation capacity, reduce unit costs of transportation, and improve service quality:

(i) The Eastern DFC (1,839 route kilometres [RKM]) extends from Dankuni near Kolkata to Ludhiana in Punjab, while the Western DFC (1,499 RKM) extends from the Jawahar Lal Nehru Port (JNPT) in Mumbai to Dadri /Rewari near Delhi.

(ii) A special purpose vehicle, the *Dedicated Freight Corridor Corporation of India Limited* has been set up to implement the project. Out of 10,703 ha of land to be acquired for the project, 7,768 ha (73 per cent) has already been awarded under the Railway Amendment Act (RAA) 2008.

(iii) The Eastern and Western DFC projects are being *funded* through a mix of bilateral/multilateral loans, gross budgetary support (GBS), and PPP. The Western DFC is being funded by the Japan International Cooperation Agency (JICA) up to 77 per cent of the total cost.

(iv) The Ludhiana to Mughalsarai section (1,183 km) of the Eastern DFC is being funded by the World Bank up to 66 per cent of the project cost.

(v) The Mughalsarai-Sonnagar sector (122 km) will be funded by Indian Railways' own resources. Civil construction work of this sector is in progress.

(vi) The Dankuni-Sonnagar section (534 km) of the Eastern DFC to be funded through PPP mode.

(vii) After commissioning of the Eastern and Western DFCs, it is planned to upgrade the speed of passenger trains to 160–200 kmph on the existing routes. A feasibility study for upgradation of speed of passenger trains to 160–200 kmph on the existing Delhi–Mumbai route has been undertaken with co-operation from the Government of Japan in 2012–13.

Apart from the Eastern and Western DFCs, a feasibility study has also been undertaken on four ***future*** freight corridors, viz., East–West Corridor (Kolkata–Mumbai), North–South Corridor (Delhi–Chennai), East Coast Corridor (Kharagpur–Vijayawada) and Southern Corridor (Goa–Chennai). A pre-feasibility study of the

Chennai–Bangalore Freight Corridor is also being proposed.

RESTRUCTURING THE PPP

The infrastructure scenario in India today is not encouraging. Many projects are financially stressed, accounting for almost a third of stressed assets in banks. New projects cannot attract sponsors, as in recent NHAI bids, and banks are unwilling to lend. Given its riskiness, pension and insurance funds have sensibly limited their exposure to these projects. This current state of the public private partnership (PPP) model is due to poorly designed frameworks, which need restructuring[67]. The *Economic Survey 2014–15* has highlighted the 'flaws' in it and also suggested the right 'remedies' for the same.

FLAWS IN EXISTING DESIGN

There are several *in-built flaws* in India's design of the PPPs in infrastructure. They can be seen as given below:

(i) Existing contracts focus more on fiscal benefits than on efficient service provision. For example, in port and airport concessions, the bidder offering the highest share of gross revenue collected to the government is selected. Thus, if this share is 33 per cent (higher in many actual contracts), the user pays 50 per cent more than what is required, since the concessionaire is able to provide service even though it gets only Rs. 1 for every Rs. 1.50 charged.

(ii) They neglect principles allocating risk to the entity best able to manage it. Instead, unmanageable risks, e.g., traffic risk in highways, even though largely unaffected by their actions, are transferred to concessionaires. This is also true for railways and in part, for ports (though inter-terminal competition is possible) and airports.

(iii) The default revenue stream is directly collected user charges. Where this is deemed insufficient, bidders can ask for a viability grant, typically disbursed during construction. This structure leaves the government with no leverage in the case of non-performance, with few contractual remedies short of termination.

Fiscal reporting practices also affect this choice in revenue stream. Current accounting rules treat future committed expenditure as a contingent liability. However, foregone future revenue is not accounted for.

(iv) There are no ex-ante structures for renegotiation. If a bureaucrat restructures a project, there are no rewards; instead it may lead to investigation for graft. Failed projects lead neither to penalties nor investigation. With such asymmetric incentives, bureaucrats naturally avoid renegotiation.

(v) Contracts are over-dependent on market wisdom, e.g., bidders in ultra-mega power projects (UMPP) could index tariff bids to both fuel prices and exchange rates, but almost all chose very limited indexation. When fuel prices rose and the rupee fell, these bids became unviable. To enforce market discipline and penalise reckless bidding, these projects should have been allowed to fail.

Given the several flaws in the model of the PPPs, India has seen significant investment in them from the privates sector. The Survey indicates the **needed modifications** in the following way:

67. **Partha Mukhopadhyay,** Center for Policy Research, New Delhi, 2014, Vol. 1, pp. 75-76.

(a) It is better to continue combining construction and maintenance responsibilities to incentivise building quality. In many projects, especially highways, maintenance costs depend significantly on construction quality. If a single entity is responsible for both construction and maintenance, it takes lifecycle costs into account. Separatingthese responsibilities provide an incentive to increase profits by cutting corners during construction. Suggestions to let the public sector build assets and have the private sector maintain and operate them ignore this linkage.

(b) Risk should only be transferred to those who can manage it. In a highway or a railway project, it is not sensible to transfer usage risk since it is outside the control of the operator. But, it can be done in telecom projects and for individual port terminals that compete with each other, where demand can respond to tariff and quality.

(c) Financing structures should be able to attract pension and insurance funds, which are a natural funding source for long-term infrastructure projects. What does this mean for key sectors? First, rather than prescribe model concession agreements, states should be allowed to experiment.For example, in ports, terminals can be bid on the basis of an annual fee, with full tariff flexibility, subject to competition oversight. For electricity generation, bids can be two-part, with a variable charge based on normative efficiency, or alternatively, determined by regulators and a capacity charge.

(d) Another option, without that drawback, is the Least Present Value of Revenue (LPVR)[68] contract, where the bid is the lowest present value (discounted at a pre-announced rate) of total gross revenue received by the concessionaire. The concession duration is variable and continues until the bid present value amount is received.

A key advantage of this contract is that it converts usage risk to risk of contract duration, which is more manageable for financial institutions. Since the bid is on gross revenue, it also selects bidders who can execute at low cost and demand relatively lower margins and by limiting the scope for renegotiation to the remaining uncollected value of the LPVR bid, it discourages opportunistic bidding. Further, since the present value is protected, this structure is suitable for pension and insurance funds.

Restructuring the Existing Contracts

To revive private interest and bank lending existing PPP contracts need to restructuring, with burden sharing among different stakeholders. The *finer points* need to be taken into account—

(i) Lenders/banks may have extended credit without necessary due diligence, assuming that projects were implicitly guaranteed. Without burden sharing, this behaviour will be reinforced.

(ii) Many bidders may have assumed that they could renegotiate in the event of negative shocks.

68. (i) E. Engel, R. Fischer and A. Galetovic, **'Highway Franchising: Pitfalls and Opportunities'**, *The American Economic Review, 87(2),* 1997, pp 68–72. (ii) Engel E. Engel, R. Fischer and A. Galetovic, **'Least-Present-Value-of-Revenue Auctions and Highway Franchising'**, *Journal of Political Economy, 109(5),* 2001, pp 993–1020. Vol. 1, pp. 75-76.

(iii) Thus, there was potentially adverse selection of firms who felt they had the capacity to renegotiate; rather than firms better at executing and operating the project.

(iv) This may have limited participation by foreign firms.

(v) In the absence of burden sharing, such adverse selection would be supported. Thus, the guiding principle should be to restructure contracts based on the project's revenues, differentiating between temporary illiquidity and insolvency.

The private sector remains key to rapid delivery of high quality infrastructure. Restructured PPP frameworks will revive their interest in infrastructure and bring in funding from pension and insurance funds. To make this happen the right policy steps could be—

(a) All stressed highway projects could be switched to electronic tolling.

(b) Revenues can go, as now, into an escrow account, but with a revised order of priority.

(c) Long-term bullet bonds, at the risk-free government rate, can be issued to the extent of the debt in the project. After operations and maintenance, interest payments on these bonds, which may also be guaranteed by the Union government, will be first in order of priority.

(d) Lenders can opt to switch existing debt to these bonds. Allocations for repayment of their principal will have second priority and existing debt that has not been switched, the next priority.

(e) Equity can be the residual claimant. If the project makes money over its lifetime, equity holders will earn a return, though some may exit now, at a discount.

BOOSTING ENERGY SECTOR

The GoI has taken several steps in recent times to boost the the enrgy sector, particularlity the crude oil and natural gas sectors. Major steps are as given below as per the *Economic Survey 2014–15:*

(i) New Gas Pricing Formula: Approved in October 2014 through which the increase in price of domestically produced natural gas strikes a fine balance between the expectations of investors and interests of consumers.

(ii) Reforms in Production-Sharing Contracts to push Investment in Exploration: It has ironed out a number of rigidities in production-sharing contracts to instil confidence among investors and ensure that work, which was stuck in a number of blocks, takes off in right earnest and without further delay.

(iii) Reassessment of Hydrocarbon Potential: An elaborate plan has been rolled out to reassess hydrocarbon resources in India's sedimentary basins, which will provide greater clarity to future investors on the prospects of the basins.

(iv) Project for Survey of Un-appraised Sedimentary Basins of India: A project has been undertaken to appraise about 1.5 million square kilometre area in twenty-four sedimentary basins where scanty geo-scientific data is available. Data generated under the project shall be stored, maintained, validated at the National Data Repository (NDR) which is being set up in the Directorate General of Hydrocarbons (DGH).

(v) Data Acquisition through Non Exclusive Multi-Client Model: A policy for acquisition of geo-scientific data through

a non-exclusive multi-client model is being implemented. This model replaces the earlier fiscal term of profit sharing after cost recovery with the payment of a one-time project fee.

(vi) *Level Playing Field for Gas operations in the North East Region:* For incentivizing exploration and production in the North East region, a 40 per cent subsidy on gas operations has been extended to private companies operating in the region.

(vii) *Gas Grid Infrastructure:* In addition to the existing 15,000 km gas pipeline network, another 15,000 km has been planned for completion of the gas grid.

RAILWAYS AS GROWTH ENGINE

The GoI has taken a number of policy steps to boost the railways to make emerge as a strong engine of growth promotion. The recent steps taken in this regard, as per the *Economic Survey 2014–15,* are as given below:

(i) *Completion of Udhampur-Katra broad gauge line:* The Udhampur-Katra broad gauge line in Jammu and Kashmir, bringing the state closer to the rest of the nation, is an engineering marvel by IR. Four train services up to Katra have commenced from July 2014.

(ii) *Meghalaya gets rail connectivity:* Meghalaya got its first rail connectivity with the completion of the new Dubhnoi-Mendipathar line in August 2014. A new route from Mendipathar in Meghalaya to Guwahati in Assam, got connected by rail in November 2014.

(iii) *High speed Bullet Trains:* Steps are under way for introduction of high speed bullet trains in the country on the Mumbai-Ahmedabad corridor, as part of the Diamond Quadrilateral network of high speed rail, connecting major metros and growth centres of the country.

(iv) *Next Generation e-ticketing (NgeT) application:* The newly launched NgeT, developed by the Central Railway Information Centre (CRIS) has enabled sharp increase in online ticket booking capacity, number of enquiries per minute, as well as the capacity to handle concurrent sessions.

(v) *Premium special trains:* To make sufficient berths available to passengers, and to earn additional revenue, as compared to trains operating on normal fares, IR has introduced premium special trains under the dynamic fare system.

(vi) *Harnessing solar energy:* The Rail Coach Factory, Rae Bareli is presently functioning completely on solar power. A 30 kw solar plant has been commissioned, on the roof top of Rail Bhawan at New Delhi and provision of solar plants at other Railway buildings is being expedited, preferably under the public-private partnership (PPP) model.

(vii) *Wi-Fi Broadband service at select railway stations:* Bengaluru and New Delhi Railway Stations have been provided Wi-Fi broadband facilities.

(viii) *e-catering service in trains:* Indian Railways Catering and Tourism Corporation, has been entrusted the task of implementation of e-catering service in trains.

(ix) *Cooperation with China:* An MoU and an Action Plan have been signed between the Government of India and People's Republic of China, for enhancing technical cooperation in the railway sector. The potential cooperation areas in the MoU include, i) training in heavy haul freight transportation, ii) raising speed of

trains on existing routes, iii) station re-development, iv) high speed rail, and v) setting up of a railway university.

(x) *Early completion of coal transportation projects:* Three rail connectivity projects for coal movement in Jharkhand, Odisha, and Chhattisgarh have been put on fast track.

STATE DISCOMS

The government in September 2012 approved the scheme for Financial Restructuring of State Distribution Companies (Discoms). The salient features of the scheme are as follows:

(i) 50 per cent of the outstanding short-term liabilities up to March 31, 2012 to be taken over by state governments. This shall be first converted into bonds to be issued by Discoms to participating lenders, duly backed by state government guarantee.

(ii) Takeover of liability by state governments from Discoms in the next two to five years by way of special securities and repayment and interest payment to be done by state governments till the date of takeover.

(iii) Restructuring the balance 50 per cent short-term loan by rescheduling loans and providing moratorium on principal.

(iv) The restructuring/reschedulement of loan is to be accompanied by concrete and measurable action by the Discoms/ states to improve their operational performance.

(v) The GoI will provide incentive by way of grant *equal to the value* of the additional energy saved by way of accelerated AT&C loss reduction beyond the loss trajectory specified under the RAPDRP and capital reimbursement support of 25 per cent of principal repayment by the state governments on the liability taken over by the state governments under the scheme.

IMPORTANT ISSUES

Infrastructural bottlenecks have been among the most important areas of concern for the government. The 'big push' which the government wanted to give to the sector has not been able to bring desired results due to various reasons. The emerging issues and concerns outlined by the *Economic Survey 2012–13* and other government documents for the sector are as given below:

(i) The *Twelfth Plan* lays special emphasis on development of the infrastructure sector including:

(a) Energy, as the availability of quality infrastructure is important not only for sustaining high growth, but also ensuring that the growth is inclusive.

(b) The total investment in the infrastructure sector during the Plan, estimated at Rs. 56.3 lakh crore (approx. US$1trillion), will be nearly double the amount committed during the Eleventh Plan.

(c) This step up in investment will be feasible primarily because of enlarged private-sector participation that is envisaged.

(ii) Unbundling of infrastructure projects, *public private partnerships* (PPP), and more transparent regulatory mechanisms have induced private investors to increase their participation in infrastructure sectors:

(a) Their share in infrastructure investment increased from 22 per cent in the Tenth Plan to 38 per cent in the Eleventh Plan and is expected

to be about 48 per cent during the Twelfth Plan.

(b) Yet, more than half of the resources required for infrastructure would need to come from the public sector, from the government, and the parastatals.

(c) This would require not only the creation of the fiscal space but also use of a *rational pricing policy*.

(d) Scaling up private-sector participation on a sustainable basis will require *redefining the contours of their participation* for the development of infrastructure sector in a transparent and objective manner with a comprehensive regulatory mechanism in place.

(e) From a *macroeconomic perspective*, a high level of investment in the infrastructure sector is essential for the overall revival of investment climate which may finally lead to sustainable growth in an economy.

(f) However, in the current macroeconomic environment, to achieve this objective, there is need to address sector-specific issues over the medium-to-long-term horizon in India.

(iii) There is an *overall shortage of power* in the country both in terms of energy deficit and peak shortage:

(a) At present, overall energy deficit is about 8.6 per cent and peak shortage of power is about 9.0 per cent.

(b) The Eleventh Plan added 55,000 MW of generation capacity which was more than twice the capacity added in the Tenth Plan.

(c) The Twelfth Plan aims to add another 88, 000 MW.

(d) Delivery of this additional capacity would critically depend on resolving *fuel* availability problems, especially when *about half* the generated capacity is expected to come from the private sector.

(e) The private developers may not be able to finance the projects if *coal linkages* are not resolved and there are delays in finalisation of fuel supply agreements (FSAs).

(f) While some decisions have been taken for restructuring Discoms' finances, these may need to be monitored and implemented in spirit.

(iv) Although India has large *coal* reserves, demand for coal is substantially outpacing its domestic availability, with Coal India Ltd. not being able to meet its coal production targets in the Eleventh Plan:

(a) Domestic coal supplies are therefore *not assured* for coal-based power projects planned during the Twelfth Plan. Thus, it is essential to ensure that domestic production of coal increases from 540 million tonnes in 2011-12 to the target of 795 million tonnes at the end of the 12th Plan.

(b) This increase of 255 million tonnes assumes an increase of 64 million tonnes of captive capacity with the rest being met by Coal India Limited.

(c) However, even with this increase, there will be a need to import 185 million tonnes of coal in 2016–17, which may further add to the financing cost of power projects.

(d) Moreeffortmustbemadeforimproving competition and efficiency in the coal sector, which may entail structural reforms.

(e) Problems like delays in obtaining environmental clearances, land acquisitions, and rehabilitation need to be suitably addressed in fast-track mode to achieve the Twelfth Plan targets for coal production, while maintaining a balance between growth needs and *environmental concerns*.

(v) Progress of *road* projects has also suffered on account of similar factors:

(a) The creation of a High-Level Cabinet Committee on Investment to quicken the pace of decision making in critical infrastructure projects by the government is expected to resolve any issues involving inter-ministerial coordination.

(b) Of late, financing of *road* projects has also run into difficulty as leveraged companies implementing road projects are unable to raise more debt in the absence of fresh equity. In current market conditions, these firms are unable to raise *new equity*.

(c) Exit route needs to be eased so that promoters can sell equity positions after construction, passing on all benefits and responsibilities to entities that step in.

(d) Promoters can then use the equity thus released for new projects.

(e) Steps are also needed to up-scale projects in PPP mode for achieving the targets envisaged for the development of roads in the Twelfth Plan.

(vi) The process of extending *transparent policies* and mechanisms for allocation of scarce natural resources to private companies for commercial purposes has also been initiated:

(a) The Mines & Mineral (Development and Regulation) Bill 2011 aims at providing a simple and transparent mechanism for grant of mining lease or prospecting licence through competitive bidding in areas of known mineralisation and on first-in-time basis in areas where mineralisation is not known.

(b) *However*, in order to meet the objective of revenue maximisation in an open, transparent and competitive manner, this should be preceded by detailed geological mapping of the mineral wealth of the country.

(c) Further, any policy prescription regarding the use of natural resources must ensure that the process of selection is fair, reasonable, non-discriminatory, transparent, and aimed at promoting healthy competition and equitable treatment.

(vii) Owing to a number of external and internal factors, viability of *airline* operations in India has come under stress.

(a) A high operating cost environment owing to high and rising cost of aviation turbine fuel (ATF) coupled with rupee depreciation is making operations unviable for carriers in India.

(b) The Expert Report of Nathan Economic Consulting India Private Ltd. (Nathan India) which went into the question of pricing and the tax

regime governing ATF concluded that ATF prices in India are significantly higher (at least 40 per cent) than in competing hubs in the region such as Singapore, Hong Kong and Dubai.

(c) Therefore, there is need to rationalise the tax regime particularly value added tax on ATF which is in the range of 20–30 per cent in most of the states.

(d) The Ministry of Civil Aviation is of the view that ATF should be included under the declared goods category under the relevant provision of the Central Sales Tax Act so that a uniform levy of 5 per cent is achieved.

(e) Equally important is the need for a transparent pricing regime for ATF in India. A high tax regime for aviation in general, and ATF in particular, will reduce the wider economic benefits available from aviation, resulting in a negative impact on economic growth and overall government revenue bases.

(viii) The *Railways* is another urgent priority for the Twelfth Plan:

(a) Capacity in railways has lagged far behind what is needed, especially given the requirement of shifting from road transport to rail in the interests of improving energy efficiency and reducing carbon footprints in development.

(b) The funding pattern of the Twelfth Plan clearly shows that the modernisation of Indian Railways cannot be achieved by simply relying on GBS (Gross Budgetary Support) as about 62 per cent of the resources would have to be generated through non-GBS sources and nearly 20 per cent through private-sector investment.

(c) There is a need to draw up clear strategies to generate resources by identifying segments where Indian Railways can adopt a low-cost policy by playing on volumes and taking advantage of economies of scale and segments where it can adopt a differentiation approach by providing high-quality services and command premium prices.

(ix) The Twelfth Plan document, a GDP growth rate of about 8 per cent requires a growth rate of about 6 per cent in total *energy use* from all sources:

(a) Unfortunately, the capacity of the economy to expand domestic energy supplies to meet this demand is severely limited.

(b) The country is not well-endowed with energy resources, except coal, and the existence of policy distortions makes management of demand and supply more difficult.

(c) Accordingly, the short-run action needed to remove impediments to implementation of projects in infrastructure, especially in the area of energy, includes ensuring fuel supply to power stations, financial restructuring of Discoms, and clarity in terms of the NELP.

(d) At the same time, the long-term strategy should focus on issues like coal production, petroleum price distortion, natural gas pricing, and effective management of the urbanisation process.

BOOSTING PUBLIC INVESTMENT

India is faced with 'the balance sheet syndrome with Indian characteristics' creating a web of difficult challenges that could hold back private investment. Private investment must remain the primary engine of long-run growth. But in the interim, to revive growth and to deepen physical connectivity, public investment, especially in the railways, will have an important role to play.

A slew of economic reforms activated by the new central government has led to a partial revival of investor sentiment. Tentative signs that the worst is over are evident, for example, in data that shows that the rate of stalled projects has begun to decline and that the rate of their revival is moving up. But increasing capital flows are yet to translate into a durable pick-up of real investment, especially in the private sector. This owes to at least five interrelated factors that lead to what the *Mid-Year Economic Analysis 2014–15* called the '*balance sheet syndrome with Indian characteristics*':

(i) Under the pressures of weak profitability and over-indebtedness, the Indian corporate sector is limited in its ability to invest going forward *(the flow challenge)*. One key indicator of profitability—the interest cover ratio (ICR), which if less than one implies firms' cash flows are not sufficient to pay their interest costs—has also worsened in recent years. Further, the debt-equity ratios of the top 500 non-financial firms have been steadily increasing, and their level now is amongst the highest in the emerging economies.

(ii) Weak institutions relating to bankruptcy means that the over-indebtedness problem cannot be easily resolved (the stock and '*difficulty-of-exit' challenge*). This is reflected in the persistence of stalled projects, which have been consistently around 7 to 8 per cent of GDP in the last four years (2010–14).

(iii) Even if some of these problems were solved, the PPP model at least in infrastructure will need to be re-fashioned to become more viable going forward *(the institutional challenge)*.

(iv) Since a significant portion of infrastructure was financed by the banking system, especially the public sector banks, their balance sheets have deteriorated.[66] For example, the sum of non-performing and stressed assets has risen sharply, and for the PSBs they account for over 12 per cent of total assets. Uncertainty about accounting and valuation, and indeed the history of banking difficulties across time and space, counsel in favor of *over-* rather than *under-* recognising the severity of the problem. When banks' balance sheets are stressed they are less able to lend, leading to reduced credit for the private sector *(the financing challenge)*.[67]

(v) In a peculiarly Indian twist, this financing problem is aggravated by generalised risk-aversion *(the challenge of inertial decision-making)*. For the public sector banks in particular, which are exposed to governmental accountability and oversight, lending in a situation of NPAs is not easy because of a generic problem of caution, afflicting bureaucratic decision-making.

STEPS AND SUGGESTIONS

The *Economic Survey 2014–15* highlights the finer points of the infrastructure sector in the follwoing way:

(a) Actions being undertaken by the government to enhance the supply of critical inputs such as coal and gas, as well

as regulatory reform, will alleviate some of the above-given constraints, especially in the public sector where the data identify them as being regulatory in character *(clearances and land acquisition)*.

(b) Steps are being taken to address the institutional problem, by creating a better framework for PPPs and for infrastructure investment in general. The RBI is making efforts to get banks to recognise their bad loan problems, and address them. But the impact of these initiatives has so far been limited. The stock of stalled projects remains extraordinarily high; firm profitability, especially for firms working in the infrastructure sector, remains low. So, questions on the pace and strength of recovery of private sector investment remain open.

(c) If the weakness of private investment offers one negative or indirect rationale for increased public investment, there are also more affirmative rationales. India's recent PPP experience has demonstrated that given weak institutions, the private sector taking on project implementation risks involves costs *(delays in land acquisition, environmental clearances, and variability of input supplies, etc.)*. In some sectors, the public sector may be better placed to absorb some of these risks.

(d) Again, there continue to remain areas of infrastructure—rural roads and railways that provide basic physical connectivity—in which private investment will be under-supplied. One irony is that while financial and digital connectivity are surging ahead, basic physical connectivity appears to lag behind.

Therefore, as emphasized in the *Mid Year Economic Analysis 2014–15,* it seems imperative to consider the case for **reviving targeted public investment** as an engine of growth in the short run not to substitute for private investment but to complement it and indeed to crowd it in.

(e) Public sector implementation capacity in India is variable. But analysis suggests that the Indian Railways could be the next locomotive of growth. Greater public investment in the railways would boost aggregate growth and the competitiveness of Indian manufacturing substantially. In part, these large gains derive from the current massive under-investment in the railways. For example, China and India had similar network capacities until the mid-1990, but because it invested eleven times as much as India in per-capita terms, China's capacity and efficiency have surged.

In contrast, stagnant investment has led to congestion, strained capacity, poor services, weak financial health, and deteriorating competitiveness of logistics-intensive sectors, typically manufacturing. Congestion has effectively led to the railways ceding a significant share in freight traffic to the roads sector. This is not a welcome development since rail transport is typically more cost and energy efficient. The profits generated by freight services have cross-subsidised passengers services and Indian freight rates (PPP adjusted) remain among the highest in the world.

The physical connectivity of the Indian population needs strengthening which has potential to bring enormous benefits in terms of higher standards of living, greater opportunities, and increased potential for human fulfillment.

CHAPTER

10

SERVICE SECTOR

- ⇨ Introduction
- ⇨ International Comparison
- ⇨ India's Services Sector
- ⇨ WTO Negotiations
- ⇨ Bilateral Agreements
- ⇨ Services Employment
- ⇨ Services Performance
- ⇨ Restrictions And Regulations
- ⇨ The Need of Reforms

*India's dynamic services sector has grown rapidly in the last decade with almost 72.4 per cent of the growth in India's GDP in 2014–15 coming from this sector. Unlike other developing economies, the Indian growth story has been led by services-sector growth which is now in double digits.**

* **Economic Survey 2014-15**, MoF, GoI, N. Delhi, Vol. 2, p. 106.

INTRODUCTION

India's services sector has not only outperformed other sectors of the Indian economy, but has also played an important role in India's integration with world trade and capital markets. India's liberalisation of services has been a challenging process in several sub-sectors, but clearly those services where integration through trade and FDI has gone further are also the ones that have exhibited more rapid growth along with positive spillovers on the rest of the economy.

There is, however, a concern[1] about the *sustainability* of a services-led growth process which largely stems from exports of skill-based services. The prevailing view is that for services growth to be sustained, the sector cannot remain dependent on external demand. It must also be driven by internal demand. More broad-based growth within the services is also required to ensure balanced, equitable and employment-oriented growth, with backward and forward linkages to the rest of the economy. In this regard further infrastructural and regulatory reforms and FDI liberalisation in services can help diversify the sources of growth withing India's services sector and provide the required momentum.

In recent years, there has been a debate in the country regarding the selection of the sector which can lead the growth process in the country. This debate originated from the fact that the services sector contributed over 62 per cent in the decade 2001–12. But the debate has been somewhat solved by the newly published *Economic Survey 2014–15* in favour of the *manufacturing sector.* The Survey has gone to quote several empirical studies of recent times linking both services and manufacturing sectors to a great many real issues—potential to create employment, need of skilled and unskilled labour force, formality anf informality of the sector, etc. For this, the idea of 'Make in India' has acclaimed timely action from the government. Again, the importance of expanding the Railways and enhancing public investment in it have also been pointed out.[2] These findings are also in line with several other studies of the recent times.[3]

INTERNATIONAL COMPARISON

The features[4] of the services sector, at the global level, have been going for a kind of shift in more than over one decade. Its contribution in countries GDP, employment, trade together with in area of attracting foreign direct investment (FDI)—all have gone for mixed changes. We will try to see them briefly:

World Services GDP: The services sector scenario in recent years has been as given below:

- In 2013, in the US$ 75.6 trillion world GDP, the share of services improved marginally to 66.0 per cent while growth rate decelerated marginally to 2.1 per cent over 2012 (taken at constant prices).
- In the last twelve years, the share of services in world GDP has declined by 2.8 percentage points (pp).
- The US ranks *first* in services GDP as well as in overall GDP, with China and Japan a distant second and third.

1. Rupa Chanda, *'Services-led Growth'* in Kaushik Basu and Annemie Maertens (eds.) ***The New Oxford Companion to Economics in India***, Vol. II, Oxford University Press, N. Delhi, 2012, pp. 624-632.
2. For detailed description the ***Economic Survey 2014–15***, Vol. 1 may be consulted, though, the theme of the analysis has been included in this book itself, in the Chapter-9 titled **'Industry and Infrastructure'**.
3. ***India Development Report 2012–13***, Oxford University Press, N. Delhi, 2013, pp. 116-131.
4. ***UN National Accounts Statistics-2014***; **ILO** and **WTO Database** for 2014.

- Among the world's top 15 countries in terms of GDP, India ranked **10th** in terms of overall GDP and **11th** in terms of services GDP in 2013.
- Among the top 15 nations, in the period 2001–13, maximum increase in services share to GDP was recorded by Spain (8.6 pp) followed by **India** (5.7 pp) and China (5.6 pp).
- During 2001–13, with a compound annual growth rate (CAGR) of **8.7** per cent, India had the second fastest growing services sector, just below China's 10.7 per cent.
- Among the 15 countries, only China's share of services in its total GDP is less than 50 per cent.

World Services Employment: As per the International Labour Organization's (ILO) *Global Employment Trends 2014*—

- Services accounted for more than half of total global employment growth of 1.4 per cent in 2013 over 2012.
- The share of services in world income declined from 68.8 per cent in 2001 to 66 per cent in 2013, while its share in employment increased from 39.1 per cent to 45.1 per cent.
- For the top 15 countries, except India and China, the shares of both services GDP and services employment are high and close to each other.
- India's services sector has a high share in income and relatively low share in employment, while in China, the shares of both services income and services employment are relatively low. But in both these countries, the shares of services in both GDP and employment have increased in the last twelve years.

World Services Trade: The situation of global trade in services are as given below:

- During 2001–13 the CAGR of world commercial services exports was 10 per cent, with India at the top among the top fifteen largest economies at **20.1** per cent followed by China at 16.5 per cent.
- In 2013, the US$ 4.6 trillion world commercial services exports grew by 5.6 per cent. Services exports of the United States, the *largest exporter* of commercial services, grew by 5 per cent while they decelerated for China to 7.5 per cent and India to 3.6 per cent due to decline in exports of transport services by 3 per cent in both countries.
- Services imports of India fell by 2.7 per cent and China's grew by 17.6 per cent.

FDI in World Services Sector: The FDI in services remained subdued:

- In 2014, global FDI inflows declined by 8 per cent to an estimated US$ 1.3 trillion, due to the fragility of the global economy, policy uncertainty, and geopolitical risks, as per the *United Nations Conference on Trade and Development (UNCTAD).*
- China became the world's *largest recipient* of FDI, with an increase of 3 per cent driven by FDI in the services sector while FDI in manufacturing fell.
- India's FDI rose by around **26** per cent to an estimated US$ 35 billion also due to inflows in the top services sector (as corroborated by the Indian data).

INDIA'S SERVICES SECTOR

Services in India are emerging as a prominent sector in terms of contribution to national and states' incomes, trade flows, FDI inflows, and employment. The *Economic Survey 2014–15*

provides the latest information about India's services sector in the following way:

GDP and GCF

As per the new method of India's National Accounts Statistics, the services sector accounting for **51.3** per cent of India's gross value added (GVA) at basic prices (current prices) in 2013–14, grew by 9.1 per cent compared to 6.6 per cent total GVA growth and 6.9 per cent GDP growth at market prices. Including construction, a borderline service, the services share is 59.6 per cent and growth is 8.1 per cent. Some *other features* have been as given below:

- The services sector has the highest share (54.6 per cent) in the gross capital formation (GCF) of in 2013–14. This is owing to the GCF in real estate, ownership of dwelling and professional services at 20.1 per cent, though the share has fallen in the last two years, followed by trade and repair services (10.6 per cent) and public administration and defence (10.6 per cent) where there is improvement in shares.
- The growth rate of services GCF at 3.1 per cent has also been higher than the total GCF growth of 1.4 per cent. Infact, the positive GCF growth in services led to positive growth in total GCF as GCF growth in agriculture and industry was negative at –0.3 per cent and –0.6 per cent, respectively. GCF growth in manufacturing was even more negative at –5.4 per cent.
- As per the Advance Estimates (AE) in 2014–15, growth of the services sector accelerated further to 10.6 per cent as compared to 9.1 per cent in 2013–14.
- There was also good growth in trade, hotels, transport, communication, and related services at 8.4 per cent in 2014–15 though it was lower than the 11.1 per cent growth in 2013–14.

State-wise Comparison

The services sector is the dominant sector in most states of India with a share of more than **40** per cent in the gross state domestic product (GSDP) in 2013–14 except for Arunachal Pradesh and Sikkim. Chandigarh is at the top with a share of **88.4** per cent followed by Delhi with **87.7** per cent. Special features are as given below:

- The major services in most of the states with high share are: trade, hotels, and restaurants followed by real estate, ownership of dwellings and business services.
- Banking and insurance has an important share only in a few states/union territories (UT) like Delhi, Maharashtra, and Chandigarh.
- As per the latest data, in 2013–14, Bihar had the highest services growth of 17.3 per cent and Uttarkhand the lowest of 5.5 per cent. Bihar has been consistently showing double-digit growth in the services sector in the last five years due to high growth in trade, hotels, and restaurants.

FDI in Services Sector

There is some ambiguity in classifying FDI in different activities under the services sector continues. The *Economic Survey 2014–15* puts financial and non-financial services, construction, telecommunications, computer hardware and software, and hotels and tourism under the services sector (though it could include some non-service elements). Thus the share of FDI in services have been as given below:

- 43.7 per cent share during 2000–14.
- The share increases to 53.8 per cent if some other services or service-related sectors

are included—trading, information and broadcasting, construction (infrastructure) activities, consultancy services, hospital and diagnostic centres, ports, agriculture services, education, air transport including air freight, and retail trading are included.

- During 2014–15 the FDI inflows to services was estimated to grow by over 105 per cent compared to around 22 per cent growth in overall FDI inflows.
- During 2014–15, the top five services attracting FDI has been (in descending order)—telecommunications, hotel and tourism, financial and non-financial services, construction.

India's Services Trade

India's services trade has been growing during the reform period. The main features of it are as follows:

- India has 3.2 per cent share in global services exports in 2013 (it was 1.2 per cent in 2000).
- India ranks 6th in the world among the leading services exporters in 2013.
- Services export growth rate was 3.7 per cent duirng first half of 2014–15. After being at a high of 31.2 per cent during 2002–09, it started declining in wake of the global financial crisis, fell to 3.4 per cent in 2011–13 and improved to 4 per cent by 2013–14.
- Services trade has been a major source of financing India's trade deficit in recent years. Surplus on account of services exports financed 49.4 per cent and 49.3 per cent of merchandise trade deficit in 2013–14 and first half of 2014–15, respectively.
- Composition of services exports—computer services (45.8 per cent share); other business services (18.8 per cent share) including professional and consulting services (10.2 per cent share), technical and trade-related services (7.8 per cent share) and R & D services (0.8 per cent share); travel (11.8 per cent share); transport (11.5 per cent share); and financial, insurance and pension services (5.8 per cent share).

There are many market access barriers and domestic regulations in India's services sector (as highlighted by the *Economic Survey 2012–13* and *2013–14*). Given the potential of India's services sector, removal of many of these barriers, both domestically and internationally, is of vital importance. Services sector negotiations both at multilateral and bilateral/regional levels are, therefore, of special significance to India. Two recent developments in India's exports sector are:

(i) the rising foreign value added content, and

(ii) services value added content.

As per the Organisation for Economic Cooperation and Development (OECD) **TiVA** (trade in value added) data, domestic value added content in India's gross exports was 78 per cent in 2009, a little above the OECD average (76 per cent), but 12 per cent lower than in 1995, reflecting increasing fragmentation of production and integration with global value chains.

India is *fifth highest* in terms of services value added content in its exports after Hong Kong, Iceland, Singapore, and EU-27. This has been driven by increasing direct exports of services and more than doubling of foreign services content of exports also indicating greater integration with global value chains.

A study for the Ministry of Finance, Government of India (GoI) by Indian Council

for Research on International Economic Relations (ICRIER), quoted by the *Economic Survey 2014–15*, also shows rising share of foreign value added in India's exports.

WTO NEGOTIATIONS

From developing countries point of view, the provisions of the WTO have been quite controversial. There has been repeated deadlocks in the negotiations of the tade body at almost all of its Ministerial Conferences. Like every country, India has also been actively protecting and promoting its trade interets on the platform of the WTO. India's stand at the WTO, as per the latest information from the GoI, has been as given below:

(i) The post Bali work programme has to be within the mandate of the Doha Development Agenda (DDA) and valuable milestones such as the Annex C on 'Services' of the Hong Kong Ministerial Declaration (HKMD), which contains the roadmap for conclusion of the Doha Round.

(ii) India does not support any *cherry picking* of issues or sectors of interest to certain economies in the name of concluding the Doha Round and the level of ambition across the negotiating pillars including in services would be governed by *agriculture*.

(iii) Since development is the central theme of the Doha negotiations, commitments in areas of export interest to developing countries and least developed countries (LDCs) is crucial for the success of the round. In the past, India has been dismayed by the negligible progress in *Mode 4* offers.

(iv) *Preferential treatment for the LDCs in the World Trade Organization (WTO):* At the High Level Meeting of the WTO services council in February 2015, discussions were held to operationalise the Bali decision on LDC services waiver.

India has been a generous partner for LDCs and offered market access for contractual services suppliers and independent professionals. An exclusive quota of 250, only for tourist guides from LDCs was offered. India has also agreed to waive visa fee for LDC applicants seeking Indian business or employment visas.

BILATERAL AGREEMENTS

India has been promoting its global economic interest with an effective economic diplomacy, specially in the reform period. The process got pace in the last decade. As per the latest informations from the GoI, India's global ties and arrangements to promote trade are as given below:

(i) India has signed *Comprehensive Bilateral Agreements (CBA)* with the Governments of Singapore, South Korea, Japan, and Malaysia. A Free Trade Agreement (FTA) in services and investment was signed with the Association of South East Asian Nations (ASEAN) in September 2014.

(ii) India has joined the *Regional Comprehensive Economic Partnership (RCEP)* plurilateral negotiations and is continuously engaged in the bilateral FTA negotiations including Trade in Services with Canada, Israel, Thailand, the European Free Trade Association (EFTA), Australia, New Zealand, and the EU.

Negotiations with Canada and Australia have not progressed much and modalities for the negotiations are still being discussed. Negotiations with Thailand are at an advanced stage and with EFTA are more or less over.

India is also engaged in bilateral trade dialogues with the US under the India–US Trade Policy

Forum (TPF), with Australia under the India-Australia Joint Ministerial Commission (JMC), with China under the India–China Working-Group on Services, and with Brazil under the India–Brazil Trade Monitoring Mechanism (TMM).

SERVICES EMPLOYMENT

The pattern of the sectoral share of employment has changed over the last two decades with the share of agriculture falling and of industry and services rising steadily. As per the latest data provided by the *Economic Survey 2014–15*, the situation of employment in the services sector are as given below:

- Services share in employment at **28.5** per cent in 2011–12 is higher than in industry at **24.4** per cent:
- Among the different services sectors, from 1993–94 to 2011–12, there was continuous *increase* in employment share in trade, hotels, and restaurants; transport, storage, and communication; and financial, insurance, real estate and business services.
- Employment share in community, social, and personal services has fallen continuously except in 2011–12 when there was an increase compared to 2009–10 and 2004–05.
- Employment *elasticity* has increased for both services and industry in 2009–10 to 2011–12 compared to 2004–05 to 2009–10, though industry had relatively higher employment elasticity.
- Among services, employment elasticity was the highest in 'financial, insurance, real estate and business services', and 'transport, storage, and communication'.

SERVICES PERFORMANCE

Some available indicators of the different services in India for 2014–15 show reasonably good performance of tourism, telecom, aviation, and railways. Estimates of the Centre for Monitoring Indian Economy (CMIE) derived from limited firm-level data indicates improved performance in retail trading, aviation, telecom and transport logistics. Other estimates like the HSBC's services PMI *(Purchasing Managers Index)* data indicate improvement in services sector growth in 2014–15 as the reading was above 50 in all months since May 2014 and it was at in January 2015.

The performance of the services sector in recent years has been reasonably good, despite the difficult international and domestic situation. However, the performance of different sectors varied. A brief description is given below about the performance of the major services in the country:

Tourism: As per the World Travel and Tourism Council (WTTC), the US$ 7 trillion travel and tourism sector's contribution to world GDP increased in 2013 to 9.5 per cent, creating 4.7 million new jobs. This resulted in total employment in this sector of nearly 266 million, that is one in eleven jobs in the world. This sector is estimated to grow by 4.3 per cent in 2014 and generate 6.5 million new jobs.

The latest World Tourism Barometer of the United Nation's World Tourism Organization (UNWTO) also shows that international tourist arrivals reached 1.1 billion in 2014, a 4.7 per cent increase over the previous year and for 2015 the forecast is an increase of 3 to 4 per cent.

France has the highest share in international tourist arrivals (ITAs) and the US in international tourism receipts (ITRs) in 2013. **India's** share in ITAs is a paltry **0.6** per cent compared to 7.8 per cent in France and 6.4 per cent in the US. Even

Vietnam and Indonesia have higher shares than India. However, in terms of ITRs, India's share at **1.5** per cent is better than those of Vietnam and Indonesia though it is way below the share of the US at 14.5 per cent.

In **India's** *National Accounts Statistics (NAS),* there is no separate heading for tourism. Some tourism activities like travel agent, tour operator, and other reservation activities are a part of the broad category administrative and support service activities and other professional activities.

As per the Second Tourism Satellite Account of India (TSA), the contribution of tourism to total GDP during 2012–13 was **6.9** per cent (3.7 per cent direct and 3.1 per cent indirect) and to total employment 12.4 per cent (5.3 per cent direct and 7.0 per cent indirect). After poor foreign exchange earnings (FEE) growth in dollar terms at 4.0 per cent, despite growing foreign tourist arrivals at 5.9 per cent, in 2013, there was an increase in growth of both foreign tourist arrivals (7.1 per cent) and FEEs (6.6 per cent) in 2014.

In *Union Budget 2014–15,* the government announced several measures for boosting tourism, such as:

(i) Streamlining of some service tax bottlenecks

(ii) Focused effort for the development of a global scale Buddhist circuit

(iii) Cleaning of the Ganga together with creation of world class amenities to enhance the spiritual experience along the Ganga.

(v) Easing of the Indian tourism visa regime through the execution of tourist visa on arrival enabled by electronic travel authorisation (ETA) for forty-three countries will provide a major boost to tourism.

Shipping: Shipping is an important indicator of both commodity and services trade of any country. Around **95** per cent of India's trade by volume and **68** per cent in terms of value is transported by sea. By December 2014, India had a fleet strength of 1,209 ships with gross tonnage (GT) of 10.3 million, with the public-sector Shipping Corporation of India (SCI) having the largest share of around **31** per cent. Of this, around 358 ships with 9.1 million GT cater to India's overseas trade and the rest to coastal trade.

Despite having one of the largest merchant shipping fleets among developing countries, India's share in total world dead weight tonnage (DWT) is only **1.1** per cent. In 2013, as per UNCTAD, India with 10.7 million twenty-foot equivalent units of container (TEUs) and a world share of **1.6** per cent ranked *eighth* among developing countries in terms of container ship operations.

India continues to be a leading *ship breaking* destination. It topped the list of ship recycling countries in 2014 with a world share of **32** per cent, scrapping 234 ships. India supplied 60,000 crew (fresh seamen) and 44,500 officers in 2014.

There are certain concerns in the shipping sector of India:

(i) It has been plagued by economic hardships since 2008. In 2014, all segments of shipping saw intermittent spikes, but there was no secular uptrend in any of them.

(ii) Internationally, deliveries of new ships are slated in 2015, which could dampen shipping freight rates even more.

(iii) The *Baltic Dry Index*, the barometer of merchandise trade as well as shipping services, which had peaked to 11,793 on May 20, 2008 has been in the lower range since then and is in the red at 530 by February 2015.

(iv) There has also been a sharp decline in the share of Indian ships in the carriage of

India's overseas trade from about 40 per cent in the late 1980s to 9.1 per cent in 2012–13. The existing Indian fleet is also ageing, with the average age increasing from 15 years in 1999 to 17.7 by 2014 (43.1 per cent of the fleet is over 20 years old and 10.7 per cent in the 16–19 age group). Thus, there is urgent need to increase India's shipping fleet.

The GoI, recognising the need to encourage the growth of Indian tonnage, has taken several policy initiatives in recent years:

(i) Indian shipping companies allowed to acquire ships abroad and flag them in the country of their convenience;
(ii) Access to cheaper finance abroad allowed;
(iii) Exemption from customs and central excise duty leviable on bunker fuels used in Indian flag vessels for transportation of export and import items and on empty containers between two or more ports in India; and
(iv) Elimination of registration requirement of ship repair units (SRUs) with the Director General of Shipping.

Port Services: The cargo traffic of Indian ports increased by 4.5 per cent to 975.7 million tonnes in 2013–14 and by 6.8 per cent in (April-December) 2014–15. In the *Maritime Agenda*, a target of 3,130 million tonnes (MT) port capacity has been set for the year 2020 with around Rs. 2,96,000 crore investment. More than 50 per cent of this capacity is to be created in the non-major ports.

FDI up to 100 per cent under automatic route is permitted for construction and maintenance of ports. In 2013–14, 16 public private partnership (PPP) projects were awarded for capacity addition of 159.7 MT in the major ports comprising construction of berths and terminals and mechanisation of existing berths.

The three ports-related performance indicators showed continued improvement with the average turnaround time and average pre-berthing detention time falling to 2.1 days and 0.2 day respectively and the average output per ship berth day improving to 14,326 tonnes in 2014–15 (April-November). The improvement in turnaround time and pre-berthing detention time could partly be due to mechanisation and systemic improvements in ports and partly to lower volume handled in some ports on account of global downturn. However, the improvement in average output per ship berth day indicates that the performance parameters of Indian ports are also improving

IT and ITeS: Software development and information technology enabled services (ITeS) including business process management (BPM), software engineering R&D services and product development has emerged as one of the most dynamic and vibrant sectors in India's economy. It has got a special position in the economy:

- It is the *single largest* contributor to services exports. As per *AT Kearney's Global Services Location Index 2014,* India ranked **first** and remains the pre-eminent destination for offshore services, with excellence in IT, BPO, and voice services.
- The sector continues to be one of the largest employers in the country, directly employing nearly **3.5** million people as per the National Association of Software and Service Companies (NASSCOM).
- As per the Central Statistics Office (CSO), computer and related services with a share of **3.3** per cent in India's GDP grew by 14.4 per cent in 2013-14.

As per NASSCOM's estimate the revenue of the IT-BPM industry at US$119 billion grew by 12 per cent in 2014–15, while the export market

at US$ 98 billion grew by 12.3 per cent ovvr the previous year.

The BPM sector is being driven by greater automation, expanding omnichannel presence, and application of analytics across the entire value chain. India is the *fourth* largest start-up hub in the world with over 3100 start-ups in the country.

- The domestic IT-BPM market is estimated at US$ 20.9 billion in 2014–15, with a growth of 10 per cent.
- Software products and services revenues for 2015–16 is projected to grow at 12–14 per cent to reach US$ 133-136 billion as per NASSCOM. Export revenues are projected to grow by 12 to 14 per cent to reach US$ 110–112 billion and domestic revenues by 10–15 per cent to reach US$ 23–24 billion during 2015–16.

In the *Union Budget 2014-15,* recognizing the need for greater penetration of IT services domestically, the Digital India programme was launched. This is an ambitious umbrella programme to prepare India for knowledge-based transformation. This would ensure—

(i) Broadband connectivity at village level,
(ii) Improved access to services through IT-enabled platforms,
(iii) Greater transparency in government processes, and
(iv) Increased indigenous production of IT hardware and software.

One of the important components of this programme is people's empowerment through availability of entitlements on the cloud, coupled with Aadhaar Authentification Platform. A *National Rural Internet and Technology Mission (NRITM)* for services in villages and schools and *E-Kranti* for government service delivery are other initiatives. Recognising the importance of IT, the government's *Make in India* mission has included IT and BPM among the twenty-five focus sectors.

R&D Services: The Research and Development (R&D) sector has been growing consistently in *double digits* in the last few years with growth at **20.8** per cent in 2012–13. Professional, scientific and technical activities including R&D grew by 14.0 per cent in 2013–14.

As per the *Global R&D Service Providers (GSPR) Rating 2014*, a report by Zinnov Management Consulting, India's R&D globalisation and services market is set to double by 2020 to US$ 38 billion. The study estimates the overall addressable R&D globalisation and services opportunity at US$ 170 billion as of 2014. Currently only US$ 55 billion of this opportunity is addressed globally. India's share of the addressed market is **33** per cent with in-house R&D centres contributing US$ 11.3 billion worth of services to their parent companies.

As per the *Global Competitiveness Report 2014–15*:

- India's capacity for innovation has been lower than that of many countries like the USA, UK, South Korea, and even other BRICS countries (Brazil, Russia, India, China, and South Africa) except Russia.
- In quality of scientific research institutions, India scores lower than China, Brazil, and South Africa. This is also exhibited through its poor score on university–industry collaboration on R&D as compared to some other BRICS nations like China and South Africa.
- In terms of patents granted per million population, India fares badly compared to other BRICS countries.
- In terms of company spending on R & D also India is far below China. Only in terms of availability of scientists and engineers, India scores better or is equal to other BRICS countries.

Consultancy Services: Consultancy services are emerging as one of the fastest growing services

in India cutting across different sectors with some overlapping. According to *Plunkett Research*, global consulting industry revenues (including human resources), IT, strategy, operations, management, and business advisory services) increased to an estimated $431 billion in 2014 compared to US$ 415 billion during the previous year. India's outsourcing and consulting industry is estimated at US$ 86.4 billion in 2014, accounting for almost **20** per cent of global consulting industry revenue, and is projected to reach US$ 99.0 billion in 2015.

India's emergence as one of the fastest growing consultancy markets worldwide is largely attributable to increased investment activities due to liberalisation of FDI, entry of many new players into the Indian market and low cost sourcing. Indian consultants have good expertise particularly in engineering consultancy, which could be leveraged to enhance consultancy exports.

Real Estate and Housing: Real estate and ownership of dwelling constitute **7.8** per cent of India's GDP. Both domestic and global slowdown affected this sector with growth decelerating 6.0 per cent in 2013–14 and FDI falling to US$ 703 million in 2014 (first 7 months). Main features of this sector stand as given below:

- House prices have increased over the years in many cities and towns as per the National Housing Bank's *RESIDEX* index of residential prices in India. In 2014, out of 26 cities, 17 witnessed increase in prices over 2013 with the maximum increase observed in Chennai (17 per cent) followed by Ahmedabad (15 per cent), while 7 saw decline, with the maximum fall witnessed in Meerut (–16 per cent) followed by Chandigarh (–8 per cent).
- The *widening gap* between demand and supply of housing units and affordable housing finance solutions is a major policy concern for India. At present urban *housing shortage* is 18.8 million units of which 95.6 per cent is in economically weaker sections (EWS)/low income group (LIG) segments and requires huge financial investment to overcome.
- Institutional credit for housing investment is well below that in countries like China, Thailand, and Malaysia though growing at a CAGR of about 19 per cent per annum.
- Procedural delay is another major constraint in this sector. According to the World Bank's *Doing Business 2015,* India ranked 184 (out of 189 economies) in terms of construction permits, requiring on an average 27 procedures to get permits as compared to an average of 14 in South Asia and 12 in OECD (Organization for Economic Cooperation and Development) countries.

Some of the recent policy actions from the government to strengthen the sector are as given below:

(i) The amendment in the FDI policy *(2013-14),* reducing the minimum floor area to 20,000 square metre from the earlier 50,000 square mtre and bringing down the minimum capital requirement to US$ 5 million from US$ 10 million.

(ii) Real Estate Investment Trusts (REITs) allowed in the *Union Budget 2014–15.*

(iii) In order to encourage savings, the deduction limit on housing loan interest for self- occupied property was increased to Rs. 2 lakh (from Rs. 1.5 lakh) in the *Union Budget 2014–15.*

(iv) In order to push development of affordable housing and achieve the target of housing for all by 2022, the RBI relaxed norms for issue of long-term bonds by banks for financing affordable housing, without

the compulsion of maintaining CRR and SLR *(2014–15)*.

Internal Trade: The trade and repair services contributes **11** per cent to India's GDP and had growth rate of 14.3 per cent in 2013–14. Trade is the major item in this category as the share of repair services in this category is just 6–7 per cent. As per the *AT Kearney's Global Retail Development Index (GRDI),* India's ***retail trade*** ranking slipped further to **20th** in 2014 from **14th** in 2013.

The retail sector was affected in 2013 by high consumer price inflation, currency fluctuations, and strict FDI policies. However, India remains an attractive long-term retail destination for several reasons, including its large population, 58.3 per cent of which is below 30 years and 31.1 per cent of which lives in urban areas with rising disposable incomes. Migration from traditional stores to modern retail continues, though the latter accounts for only **8** per cent of the total market.

India's ***e-commerce*** market is expected to grow by more than **50** per cent in the next five years. Inventory management, logistics planning, and resource availability are important hurdles for online retail in India. Consumer safeguard being another concern for consumers of e-commerce, the government proposes including sufficient provisions in the ongoing amendment to the Consumer Protection Act 1986.

Media and Entertainment Services: The Indian media and entertainment industry comprises various segments which include television, print, films, radio, music, animation, gaming and visual effects, and digital advertising.

As per a report by *FICCI–KPMG,* the Indian media and entertainment industry grew by 11.8 per cent in 2013 (Rs. 918 billion) and is projected to grow at a CAGR of 14.2 per cent by 2018. This sector has a share of **1.6** per cent in India's total FDI flows. Digital advertising and gaming are projected to drive the growth of this sector in the coming years. Major fetures of the sector are:

- With 161 million TV households, India is the world's *third largest* TV market after China and the USA.
- There are about 826 satellite television channels, 86 teleports, 243 FM radio channels, and 179 community radio stations operating in India.
- India's broadcasting distribution network comprises 6,000 multi–system operators (MSOs), around 60,000 local cable operators (LCOs), and 7 direct to home (DTH) operators.
- The Government has embarked on an ambitious exercise of digitizing its cable network in four phases leading to complete switch off of ***Analog TV*** services by December 2016.
- India also has a liberalised FDI regime for the broadcasting sector where 26 per cent FDI is allowed in content and 74 per cent in various carriage services like DTH, HITS (headend in the sky).
- India is emerging as the new favourite of international ***studios***, with *100 per cent FDI* permitted in the film sector. Disney, Fox, Sony, and Warner Brothers have entered into coproduction and distribution deals with domestic production houses. India has co-production treaties with ten countries. During the year 2014–15 (till December 2014), the government has accorded permission for film shooting in India to **21** foreign production houses.

RESTRICTIONS AND REGULATIONS

One major issue in services is the domestic barriers and regulations. Domestic regulations, in strict WTO terms, include licensing requirements, licensing procedures, qualification requirements, qualification procedures, and technical standards

but here other restrictions and barriers are also considered. While there are many domestic regulations in our major markets, which deny market access to us and therefore need to be negotiated at multilateral and bilateral levels, there are also many domestic regulations in India which hinder the growth of this sector.

Since domestic regulations perform the role of tariffs in regulating services, there is need to list the domestic regulations in India which need to be curbed to help growth of the sector and its exports, while retaining those which are necessary for regulating the sector at this stage. An indicative list of some important domestic regulations in India which need to be examined for suitable policy reforms[5] in the services sector is as follows:

Trade & Transport Services: Some constraints in these sectors include restrictions on inter-state movement of goods which could ease with the adoption of the model *Agriculture Produce and Marketing Committee (APMC) Act* by many states; the *Multimodal Transportation of Goods Act 1993* which needs revision to ease the existing restrictions on transportation and documentation through different modes of transport, particularly restrictions in the *Customs Act*, which do not allow seamless movement of goods; and restrictions on free movement of cargo between *Inland Container Depots (ICDs), Container Freight Stations (CFSs)* and *Ports*.

Construction Development: In this sector, bottlenecks result from continuation of restrictions under the *Urban Land Ceiling and Regulation Act (ULCRA)* in some states namely Andhra Pradesh, Assam, Bihar, and West Bengal, which have not yet repealed it and the confusion in the process required for clearance of buildings even after the repeal of ULCRA by passing of the Urban Land(Ceiling and Regulations) Repeal Act 1999 by the other states.

There is also lack of clarity on the role of states as facilitators in the *land acquisition* policy resulting in increasing number of court litigations adding to risk profile of builders/projects thereby restricting lenders from extending finance to such builders/ projects.

There are also restrictions on floor area ratio (FAR) in many states; and other restrictions like the application of bye laws/regulations and its exemptions, e.g., increase in FAR which varies from project to project and is sometimes discriminatory. Obtaining environment clearance is another major hindrance.

Accountancy Services: While the accountancy professionals were hitherto allowed to operate either as a partnership firm or as a sole proprietorship firm or in their own name since the Indian regulations do not permit exceeding 20 professionals under one firm, the emergence of *Limited Liability Partnership (LLP)* structure is likely to address this impediment. However, the number of statutory audits of companies per partner is restricted to 20.

FDI is also not allowed in this sector and foreign service providers are not allowed to undertake statutory audit of companies as per the provisions of the laws in India. There are also domestic regulations like prohibition on the use of individual *logos* for partnership and single proprietorship accounting firms. These regulations need to be relaxed and streamlined to facilitate tie-ups and penetrate foreign markets given the potential for exporting these services by the outsourcing mode.

Legal Services: In this sector, FDI is not permitted and international law firms are not authorised to advertise and open offices in India. Foreign service providers can neither be appointed as

5. H.A.C. Prasad and R. Sathish, Working Paper No. 1/2010-DEA on **Policy for India's Services Sector**, 2010 with updates from concerned Departments and Institutions. [Source: ***Economic Survey 2012–13***, MoF, GoI, N. Delhi, p. 228].

partners nor sign legal documents and represent clients. The *Bar Council* is opposed to entry of foreign lawyers/law firms in any manner. Indian advocates are not permitted to enter into profit-sharing arrangements with persons other than Indian advocates.

Education Services: These come under the *Concurrent List* with multiple controls and regulations by central and state governments and statutory bodies. Regulations of minimum of 25 acres of land to establish a medical college restricts the setting up of medical colleges in cities like Delhi. *Patient load factor* regulations related to establishment of new medical colleges also need to be in tune with present day equipment-intensive patient care and modern practices and procedures of medical education.

THE NEED FOR REFORMS

Indian services sector have the potential to garner higher economic benefits to the country. But there are many issues both general and sector specific including domestic regulations hinder the growth prospects of the services sector. If these issues are addressed deftly the sector could lead to exponential gains for the economy. The need of policy reforms[6] in this regards are outlined in the following way:

1. General Issues

There are some general issues related to the policy framework which hamper the healthy growth and expansion of the services sector in the country. They are broadly related to the following areas:

Nodal agency and marketing: Despite having strong growth potential in various services sub-sectors, there is no single nodal department or agency for services. An inter-ministerial committee for services has been set up to look into this. But services activities cover issues beyond trade and a more proactive approach and proper institutional mechanism is needed to weed out *unwanted regulations* and tap the opportunities in the services sector in a coordinated way. There is also need for promotional activities for service exports like,

(a) setting up a portal for services,
(b) showcasing India's competence also in non-software services in trade exhibitions, c) engaging dedicated brand ambassadors and experts.

Disinvestment: There is plenty of scope for disinvestment in services PSUs under both central and state governments. Speeding up disinvestment in some services-sector PSUs could not only provide revenue for the government but also speed up the growth of these services.

Credit related: The issues here include 'collateral free' soft loans to support the sector's cash needs and possibility of considering even export or business orders as collateral for credit-worthy service firms.

Tax and Trade Policy related: These include use of 'net' instead of 'gross' foreign exchange criteria for export benefit schemes, the issue of *retrospective* amendments of tax laws like,

(a) amendment to the definition of royalty to include payment of any rights via any medium for use of computer software,
(b) tax administrative measures to tackle delay in refunds,
(c) introducing VAT (value added tax) refund for foreign tourists, and
(d) addressing the issue of bank guarantees based on past performance to avail of export promotion benef its in services.

6. H.A.C. Prasad, R. Sathish, and Salam Shyamsunder Singh (2014), working paper 1/2014-DEA on *'Emerging Global Economic Situation: Opportunities and Policy Issues for Services Sector'* and updates from some ministries and institutions. [Source: ***Economic Survey 2013–14,*** p. 190].

2. Sectoral Issues

Area-specific policy hurdles to the services sector are also there. Together with the general issues, these area-sepcific bottlenecks do not allow the sector to realise its real potential. The major ones in this area are being outlined below.

Tourism and hospitality sector: As per the latest data of world tourism, India's tourism has not been competitive enough to attract tourist due to sevral reasons –

(i) India's share in world tourist inflows was only **0.64** per cent in 2012 (rank **41**), while that of the USA was 6.47 per cent (rank 2) and China 5.57 per cent (rank 3).

(ii) India's share in world tourism expenditure is relatively higher at **1.65** per cent (rank 16) implying that foreign tourists spend relatively more in India.

(iii) Singapore, a small country, attracted 11.10 million tourists in 2012, while a large country like India attracted only 6.97 million foreign tourists during 2013.

Some suggested measures in this area, as per the *Economic Survey 2014–15,* are:

(a) creating world class tourism infrastructure even by PPP;

(b) addressing multiple taxation issues;

(c) skill and etiquettes training to cater to the needs of tourists;

(d) special focus on cleanliness at tourist sites and safety of tourists;

(e) using the MGNREGA for creating permanent assets like tourism infrastructure and facilities;

(f) organising mini India cultural shows on a daily basis at important tourist sites that will not only attract tourists but also generate employment for Indian artists; and

(g) implementing urgently visa on arrival and E visa facilities at 9 airports to 180 countries barring 8 'prior reference' countries (this decision has already been taken).

Port services: Indian ports are not world-class ports and lack the necessary draft. As a result, 'third-generation ships' are not able to enter the harbour and goods have to be offloaded outside in smaller ships, adding to costs. If India can develop world-class airport infrastructure and metros, there is every reason to attend the concerns of the port services. Its immediate focus should be on—

(a) building world class ports providing world class services that will also help the trade sector by reducing costs and turnaround time in ports, and

(b) reducing port charges which are considerably higher.

Shipping, shipbuilding and ship repairs: Indian ships in the carriage of India's overseas cargo has fallen sharply and Indian ships are ageing, too. Government-owned shipyards like Visakhapatnam are facing problems like declining orders. India's shipbuilding industry has the capacity and expertise but is functioning below capacity. Some of the suggested steps to boost the sector are:

(a) need to replace our ageing ships with new ones,

(b) increasing shipping fleet (with prices falling on account of global slowdown),

(c) a special financing mechanism needs to be developed.

(d) utilising India's shipbuilding and repairs yards and enhancing their capacity (as India needs to replace many old ships and growing ship repairs business in the world).

Railways: The FDI policy of Railways sector restricts FDI in rail transport, except in mass rapid transit systems. FDI and privatisation in the railways could be the next big ticket reforms. A proposal has been initiated by Indian Railways, for making suitable changes in the existing FDI policy in order to allow FDI in railways, to foster creation of world class rail infrastructure. The proposal envisages—

(a) allowing FDI in all areas of the rail sector except railway operations.

(b) even in railway operations, FDI is proposed in PPP projects, for suburban corridors, high speed train systems, and dedicated freight lines.

While privatization of railways has been successful in some countries like Japan, it has failed in some others like the UK. So this proposal needs to be examined carefully and quickly to allow privatization and inflows of FDI in areas where it is feasible, suggests the *Economic Survey 2014–15*.

CHAPTER

11

INDIAN FINANCIAL MARKET

- Introduction
- Indian Money Market
- Mutual Funds
- DFHI
- Indian Capital Market
- Project Financing
- Monetary Policy Tools
- Financial Regulators

*There is now ample empirical research to corroborate Schumpeter's conjecture that financial development facilitates real economic growth. The depth of the financial markets and availability of diverse products should therefore not be treated as mere adornment but as critical ingredients of inclusive growth.**

** As the Economic Survey 2011-12 (MoF, GoI, N Delhi, p. 40) refers to the Australian economist Joseph A. Schumpeter (1883–1950) to emphasise the importance of the financial market in an economy.*

INTRODUCTION

The market of an economy where funds are transacted between the fund-surplus and fund-scarce individuals and groups is known as the financial market *(definition)*.[1] The basis of transaction is either *interest* or *dividend*. This market might have its organised (institutionalised) as well as non-organised (unregulated/non-institutionalised) segments in an economy.

Financial markets in every economy are having two separate segments today, one catering to the requirements of *short-term funds* and the other to the requirements of *long-term funds*.[2] The short-term financial market is known as the **money market,** while the long-term financial market is known as the **capital market.** The money market fulfils the requirements of funds for the period upto 364 days (*i.e., short term*) while the capital market does the same for the period above 364 days (*i.e., long term*).[3] A brief discussion on the Indian financial market is given below.

INDIAN MONEY MARKET

Money market is the short-term financial market of an economy. In this market, money is traded between individuals or groups (i.e., financial institutions, banks, government, companies, etc.), who are either *cash-surplus* or *cash-scarce*. Trading is done on a rate known as *discount rate* which is determined by the market and guided by the availability of and demand for the cash in the day-to-day trading.[4] The 'repo rate' of the time (announced by the RBI) works as the guiding rate for the current 'discount rate'. Borrowings in this market may or may not be supported by collaterals. In the money market the *financial assets*, which have quick conversion quality into money and carry minimal transaction cost, are also traded.[5] Money market may be *defined* as a market where short-term lending and borrowing take place between the cash-surplus and cash-scarce sides.

The market operates in both 'organised' and 'unorganised' channels in India. Starting from the 'person-to-person' mode and converting into 'telephonic transaction', it has now gone *online* in the age of internet and information technology. The transactions might take place through the intermediaries (known as brokers) or directly between the trading sides.

Need for Money Market: Income generation (i.e., growth) is the most essential requiremnt of any economic system. In the modern industrial economies creation of productive assets is not an easy task, as it requires investible capital of long-term nature. Long-term capital can be raised either through bank loans, corporate bonds, debentures or shares (i.e., from the capital market). But once a productive asset has been created and production starts there comes the need of another kind of capital, to meet the day-to-day shortfalls of working capital. It means that only setting-up of firms does not guarantee production as these firms keep facing *fund mismatches* in the day-to-day production process. Such funds are required only for a short period (days, fortnights or few months) and are needed to meet shortfalls in working capital requirements. This requires creation of a different segment of the financial market which

1. Based on the discussion in Samuelson and Nordhaus, ***Economics***, op.cit., pp. 543–45.
2. Based on Stiglitz and Walsh, ***Economics***, op.cit., pp. 612–14.
3. Many Report on Currency and Finance, RBI, GoI, N. Delhi.
4. In the capital market, money is traded on interest rate as well as on dividends. Long-term loans are raised on well-defined interest rates while long-term capital is raised on dividends through the sale of shares.
5. Such financial assets are known as 'close substitutes for money '.

can cater to the short-term requirements of such funds for the eneterprises—known as the **money market** or the **working capital market.** The short-term period is defined as upto 364 days. The crucial role money market plays in an economy is proved by the fact that if only a few lakhs or crores of rupees of working capital is not met in time, it can push a firm or business enterprise to go for lock-out, which has been set-up with thousands of crores of capital. If lock-out happens, the firm might default in its payments, losing its age-old credit-worthiness, consequently creating a chain of negatives in the economic system. This is why it is essential for every economy to organise a strong and vibrant money market which has wider geographic presence (the reason why it is today internet-based).

Money Market in India: The organised form of money market in India is just close to three decades old. However, its presence has been there, but restricted to the government only.[6] It was the **Chakravarthy Committee** (1985) which, for the first time, underlined the need of an organised money market in the country[7] and the **Vahul Committee** (1987) laid the blue print for its development.[8] Today, money market in India is not an integrated unit and has two segments—*Unorganised Money Market* and *Organised Money Market*.

1. Unorganised Money Market

Before the government started the organised development of the money market in India, its unorganised form had its presence since the ancient times—its remnant is still present in the country. Their activities are not regulated like the organised money market, but they are recognised by the government. In recent years, some of them have been included under the regulated organised market (for example, the NBFCs were put under the regulatory control of the RBI in 1997). The unorganised money market in India may be divided into three differing categories:

(i) Unregulated Non-Bank Financial Intermediaries: Unregulated Non-Banking Financial Intermediaries are functioning in the form of *chit funds, nidhis* (operate in South India, which lend to only their members) and loan companies. They charge very high interest rates (i.e., 36 to 48 per cent per annum), thus, are exploitative in nature and have selective reach in the economy.

(ii) Indigenous Bankers: Indigenous bankers receive deposits and lend money in the capacity of an individual or a private firms. There are, basically, four such bankers in the country functioning as non-homogenous groups:

(a) *Gujarati Shroffs*: They operate in Mumbai, Kolkata as well as in industrial, trading and port cities in the region.

(b) *Multani* or *Shikarpuri Shroffs*: They operate in Mumbai, Kolkata, Assam tea gardens and North Eastern India.

(c) *Marwari Kayas*: They operate mainly in Gujarat with a little bit of presence in Mumbai and Kolkata.

(d) *Chettiars*: They are active in Chennai and at the ports of southern India.

6. The only instrument of the money market was the Treasury Bills which were sold by tender at weekly auctions upto 1965. But later these bills were made available throughout the week at discount rates by the RBI (RBI, GoI, N. Delhi).
7. **Review of the Working of the Monetary System** headed by Sukhomoy Chakravarthy, RBI, N. Delhi, 1985.
8. **Working Group on Money Market** (Vaghul Committee), RBI, N. Delhi, 1987 (headed by M.Vaghul, Chairman, ICICI. The committee was set up in 1986).

(iii) **Money Lenders:** They constitute the most localised form of money market in India and operate in the most exploitative way. They have their two forms:

(a) The professional money lenders who lend their own money as a profession to earn income through interest.

(b) The non-professional money lenders who might be businessmen and lend their money to earn interest income as a subsidiary business.

Today, India has **eight** organised instruments of the money market which are used by the prescribed firms in the country, but the unorganised money market also operates side by side—there are certain reasons[9] behind this:

(i) Indian money market is still under-developed.

(ii) Lack of penetration and presence of the instruments of the organised money market.

(iii) There are many needful customers in the money market who are current outside the purview of the organised money market.

(iv) Entry to the organised money market for its customers is still restrictive in nature—not allowing small businessmen.

2. Organised Money Market

Since the government started developing the organised money market in India (mid-1980s), we have seen the arrival of a total of **eight** instruments designed to be used by different categories of business and industrial firms. A brief description of these instruments follows:

(i) *Treasury Bills (TBs):* This instrument of the money market though present since Independence got organised only in 1986. They are used by the Central Government to fulfil its short-term liquidity requirement upto the period of 364 days. There developed **five types** of the TBs in due course of time:

(a) 14-day (Intermediate TBs)

(b) 14-day (Auctionable TBs)

(c) 91-day TBs

(d) 182-day TBs

(e) 364-day TBs

Out of the above five variants of the TBs, at present only the **91-day TBs**, **182-day TBs** and the **364-day TBs** are issued by the government. The other two variants were discontinued in 2001.[10]

The TBs other than providing short-term cushion to the government, also function as short-term investment avenues for the banks and financial institutions, besides functioning as requirements of the CRR and SLR of the banking institutions.

(ii) *Certificate of Deposit (CD):* Organised in 1989, the CD is used by **banks** and issued to the depositors for a specified period ranging less than one year—they are negotiable and tradable in the money market. Since 1993 the RBI allowed the **financial institutions** to operate in it—IFCI, IDBI, IRBI (IIBI since 1997) and the Exim Bank—they can issue CDs for the maturity periods above one year and upto three years.

(iii) *Commercial Paper (CP):* Organised in 1990 it is used by the **corporate houses** in India (which should be a listed company with a working capital of not less than Rs. 5 crore). The CP issuing companies need

9. Based on the suggestions of experts belonging to the Indian financial market.

10. ***Economic Survey 2001–02*** & ***2009–2010,*** MoF, GoI, N. Delhi.

to obtain a specified credit rating from an agency approved by the RBI (such as CRISIL, ICRA, etc).

(iv) *Commercial Bill (CB):* Organised in 1990, a CB is issued by the **All India Financial Institutions** (AIFIs), **Non-Banking Finance Companies** (NBFCs), **Scheduled Commercial Banks, Merchant Banks, Co-operative Banks** and the **Mutual Funds**. It replaced the old Bill Market available since 1952 in the country.

(v) *Call Money Market (CMM):* This is basically an **inter-bank** money market where funds are borrowed and lent, generally, for one day—that is why this is also known as **over-night borrowing market** (also called **money at call**). Fund can be borrowed/raised for a maximum period upto 14 days (called **short notice**). Borrowing in this market may take place against securities or without securities.[11] Rate of interest in this market 'glides' with the 'repo rate' of the time the principle remains very simple—longer the period, higher the interest rate. Depending upon the availability and demand of fund in this market the real call rate revovles nearby the current repo rate.

The scheduled commercial banks, co-operative banks operate in this market as both the borrowers and lenders while LIC, GIC, Mutual Funds, IDBI and NABARD are allowed to operate as only lenders in this market.

(vi) *Money Market Mutual Fund (MF):* Popular as Mutual Funds (MFs) this money market instrument was intorduced/organised in 1992 to provide short-term investment opportunity to **individuals**. The initial guidelines for the MF have been liberalised many times. Since March 2000, MFs have been brought under the preview of SEBI, besides the RBI. At present, a whole lot of financial institutions and firms are allowed to set up MFs, viz., commercial banks, public and private financial institutions and private sector companies. At present 45 MFs are operating in the country—managing a corpus of over Rs. 4 lakh crore.

(vii) *Repos and Reverse Repos:* In the era of economic reforms there developed two new instruments of money market—**repo** and **reverse repo.** Considered the most dynamic instruments of the Indian money market they have emerged the most favoured route to raise short-term funds in India. 'Repo' is basically an acronym of the **rate of repurchase.** The RBI in a span of four years, introduced these instruments—**repo** in December 1992 and **reverse repo** in November 1996.

Repo allows the banks and other financial institutions to borrow money from the RBI for short-term (by selling government securities to the RBI). In **reverse repo,** the banks and financial institutions purchase government securities from the RBI (basically here the RBI is borrowing from the banks and the financial institutions). All government securities are dated and the interest for the repo or reverse repo transactions are

11. The State Bank of India (operates in this market as lender as it is available with comfortable cash position) lends against government securities, while others lend against the 'deposit receipts' of the borrowing banks. The SBI functions as the 'lender of intermediate resort' (while the RBI functions as the 'lender of last resort').

announced by the RBI from time to time. The provision of repo and the reverse repo have been able to serve the liquidity evenness in the economy as the banks are able to get the required amount of funds out of it, and they can park surplus idle funds through it. These instruments have emerged as important tools in the management of the monetary and credit policy in recent years.[12]

Accepting the recommendations of the **Urjit Patel Committee**, the RBI in April 2014 (while announcing the first *Bi-monthly Credit & Monetary Policy-2014–15*) announced to introduce **term repo** and **term reverse repo**. This is believed to bring in higher stability and better signalling of interest rates across different loan markets in the economy.

(viii) *Cash Management Bill (CMB):* The Government of India, in consultation with the RBI, decided to issue a new short-term instrument, known as Cash Management Bills, since August 2009 to meet the temporary cash flow mismatches of the government. The Cash Management Bills are *non-standard* and *discounted instruments* issued for maturities less than 91 days.

The CMBs have the *generic character of Treasury Bills* (issued at discount to the face value); are tradable and qualify for *ready forward facility;* investment in it is considered as an eligible investment in government securities by banks for SLR.

It should be noted here that the existing Treasury Bills serve the same purpose, but as they were put under the WMAs (Ways & Means Advances) provisions by the GoI in 1997, they did not remain a discretionary route for the government in meeting its short-term requirements of funds at will (see 'Fiscal Consolidation in India', sub-topic in **Chapter 18** *Public Finance* for details). CBM does not come under the similar WMAs provisions.

MUTUAL FUNDS

Of all investment options, mutual funds are touted to be the best tool for wealth creation over the long term. They are of several types, and the risk varies with the kind of asset classes these funds invest in. As the name suggests, a mutual fund *is a fund that is created when a large number of investors put in their money, and is managed by professionally qualified persons with experience in investing in different asset classes—shares, bonds, money market instruments like call money, and other assets such as gold and property.* Their names usually give a good idea about what type of asset class a fund, also called a scheme, will invest in. For example, a **diversified equity fund** will invest in a large number of stocks, while a **gilt fund** will invest in government securities, while a **pharma fund** will mainly invest in stocks of companies from the pharmaceutical and related industries.

Mutual funds, first of all came in the money market (regulated by the RBI), but they have the freedom to operate in the capital market, too. This is why they have provision of dual regulator—the RBI and SEBI. Mutual funds are compulsorily registered with the Securities and Exchange Board of India (SEBI), which also acts as the **first wall of defence** for all investors in these funds. For those who do not understand how mutual funds operate but are willing to invest, the move by SEBI is seen as a big relief.

Each mutual fund is run by a group of qualified people who form a company, called an *asset management company (AMC)* and the operations

12. ***Report on Currency and Finance, 1999 and 2000***, RBI, GoI, N. Delhi.

of the AMC are under the guidance of another group of people, called *trustees*. Both, the people in the AMC as well as the trustees, have a *fiduciary responsibility,* because these are the people who are entrusted with the task of managing the hard-earned money of people who do not understand much about managing money.

A fund house or a distributor working for the fund house (which could be an individual, a company or even a bank) are qualified to sell mutual funds. The fund house allots the 'units' of the MF to the investor at a price that is fixed through a process approved by SEBI, which is based on the net asset value (NAV). In simple terms, NAV is the total value of investments in a scheme divided by the total number of units issued to investors in the same scheme. In most mutual fund schemes, NAVs are computed and published on a daily basis. However, when a fund house is launching a scheme for the first time, the units are sold at Rs. 10 each. There are **three types** of schemes offered by MFs:

(i) Open-ended Schemes: An open-ended fund is one which is usually available from an MF on an ongoing basis, that is, an investor can buy or sell as and when they intend to at a NAV-based price. As investors buy and sell units of a particular open- ended scheme, the number of units issued also changes every day and so changes the value of the scheme's portfolio. So, the NAV also changes on a daily basis. In India, fund houses can sell any number of units of a particular scheme, but at times fund houses restrict selling additional units of a scheme for some time.

(ii) Closed-ended Schemes: A close-ended fund usually issue units to investors only once, when they launch an offer, called *new fund offer (NFO)* in India. Thereafter, these units are listed on the stock exchanges where they are traded on a daily basis. As these units are listed, any investor can buy and sell these units through the exchange. As the name suggests, close-ended schemes are managed by fund houses for a limited number of years, and at the end of the term either money is returned to the investors or the scheme is made open ended. However, there is a word of caution here that usually, units of close ended funds which are listed on the stock exchanges, trade at a high discount to their NAVs. But as the date for closure of the fund nears, the discount between the NAV and the trading price narrows, and vanishes on the day of closure of the scheme.

(iii) Exchange-Traded Funds (ETFs): ETFs are a mix of open-ended and close-ended schemes. ETFs, like close-ended schemes, are listed and traded on a stock exchange on a daily basis, but the price is usually very close to its NAV, or the underlying assets, like gold ETFs.

If investment have been done in a well-managed MF, the advantages outweigh disadvantages in the long term, which is 10 years or more. There is a very high probability for investors of making more money than by investing in other risk-free investments such as FDs, public provident fund etc. Advantages of investing in MFs include:

(i) diversification of portfolio,
(ii) good investment management services,
(iii) liquidity,
(iv) strong government-backed regulatory help,
(v) professional service, and
(vi) low cost for all the benefits.

An investor, by investing in a mutual fund scheme that has blue chip stocks in its portfolio, indirectly gets an exposure to these stocks. Compared to this, if the same investor wants to have each of these stocks in his portfolio, the cost of buying and managing the portfolio will be much higher.

Mutual funds invest the investors money in both the **loan** and **share** markets. Buyers of MF units are given choice/option as in which of the markets they wish their money to be invested by the fund managers of the MF. This way investors get the following choices:

(i) *Loan* (100 per cent of the funds will be invested in the loan market),

(ii) *Share* (100 per cent of the funds will be invested in the share market), and

(iii) *Balance* (60 per cent of the funds will be invested in the loan market while the rest 40 per cent in the share market—this provision keeps changing depending upon the health of the share market—clearly announced by the MFs).

DFHI

The Discount and Finance House of India Limited[13] (DFHI) was set up in April 1988 by the RBI jointly with the public sector banks and financial investment institutions (i.e., LIC, GIC and UTI). Its establishment was an outcome of the long-drawn need of the following two types:

(i) to bring an equilibirium of liquidity in the Indian banking system and

(ii) to impart liquidity to the instruments of the money market prevalent in the economy.

In 2004, the RBI transferred its total holding in the DFHI to the Stae Bank of India arm SBI Gilts Limited. Its new name is SBI DFHI. It functions as the biggest 'primary dealer' in the economy and functions on commercial basis. It deals in all kinds of instruments in the money market without any upper ceiling. Operating in 'two way' (as a lender and borrower) its objective is to provide needful liquidity and stability in the financial market of the country.

INDIAN CAPITAL MARKET

The long-term financial market of an economy is known as the 'capital market'. This market makes it possible to raise *long-term money* (capital), i.e., for a period of minimum 365 days and above. Ceation of productive assets is not possible without a string capital market—the market gained more importance once most of the economies in the world started industrialising. Across the world, banks emerged as the first and the foremost segment of the capital market. In coming times many other segments got added to it, viz., insurance industry, mutual funds, and finally the most attractive and vibrant, the security/stock market. Organised development of capital market together with putting in place the right regulatory framework for it, has always been a tough task for the economies. It is believed today that for strong growth prospects in an economy presence of a strong and vibrant capital market is essential.

13. It was in 1979 that the Chore Committee for the first time recommended for a discount house to level the liquidity imbalances in the banking system. The government became active after the recommendations of the Working Group on the Money Market (i.e., the Vaghul Committee, 1987) and finally established DFHI in 1988. The Vaghul Committee suggested to set up a discount finance institution which could deal in short-term money market instruments so that liquidity could be provided to these instruments. The committee also recommended the house to operate on 'commercial basis' which was accepted by the government while setting up DFHI.

Though the capital market of India is far stronger and better today in comparision to the periods just after Independence, the process of emergnece has not been easy and smooth. Once India opted 'industry' as its prime moving force, the first challenge was to raise long-term funds for industrial establishments and their expansion. As banks in India were weak, small and geographically unevenly distributed they were not in a position to play the pivotal role they played in case of the industrialising Western economies. This is why the government decided to set up 'financial institutions' which could play the role of banks (till bakns gain strength and presence) and carry on the responsibilities of 'project financing'.

PROJECT FINANCING

After Independence, India went for intensive industrialisation to achieve rapid growth and development. To this end, the main responsibility was given to the Public Sector Undertakings (PSUs). For industrialisation we require capital, technology and labour, all being typically difficult to manage in the case of India. For capital requirement, the government decided to depend upon internal and external sources and the government decided to set up financial institutions (FIs). Though India was having banks, but due to low saving rate and lower deposits with them, the upcoming industries could not be financed through them. The main borrowers for industrial development were the PSUs. To support the capital requirement of the 'projects' of the public sector industries, the government came up with different types of financial institutions in the coming years. The industrial financing supported by these financial institutions was known as 'project financing' in India. Over the time, Indian capital market started to have the following segments:

A. Financial Institutions

The requirement of project financing made India to go for a number of FIs from time to time, which are generally classified into four categories:[14]

(i) All India Financial Institutions (AIFIs)

The all India FIs are IFCI (1948); ICICI (1955); IDBI (1964); SIDBI (1990) & IIBI (1997). All of them were public sector FIs except ICICI, which was a joint sector venture with initial capital coming from the RBI, some foreign banks and FIs. The public sector FIs were funded by the Government of India.

By 1980s, all Indian banks acquired wider capital base and by early 1990s when the stock market became popular, it became easier for the corporate world to tap cheaper capital from these segments of the capital market.[15] The era of economic reforms had given the same option to the PSUs to tap new capital. As the AIFIs had more or less fixed rate of interest as compared to the banks which could mobilise cheaper deposits to lend cheaper—the AIFIs seemed to become irrelevant. The AIFIs witnessed a sharp decline in recent years.[16] At this juncture the government decided to convert them into **Development Banks**[17] (suggested by the Narasimhan Committee-I) to be known as the All India Development Banks (AIDBs). In 2000, the government allowed ICICI to go for a **reverse merger** (when an elder enterprise is merged with a younger one) with

14. ***Industrial Finance Corporation of India Act, 1948***, GoI, N. Delhi.
15. ***Economic Survey 2000-01***, MoF, GoI, N. Delhi.
16. ***Economic Survey 2006-07***, MoF, GoI, N. Delhi.
17. **Narasimhan Committee on the Financial System (CFS), 1991** suggested for the conversion of the AIFIs into Development Banks.

the ICICI Bank—the first AIDB emerged with no obligation of project financing—such entities in coming times will be known as the **universal banks**[18] (allowed to set up as many financial institutions they wish to, such as insurance, merchant banks, mutual funds, etc.). In a similar move, the IDBI was reverse merged with the IDBI Bank in 2002 and the second AIDB emerged. But it has still the obligation of carrying its project financing duties.

In 2002, the government, proposed to merge IFCI and IIBI with the nationalised bank PNB to ctraete a big **Universal Bank.** It is believed that PNB was unwilling to go for this merger as these FIs were running at heavy losses. This move was part correct as per the recommendations of the Narasimhan Committe-II (to the extent merger is concerned, following its 3-Tier Banking Structure of India), but part against it (the committee has advised not to merge weak banks/FIs with either weak or strong banks/FIs).[19] Presently, the government is trying to make IFCI and IIBI to turn around their business and emerge as profitable entities—they are busy recovering their dues and improving their balance sheet.

Meanwhile, at present, there are only **four** financial institutions operating in the country as AIFIs **regulated** by the RBI, viz., the NABARD, SIDBI, Exim Bank and the NHB.

(ii) Specialised Financial Institutions (SFIs)[20]

Two new FIs were set up by the Central Government in the late 1980s to finance **risk** and **innovation** in the area of industrial expansion; this was India's trial in the area of **venture capital funding**.

(a) *IFCI Venture Capital Funds Ltd (IFCI Venture), 2000:* It was promoted as a Risk Capital Foundation (RCF) in 1975 by IFCI Ltd., a society to provide financial assistance to first generation professionals and technocrat entrepreneurs for setting up own ventures through soft loans, under the Risk Capital Scheme.

In 1988, RCF was converted into a company—Risk Capital and Technology Finance Corporation Ltd. (RCTC)—when it also introduced the Technology Finance and Development Scheme (TFDS) for financing development and commercialisation of indigenous technology. Besides, under Risk Capital Scheme, RCTC started providing financial assistance to entrepreneurs by way of direct equity participation. Based on IFCI Venture's credentials and strengths, Unit Trust of India (UTI), entrusted RCTC with the management of a new venture capital fund named **Venture Capital Unit Scheme (VECAUS-III)** in 1991 with its funds coming from the UTI and IFCI. To reflect the shift in the company's activities, the name of RCTC was changed to IFCI Venture Capital Funds Ltd. (IFCI Venture) in February 2000.

In order to focus on Asset Management Activities, IFCI Venture discontinued Risk Capital and Technology Finance Schemes in 2000-01 and continued managing VECAUS-III. In 2007, as UTI had ceased to carry out its activities

18. It was the **S. H. Khan Committee on Development Financial Institutions (DFIs), 1998** which forwarded the concept/idea of Universal Banking in India.
19. ***Economic Survey 2011–12,*** op. cit., p. 115–116.
20. The write-up is based on the information available from **SEBI, RBI** and different releases of the **Ministry of Finance,** GoI, N. Delhi, since 1996 onwards.

and its assets vested with **Specified Undertaking of the Unit Trust of India (SUUTI)**, the portfolio of VECAUS-III under management of IFCI Venture was transferred to SUUTI.

(b) *Tourism Finance Corporation of India Ltd (TFCI), 1989:* The Government of India had, on the recommendations of the National Committee on Tourism *(Yunus Committee)* set up under the aegis of the Planning Commission, decided in 1988, to promote a separate All India Financial Institution for providing financial assistance to tourism-related activities/projects. In accordance with the above decision, the IFCI Ltd. along with other all-India financial/investment institutions and some nationalised banks promoted a Public Limited Company under the name of "Tourism Finance Corporation of India Ltd. (TFCI)" to function as a Specialised All-India Development Financial Institution to cater to the financial needs of the tourism industry.

TFCI was incorporated as a Public Limited Company in 1989 and became operational with effect from 1989. TFCI was notified as a Public Financial Institution in January 1990. Its promoter, the IFCI, holds major share (41.6 per cent) in it, while the rest of the shares are with the 'public' (26 per cent), public sector banks, public insurance companies and public mutual fund (i.e., UTI Mutual Fund Ltd.).

(iii) Investment Instituions (IIs)

Three investment institutions also came up in the public sector, which are yet another kind of FIs, i.e., the LIC (1956), the UTI (1964) and the GIC (1971).

In the present time they are no more considered as FIs. LIC is now the public sector insurance company in the life segment, GIC was been converted into a public sector re-insurance company in 2000, while UTI was converted into a mutual fund company in 2002. Now these investment institutions (IIs) are no more like the past. LIC is now called an 'insurance company', part of the Indian Insurance Industry and is the lone public sector playing in the life insurance segment competeing with the private life insurance companies. Similarly, the UTI is now part of the Indian Mutual Fund industry and the lone such firm in the public sector competing with other private sector mutual funds. Similarly, the earstwhile four public sector general insurance companies are part of India's general insurance industry and competeing with private companies in the area (they were Holding Comapnies of the GIC—now these are owned by the GoI directly and GIC only looks after its 're-insurance' business). This is why we do not get the use of the term 'IIs' in recent times in any of the GoI official documents.

(iv) State Level Finance Institutions (SLFIs)

In the wake of states involvement in the industrial development, the central government allowed the states to set up their own financial institutions (after the states demanded so). In this process two kinds of FIs came up:

(a) *State Finance Corporations (SFCs):* First came up in Punjab (1955) with other states following its example. There are 18 SFCs working presently.

(b) *State Industrial Development Corporations (SIDCs):* A fully dedicated state public sector FI to the cause of industrial development in the concerned states. First such FIs were set up (1960) in Andhra Pradesh and Bihar.

Almost all of the SFCs and SIDCs are at present running in huge losses. They may be restructured on the lines of the AIFIs, but there is lack of will from the states and private financiers who are not interested to go in for their takeovers as such.

B. Banking Industry

With the passage of time, the industry saw its nationalisation (1969 and 1980) and again opening up for private sector entry (1993–94) to emerge as the most dependable segement of Indian financial system—in a way its mainstay. Presently, the industry consists of commercial banks both in public and private sectors, Regional Rural Banks (RRBs) and co-operative banks—a total of 171 Scheduled Commercial Banks (SCBs) out of whch 113 are in the public sector (19 nationalised banks, 7 banks in SBI group, one IDBI Bank Ltd. and 86 RRBs); with the rest of the 58 banks owned by the private sector (domestic and foreign—FDI in banks is allowed upto 26 per cent).[21]

In the wake of the economic reforms the government has promised speedier expansion of the banking sector. But the entry of new private players in the banking sector has been slow, hapmering the growth and expansion of the sector. But in a *recent release* the RBI has committed to allow new banks to come up on regular basis – in **April 2014** the RBI allowed two new private sector banks to start their operations. [for a detailed discussion on the banking sector refer the *Chapter 12*].

C. Insurance Industry

After Independence, for the purpose of expanding the industry, one after another the life and non-life insurance businesses were nationalised by the government (in 1956 and 1970, respectively), and the public sector insurance companies did serve the better purpose in the areas of providing safety net and nation-building. In the wake of the process of economic refroms a restructuring of the sector was started and the industry was opened for entry of private players in 1999 and an independent regulator was set up—the IRDA (domestic and foreign—with an FDI cap of 49 per cent). Since then many private players have entered the industry. Presently, Indian insurance industry consists of one public sector life insurer (LIC) and four public sector general insurers; two specialised public sector insurers (AICIL and ECGC); one public sector re-insurer (GIC) and 37 private insurance companies (in collaboration with established foreign insurers from across the world).[22] The expansion and penetration insurance in the country have increased during the reform period, but not as per the expectations of the governments and the experts—several reasons have been responsible for this (for a detailed discussion on the insurance industry refer *Chapter 13*).

D. Security Market

After the government's attempts to formally organise the security and stock market of India, the segment has seen accelerated expansion. Today, it is counted among the most vibrant share markets of the world and has challenged the monopoly of banks in the capital market of the country.[23] The security market of India is regulated by SEBI. India has developed a regulated 'forward market' also where hunderds of commodities and derivatives are traded on spot and non-spot basis—regulated by FMC [for a detailed discussion on thses markets refer to *Chapter 14*].

21. ***India 2014***, Publications Division, MoIB, GoI, N. Delhi, p. 326.
22. ***India 2014***, Publications Division, MoIB, GoI, N. Delhi, p. 329.
23. ***Economic Survey 2012-13***, MoF, GoI, N Delhi, p. 116.

MONETARY POLICY TOOLS

Monetary policy deals with all those instruments/ means by which short-term money/capital is raised in the economy, i.e., the money which is raised for 1 to 364 days. The policy and the instruments are regulated by the RBI. The monetary policy tools used presently and their operating procedure are as given below:[24]

(i) Call Money Market: The call money market is an important segment of the money market where uncollateralised borrowing and lending of funds take place on **over night basis**. Participants in the call money market in India currently include scheduled commercial banks (SCBs)—excluding regional rural banks), cooperative banks (other than land development banks), and primary dealers, both as *borrowers* and *lenders* (RBI's Master Circular dated July 1, 2011). Prudential limits, in respect of both outstanding borrowing and lending transactions in the call money market for each of these entities, are specified by the RBI.

(ii) Open Market Operations (OMOs): OMOs are conducted by the RBI via the sale/purchase of government securities (G-Sec) to/from the market with the **primary aim** of modulating rupee liquidity conditions in the market. OMOs are an effective quantitative policy tool in the armoury of the RBI, but are constrained by the stock of government securities available with it at a point in time.

(iii) Liquidity Adjustment Facility (LAF): The LAF is the key element in the monetary policy operating framework of the RBI (introduced in June 2000). On a daily basis, the RBI stands ready to lend to or borrow money from the banking system, as per the latter's requirement, at fixed interest rates. The **primary aim** of such an operation is to assist banks to adjust their day-to-day mismatches in liquidity, via *repo* and *reverse repo* operations.

Under the repo or repurchase option, banks borrow money from the RBI via the sale of securities with an agreement to purchase the securities back at a fixed rate at a future date. The rate charged by the RBI to aid this process of liquidity injection is termed as the repo rate. Under the reverse repo operation, the RBI borrows money from the banks, draining liquidity out from the system. The rate at which the RBI borrows money is the reverse repo rate. The interest rate on the LAF is fixed by the RBI from time to time (with crucial changes introduced recently in the operating procedure of Monetary Policy detailed in the next paragraph). LAF operations help the RBI effectively transmit **interest rate signals** to the market.

RECENT CHANGES IN MONETARY POLICY

Effective May 3, 2011, based on the recommendations of the *Working Group on Operating Procedure of Monetary Policy*, the operating framework of monetary policy has been refined with the following changes:

(i) The repo rate has been made the only independently varying policy rate. In *Bi-monthly Credit & Monetary Policy for 2014–15*, the RBI has announced to introduce 'term repos', too (which will have provisions for more than 'one-day' borrowing in the short-term market).

(ii) A new marginal standing facility (MSF) has been instituted, under which SCBs

24. ***Economic Survey 2011-12,*** op. cit., p. 96.

have been allowed to borrow overnight at their discretion, up to 1 per cent of their respective NDTL, at 100 basis points above the repo rate (the gap between 'repo' and 'MSF' rates was though changed by the RBI many times till *April 2014*). The revised MSF reverse repo corridor has been defined with a fixed width of 200 bps with the repo rate placed in the middle of the corridor (fluctuates as per the gap between the 'repo' and the MSF rates).

(iii) The reverse repo rate has been placed 100 bps below and the MSF rate 100 bps above the repo rate (fluctuates as per the gap between the 'repo' and the MSF rates). In *Bi-monthly Credit & Monetary Policy for 2014-15,* the RBI has announced to introduce 'term reverse repos', too (which will have provisions for more than 'one-day' lending—parking of funds by banks with the RBI—in the short-term market).

It is expected that the fixed interest rate corridor, set by the MSF rate and reverse repo rate, by reducing uncertainty and avoiding difficulties in communication associated with a variable corridor, will help in keeping the overnight average call money rate close to the repo rate. Similarly, the introduction of 'term repos' and 'term reverse repos' will provide stability element in the market together with better signalling through the loan market in the economy.

FINANCIAL REGULATORS

At present Indian financial market has a number of regulators, precisely **eleven**, *viz.*, RBI, SEBI, FMC, NABARD, IRDA, SIDBI, NHB, SFCs, IDBI, CLB and Registrar of Cooperative Societies. The Narasimhan Committee on Financial System (1991) has made a strong case for a *single requlator* for banks, financial institutions and the non-banking financial institutions in India.

Meanwhile, **Justice B. N. Srikrishna** headed Financial Sector Legislative Reforms Commission (FSLRC) handed over its report (*March 2013)* for examining the regulatory structure and the laws governing the financial sector. The 10-member committee had a broad *mandate* covering all financial services as well as everything currently overseen by any financial regulator. Broadly, the commission has recommended what can be called a changeover from an 'area-based' division of regulators to a 'task-based' division. Major highlights of the recommendations are as follows:

(i) Today, each agency like SEBI or IRDA or FMC looks after one type of financial service or one area – this would be replaced by a horizontal structure whereby the basic regulatory and monitoring functions of all areas would be done by a Unified Finacial Agency (UIA).

(ii) All consumer complaints, regardless of the area will be handled by a Financial Redressal Agency (FRA).

(iii) There will be a single tribunal, the Financial Sector Appellate Tribunal (FSAT) which will hear appeals by the entire sector.

(iv) There are also three other agencies in the recommendations, along with the Reserve Bank of India which will continue to oversee banking.

The *horizontal structure* will serve the interests of the consumers of financial services (of individuals and businesses, both) much better. For one, it should *eliminate regulatory arbitrage* – the recent IRDA vs. SEBI spat on **ULIPs** happened because the two agencies' views on the characteristics of investment products were very different. Another advantage of the horizontal structure would be that consumer complaints about a sector would get separated from the regulator. This is important because a certain class of consumer complaints have mistakes or oversights by the regulator at

their root. Recognising this root cause means admitting to its own flaw, something that is hard for any organisation.

Due to severe recessionary situations among the major trading partners of India (i.e., the USA and Western European nations) and a situation of delayed policy-decisions in the country (due to the nature of coalition government at the Centre—as the Prime Minister puts it), Indian financial system has been facing some pressure since 2010–11 onwards. Higher *non-performing assets* of banks; lack of *level-playing field* to private sector banks and the insurance companies, under-developed *corporate bond market* together with *regulatory concerns* are the emerging areas of challenges/concerns for India, which have been hampering the proper growth and expansion of the financial market in the country.

CHAPTER

12

BANKING IN INDIA

- ⇨ Introduction
- ⇨ Bank & Non-Bank Institutions
- ⇨ Non-Banking Financial Companies (NBFCs)
- ⇨ Reserve Bank of India
- ⇨ Base Rate
- ⇨ Revised LMF
- ⇨ Nationalisation and Development of Banking in india
- ⇨ Financial Sector Reforms
- ⇨ Banking Sector Reforms
- ⇨ Non-Performing Assets
- ⇨ Willful Defaulter
- ⇨ Capital Adequacy Ratio
- ⇨ Basel III Compliance of the PSBs & RRBs
- ⇨ Non-Resident Indian Deposits
- ⇨ Labels of ATM

*Banks are perhaps the most important financial intermediary. In the nineteenth century, banks mainly lent money to firms to help finance their inventories – which were held as collateral – in the cases of defaulters banks seized them. Gradually, banks expanded their lending activities – to finance houses and commercial real estates – holding the buildings as collateral. Emergence of the information technology has presented special problems to these traditional forms of finance – if the idea does not pan out, the firm may go bankrupt, but there is no collateral – there is little of value that the creditor can seize.**

* *See Joseph E Stiglitz and Carl E Walsh, **Economics**, W W Norton, New Yok, USA, 4th Edition, 2006, p. 205.*

- NIDHI
- Chit Fund
- Urjit Patel Committee
- Nachiket Mor Committee
- Small & Payment Banks
- Financial Inclusion
- ALM of Banks
- New Initiatives in the Banking Sector

INTRODUCTION

The sense in which we today use the term banking has its origin in the western world to which India was introduced by the British rulers, way back in the 17th century. Since then, enough water has flown and today Indian banks are considered among the best banks in the developing world and its attempts to emerge among the best in the world is going on.

BANK & NON-BANK INSTITUTIONS

A financial institution which accepts different forms of deposits and lends them to the prospective borrowers as well as allows the depositors to withdraw their money from the accounts by cheque is a ***bank***.

If the financial institution has all the same functions but does not allow depositors to issue cheque and withdraw their money from deposits then it is a ***non-bank institution.***

NON-BANKING FINANCIAL COMPANIES (NBFCs)

A non-banking financial company (NBFC) is a company[1] registered under the Companies Act, 1956 and is engaged in the business of loans and advances, acquisition of shares/stock/bonds/debentures/securities issued by government or local authority or other securities of like marketable nature, leasing, hire-purchase, insurance business, chit business, but ***does not include*** any institution whose principal business is that of agriculture activity, industrial activity, sale/purchase/construction of immovable property.

A non-banking institution which is a company and which has its principal business of receiving *deposits* under any scheme or arrangement or any other manner, or lending in any manner is also a non-banking financial company (residuary non-banking company, i.e., RNBC).

NBFCs are doing functions akin to that of banks, however there are a few differences:

(i) An NBFC cannot accept demand deposits (which are payable on demand), like the *savings* and *current accounts*.

(ii) It is not a part of the payment and settlement system and as such *cannot issue cheques* to its customers; and

(iii) Deposit insurance facility is not available for NBFC depositors unlike in the case of banks. (It means the public deposits with them are 'unsecured'. In case an NBFC defaults in repayment of deposit, the depositor can approach Company Law Board or Consumer Forum or file a civil suit to recover the deposits).

Under the RBI Act, 1934, the NBFCs have to get registered with the RBI. However, to obviate ***dual regulation***, certain category of NBFCs which are regulated by other regulators are exempted from the requirement of registration with RBI such as:

(i) venture capital fund, merchant banking companies, stock broking companies register with SEBI;

(ii) insurance company holding a valid certificate of registration issued by IRDA;

(iii) *nidhi* companies under the Companies Act, 1956;

(iv) chit companies under the Chit Funds Act, 1982;

(v) housing finance companies regulated by National Housing Bank (of the RBI).

A company incorporated under the Companies Act, 1956 and desirous of commencing business of the NBFC should have a minimum net owned fund (NOF) of Rs. 25 lakh (raised to Rs. 2 crore

1. The discussion here is based on the updated informations released by the ***RBI,*** May 11, 2012.

from April 21, 1999). NBFCs registered with RBI have been reclassified (since 2006) as Asset Finance Company (AFC), Investment Company (IC), and the Loan Company (LC). ***Provisions*** for accepting deposits are:

(i) There is ceiling on acceptance of public deposits, an NBFC maintaining required NOF and CRAR, and complying with the prudential norms can accept public deposits maximum upto 4 times of NOF;

(ii) Can offer the maximum 11 per cent rate of interest;

(iii) Minimum investment grade credit rating (MIGR) is essential (may get itself rated by any of the four rating agencies namely, CRISIL, CARE, ICRA and FITCH Ratings India Pvt. Ltd.);

(iv) Allowed to accept/renew public deposits for a minimum period of 12 months and maximum period of 60 months; and

(v) Effective from April 2004, cannot accept deposits from NRIs except deposits by debit to NRO account of NRIs provided such amount do not represent inward remittance or transfer from NRE/FCNR (B) account, however, the existing NRI deposits can be renewed *(**Note:** different foreign currency accounts opened by the Indian banks have been given as the last sub-topic of this Chapter)*.

There is no ceiling on raising of deposits by RNBCs, but every RNBC has to ensure that the amounts deposited and investments made by the company are not less than the aggregate amount of liabilities to the depositors. To secure the interest of depositors, such companies are required to invest in a portfolio comprising highly liquid and secured instruments, viz., central/state government securities, fixed deposit of scheduled commercial banks (SCB), certificate of deposits of SCB/FIs, units of Mutual Funds, etc. The amount payable by way of interest, premium, bonus or other advantage, by whatever name called by them in respect of deposits received shall not be less than the amount calculated at the rate of 5 per cent (to be compounded annually) on the amount deposited in lump sum or at monthly or longer intervals; and at the rate of 3.5 per cent (to be compounded annually) on the amount deposited under daily deposit scheme. Further, an RNBC can accept deposits for a minimum period of 12 months and maximum period of 84 months from the date of receipt of such deposit. Like the NBFCs they cannot accept deposits repayable on demand (it means they, too cannot open saving and current accounts).

Debenture Redemption: The norms for the NBFCs which raise capital through debentures have become stricter after the new *Company Act, 2013* came into effect (w.e.f. April 1, 2014) which are as given below:

(i) They need to create a **debenture redemption reserve** (DRR) account out of their profits, to be used only to redeem debentures. The corpus of DRR should be at least 50 per cent of the amount raised through debentures.

(ii) They need to invest or deposit a sum not less than 15 per cent of the amount in the form of deposits in banks or government or corporate bonds. This amount cannot be used for any purpose other than redeeming debentures.

The norms are aimed at minimising the risk of debenture buyers in a NBFC and check the mishaps like the *'Sahara OFCD'* [for Sahara OFCD see *Chapter 14*].

RESERVE BANK OF INDIA

The Reserve Bank of India (RBI) was set up in 1935 (by the *RBI Act, 1934*) as a private bank with two extra functions—regulation and control of the banks in India and being the banker of

the government. After nationalisation in 1949, it emerged as the central banking body of India and it did not remain a 'bank' in the technical sense. Since then, the governments have been handing over different functions[2] to the RBI, which stand today as given below:

(i) It is the issuing agency of the currency and coins other than rupee one currency and coin (which are issued by Ministry of Finance itself with the signature of the Finance Secretary on the note).
(ii) Distributing agent for currency and coins issued by the Government of India.
(iii) Banker of the government.
(iv) Bank of the banks/Bank of last resort.
(v) Announces the credit and monetary policy for the economy.
(vi) Stabilising the rate of inflation.
(vii) Stabilising the exchange rate of rupee.
(viii) Keeper of the foreign currency reserves.
(ix) Agent of the Government of India in the IMF.
(x) Performing a variety of developmental and promotional functions under which it did set up institutions like IDBI, SIDBI, NABARD, NHB, etc.

Credit and Monetary Policy

The policy by which the desired level of money flow and its demand is regulated is known as the credit and monetary policy. All over the world it is announced by the central banking body of the country—as the RBI announces it in India. In India there has been a tradition of announcing it twice in a financial year—before the starting of the *busy* and the *slack* seasons. But in the reform period, this tradition has been broken. Now the RBI keeps modifying this as per the requirement of the economy, though the practice of the two policy announcements a year still continues.

In India, a debate regarding autonomy to the RBI regarding announcement of the policy started when the Narasimham Committee-I recommended on these lines. As the Governor RBI it was Bimal Jalan who vocally supported the idea. No such move came from the governments officially, but it is believed that the RBI has been given almost working autonomy in this area. In most of the developed economies, the central bank functions with autonomous powers in this area (bifurcation of politics from the economics). Though we lack such kind of officially open autonomy for the RBI, we have learnt enough by now and are better off today.

There are many tools by which the RBI regulates the desired/required kind of the credit and monetary policy—CRR, SLR, Bank Rate, Repo rate, Reverse Repo rate, PLR, Exim interest rate, Small Saving Schemes' interest rates (SSSs), interest changes for the instruments of the money market, etc.

CRR

The cash reserve ratio (CRR) is the ratio (fixed by the RBI) of the total deposits of a bank in India which is kept with the RBI in the form of cash. This was fixed to be in the range of 3 to 15 per cent.[3] A recent Amendment (2007) has removed the 3 per cent floor and provided a free hand to the RBI in fixing the CRR.

At present it is 4 per cent and a 1 per cent change in it today affects the economy with Rs. 96,000 crore[4]—an increase sucks this amount from the economy, while a decrease injects this amount into the economy.

2. Based on the ***RBI Nationalisation Act, 1949*** and further announcements of the Government of India (MoF).
3. ***RBI Act, 1934,*** sub-section (1) of Section 42.
4. ***Annual Policy Statement 2013–14,*** RBI, May 3, 2013, N. Delhi.

Following the recommendations of the Narasimham Committee on the Financial System (1991) the government started two major changes concerning the CRR:

(i) reducing the CRR was set as the medium-term objective and it was reduced gradually from its peak of 15 per cent in 1992 to 4.5 per cent by June 2003.[5]

After the RBI (Amendment) Act has been enacted in June 2006, the RBI can now prescribe CRR for scheduled banks without any floor or ceiling rate thereby removing the statutory minimum CRR limit of 3 per cent.[6]

(ii) Payment of interest by the RBI on the CRR money to the scheduled banks started in financial year 1999–2000 (in the wake of the banking slow down). Though the RBI discontinued interest payments from mid-2007.[7]

SLR

The statutory liquidity ratio (SLR) is the ratio (fixed by the RBI) of the total deposits of a bank which is to be maintained by the bank with itself in non-cash form prescribed by the government to be in the range of 25 to 40 per cent.[8]

The ratio was cut to 25 per cent (done in October 1997 after CFS suggestions).[9] It used to be as high as 38.5 per cent. The CFS has recommended the government not to use this money by handing G-Secs to the banks. In its place a ***market-based interest*** on it should be paid by the government, it was being advised. However, there has been no follow up in this regard by the governments. The Government of India has removed the 25 per cent floor for the SLR by an Amendment (2007) providing the RBI a free hand in fixing it.

Bank Rate

The interest rate which the RBI charges on its **long-term** lendings is known as the Bank Rate. The clients who borrow through this route are the GoI, state governments, banks, financial institutions, co-operative banks, NBFCs, etc. The rate has direct impact on long-term lending activities of the concerned lending bodies operating in the Indian financial system. The rate was realigned[10] with the MSF (Marginal Standing Facility) by the RBI in February 2012.

Repo Rate

The rate of interest the RBI charges from its clients on their ***short-term*** borrowing is the repo rate in India.[11] Basically, this is an abbreviated form of the 'rate of repurchase' and in western economies it is known as the 'rate of discount'.[12]

In practice it is not called an interest rate but considered a discount on the dated government securities, which are deposited by institution to borrow for the short term. When they get their securities released from the RBI, the value of the securities is lost by the amount of the current repo rate. This rate functions as the benchmark rate for the inter-bank short-term market (i.e.,

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5. ***Economic Survey, 2006–07,*** MoF, GoI, N. Delhi.
6. ***RBI (Amendment) Act,*** 2006, GoI, N. Delhi.
7. ***Credit and Monetary Policy,*** April 1, 2007, op. cit.
8. ***RBI Act, 1934*** and ***Banking Regulation Act, 1949*** Section 24.
9. ***Committee on Financial System*** (CFS) headed by the then RBI Deputy Governor M. Narasimhan, 1991.
10. Through an RBI announcement on 15th Feb. 2012.
11. **RBI Act, 1934** and **Banking Regulation Act, 1949**.
12. Stiglitz and Walsh, ***Economics,*** op. cit., p. 629–630.

call Money Market) in India. Banks usually use this route for one-day borrowing to fulfil their short-term liquidity crunch. Higher the repo rate costlier the loans banks forward and vice versa. It has direct impact on the *nominal interest* rates of the bank's lending. The ***repo rate*** was introduced in December 1992.

Reverse Repo Rate

It is the rate of interest the RBI pays to its clients who offer short-term loan to it. At present (July 2013) the rate is at 6.25 per cent.

It is reverse of the repo rate and this was started in November 1996 as part of liquidity Adjustment Facility (LAF) by the RBI. In practice, financial instituions operating in India park their surplus funds with the RBI for short-term period and earn money. It has a direct bearing on the interest rates charged by the banks and the financial institutions on their different forms of loans.

This tool was utilised by the RBI in the wake of over money supply with the Indian banks and lower loan disbursal to serve twin purposes of cutting down banks losses and the prevailing interest rate.[13] It has emerged as a very important tool in direction of following cheap interest regime—the general policy of the RBI since reform process started.

Marginal Standing Facility (MSF)[14]

MSF is a new scheme announced by the RBI in its Monetary Policy, 2011–12 which came into effect from May, 2011. Under this scheme, banks can borrow overnight upto 1 per cent of their net demand and time liabilities (NDTL) from the RBI, at the interest rate 1 per cent (100 basis points) higher than the current repo rate. In an attempt to strengthen rupee and checking its falling exchange rate, the RBI increased the gap between 'repo' and MSF to 3 per cent (late July 2013).

The MSF would be the last resort for banks *once they exhaust* all borrowing options including the liquidity adjustment facility by pledging through government securities, which has lower rate (i.e., repo rate) of interest in comparison with the MSF. The MSF would be a **penal rate** for banks and the banks can borrow funds by pledging government securities within the limits of the statutory liquidity ratio. The scheme has been introduced by RBI with the main aim of reducing volatility in the overnight lending rates in the inter-bank market and to enable smooth monetary transmission in the financial system.

Banks can borrow through MSF on all working days except Saturdays, between 3:30 and 4:30 p.m. in Mumbai where RBI has its headquarters. The minimum amount which can be accessed through MSF is Rs.1 crore and in multiples of Rs. 1 crore.

MSF represents the upper band of the interest corridor and reverse repo (7.25 per cent) as the lower band and the repo rate in the middle. To balance the liquidity, RBI would use the sole independent policy rate which is the repo rate and the MSF rate automatically adjusts to 1 per cent above the repo rate.

Similar to India's MSF the ECB (European Central Bank) also offers standing facilities called *marginal lending facilities* (MLF) and the Federal Reserve (the US Central Bank) has *discount window systems* (DWS). Like the MSF, the secondary credit facility made available by the Federal Reserve to the depository institutions in USA is typically overnight credit on a very short term basis at rates above the primary credit rate.

13. ***Economic Survey 2001–02,*** MoF, GoI, N. Delhi.
14. The write-up is based on the *RBI's Credit & Monetary Policy, 2011-12* (in which the Scheme was introduced); and the *European Central Bank*, Frankfurt, Germany and *Federal Reserve System* (also known as the *Federal Reserve*, and informally as the *Fed*) Washington, DC, USA

In an attempt to strengthen rupee and checking its falling exchange rate, the RBI increased the gap between 'repo' and MSF to 3 per cent (late July 2013). The effectiveness of standing facilities in reducing volatility have been examined by many scholars and certain studies have pointed out that in the Federal Reserve System in the United States, the design of the facility decreases a bank's incentive to participate actively in *interbank market* (i.e., India's call money market) due to the perceived stigma from using such facility. This in turn reduces the effectiveness of standing facility in reducing interest rate volatility.

BANK RATE REALIGNED WITH MSF

The RBI on February 15, 2012 increased the Bank Rate by 350 basis points from 6 per cent to 9.50 per cent and realigned the Bank Rate with Marginal Standing Facility (MSF) rate, which, in turn, is linked to the policy repo rate.[15] Henceforth, whenever there is an adjustment of the MSF rate, the RBI will consider and align the bank rate with the revised MSF rate.

Being the discount rate, the bank rate should technically be higher than the policyrepo rate. The bank rate has, however, been kept unchanged at 6 per cent since April 2003. This was mainly for the reason that monetary policy signalling was done through modulations in the reverse repo rate and the repo rate till May 3, 2011, and the policy repo rate under the revised operating procedure of monetary policy from May 3, 2011 onwards.

Moreover, under the revised operating procedure, MSF, instituted at 100 basis points above the policy repo rate, has been in operation, which more or less served the purpose of the bank rate. At present, the repo rate is 8.50 per cent, reserve repo 7.50 per cent and MSF 9.50 per cent. Repo rate is the rate at which banks borrow funds from the RBI and reverse repo rate is the rate at which banks park their funds with the RBI. Under the MSF, banks are permitted to avail themselves of funds from the RBI on overnight basis.

The bank rate acts as the **penal rate** charged on banks for shortfalls in meeting their reserve requirements (CRR and SLR). The bank rate is also used by several financial institutions as a reference rate for indexation purposes.

BASE RATE

Base Rate is the interest rate below which Scheduled Commercial Banks (SCBs) will lend no loans to its customers—its means it is like prime lending rate (PLR) and the benchmark prime lending Rate (BPLR) of the past and is basically a floor rate of interest. It replaced[16] the existing idea of BPLR on July 1, 2010.

The BPLR system (while the existing system was of PLR), introduced in 2003, fell short of its original objective of *bringing transparency* to lending rates. This was mainly because under this system, banks could lend below BPLR. This made a bargaining by the borrower with bank- ultimately one borrower getting cheaper loan than the other, and blurred the attempts of bringing in transparency in the lending business. For the same reason, it was also difficult to assess the transmission of *policy rates* (i.e., repo rate, reverse repo rate, bank rate) of the Reserve Bank to lending rates of banks. The Base Rate system is **aimed at** enhancing transparency in lending rates of banks and enabling better assessment of transmission of monetary policy. To look into this matter, the RBI constituted a Working Group on Benchmark Prime Lending Rate (chaired Deepak Mohanty) to review the present benchmark prime lending rate (BPLR) system and suggest changes to make credit pricing more transparent—report

15. ***RBI Announcement,*** RBI, MoF, GoI, New Delhi, Feb. 15, 2012.
16. ***RBI Announcement,*** RBI, MoF, GoI, New Delhi, Apr.5, 2010.

submitted in October 2009 and accordingly the idea of base rate was implemented.

Now, all categories of loans are priced with reference to the base rate only, except (a) differential rate of interest (DRI) loans (b) loans to banks' own employees, and (c) loans to banks' depositors against their own deposits. Since the base rate will be the minimum rate for all loans, banks are not permitted to resort to any lending below this rate—accordingly, the provision of lending below the BPLR to a customer by banks if the loan amount is not less than Rs. 2 lakh has been withdrawn. It is expected that the above **deregulation** of lending rate will increase the credit flow to small borrowers at reasonable rate and direct bank finance will provide effective competition to other forms of high cost credit. For export credit, RBI announces the floor rate, separately. Banks are required to review the base rate at least once in a quarter and publish the same for the general public.

C & M Policy – New Initiatives

The last Bi-monthly Credit & Monetary Policy of the RBI was announced on February 3, 2015—as per which the rates and ratios stans as follows:

Policy Rates: Bank Rate 8.5 per cent; Repo Rate 7.5 per cent; Reverse Repo Rate 6.5 per cent and MSF Rate 8.5 per cent.

Reserve Ratios: CRR 4 per cent and SLR 21.5 per cent.

Lenidng /Deposit Rates: Base Rate from 10.00–10.25 per cent; Saving Deposit Rate 4.0 per cent (relates to 5 major banks) and Term Deposit Rate from 8.00–8.75 per cent.

The RBI has started some **new things** in the C & M Policy, in recent times—major ones are as given below:

- Transition to a *bi-monthly* monetary policy cycle.
- Recognition of the *glide path for disinflation* – the recommendation of *Urjit R. Patel Committee* report have been implemented, including adoption of the new **CPI-C** as the key measure of inflation.
- A *Monetary Policy Framework* has been put in place—an agreement in this regard was signed between the GoI and the RBI late February 2015. Under the framework, the RBI is to *'target inflation'* at 4 per cent with a variations of 2 per cent. It means, the 'range of inflation' to be between 2 to 6 per cent.
- Progressive *reduction* in access to overnight liquidity at the fixed repo rate, and *increase* in access to liquidity through term repos (the liquidity provided under 7-day and 14-day term repos have been *increased* from 0.5 per cent of the banking system to 0.75 per cent, and the liquidity provided under overnight repos has been *decreased* from 0.5 per cent to 0.25 per cent (done in pursuance of the Urjit R. Patel Committee's recommendations). This aims to improve the transmission of policy impulses across the interest rate spectrum.
- Introduction of longer-tenor *term repos* as well as *term reverse repos*.

REVISED LMF

In August 2014, the RBI announced a revised Liquidity Management Framework (LMF) as a way to check volatility in the inter-bank call money markets, where banks lend to each other, and also allow the lenders to manage their liquidity needs better. Major features of the LMF is as given below:

- RBI started conducting 14-day *term repurchase* auctions four times a fortnight,

up to an aggregate amount equal to 0.75 per cent of the system's deposit base or net demand and time liabilities (NDTL).

- Unlike earlier, RBI has announced a fixed schedule for these 14-day *term repo* operations, which are used by banks for their day-to-day liquidity requirements. One-fourth of the total amount of 0.75 per cent of NDTLs would be put up for auction in each of the four auctions, RBI said in a statement.
- No change in the amount that banks can access from the liquidity adjustment facility (LAF) window at fixed repo rate of the time. Banks are currently allowed to borrow up to 0.25 per cent of their deposit base or NDTL from the LAF window.
- Additionally, RBI conducts overnight variable rate repo auctions based on an assessment of liquidity in the system and government cash balances available for auction for the day.
- The LMF is aimed at reducing volatility in the call rate. Better interest signalling and medium-term stability in the loan market are other objectives of it.

NATIONALISATION AND DEVELOPMENT OF BANKING IN INDIA

The development of banking industry in India has been intertwined with the story of its nationalisation. Once the Reserve Bank of India (RBI) was nationalised in 1949 and a central banking was in place, the government considered the nationalising of selected private banks in the country due to the following ***major*** reasons:

(i) As the banks were owned and managed by the private sector the services of the banking were having a narrow reach—the masses had no access to the banking service;

(ii) The government needed to direct the resources in such a way that greater public benefit could take place;

(iii) The planned development of the economy required a certain degree of government control on the capital generated by the economy. Nationalisation of banks in India took place in the following two stages:

1. Emergence of the SBI

The Government of India, with the enactment of the *SBI Act, 1955* ***partially nationalised*** the three Imperial Banks (mainly operating in the three past Presidencies with their 466 branches) and named them the State Bank of India—the first public sector bank emerged in India. The RBI had purchased 92 per cent of the shares in this partial nationalisation.

Satisfied with the experiment, the government in a related move ***partially nationalised*** eight more private banks (with good regional presence) via *SBI (Associates) Act, 1959* and named them as the Associates of the SBI—the RBI had acquired 92 per cent stake in them as well. After merging the State Bank of Bikaner and the State Bank of Jaipur as well, the RBI came up with the state Bank of Bikaner and Jaipur. Now the SBI Group has a total number of six banks—SBI being one and five of its associates.

2. Emergence of Nationalised Banks

After successful experimentation in the partial nationalisations the government decided to go for complete nationalisation. With the help of the *Banking Nationalisation Act, 1969,* the government nationalised a total number of 20 private banks:

(i) 14 banks with deposits were more than Rs. 50 crore of nationalised in July 1969, and
(ii) 6 banks with deposits were more than Rs. 200 crore of nationalised in April 1980.

After the merger of the loss-making New Bank of India with the Punjab National Bank (PNB) in September 1993, the total number of nationalised banks came down to 19. Today, there are 27 public sector banks in India out of which 19 are nationalised (though none of the so-called nationalised banks have 100 per cent ownership of the Government of India).

After the nationalisation of banks the government *stopped* opening of banks in the private sector though some foreign private banks were allowed to operate in the country to provide the external currency loans. After India ushered in the era of the economic reforms, the government started a comprehensive banking system reform in the fiscal 1992–93. Three related developments allowed the further expansion of banking industry in the country:

(i) In 1993 the SBI was allowed access to the capital market with permission given to sell its share to the tune of 33 per cent through *SBI (Amendment) Act, 1993*.

At present the Government of India has 59.73 per cent shares in the SBI (*It was on July 9, 2007 that the entire equity stake of the RBI was taken over by the Government of India. Thus, the RBI is no more the holding bank of the SBI and its Associates.*).

On October 10, 2007 the government announced its proposal of selling the shares of the SBI and cutting down its stake in it to 53 per cent level so that the bank can go for capitalisation.

(ii) In 1994 the government allowed the nationalised banks to have access to the capital market with a ceiling of 33 per cent sale of shares through the *Banking Companies (Amendment) Act, 1994*.

Since then many nationalised banks have tapped the capital market for their capital enhancement—Indian Overseas Bank being the first in the row. Though such banks could be better called the public sector banks (as the GoI holds more than 50 per cent stake in them) they are still known as the nationalised banks.

(iii) In 1994 itself the government allowed the opening of private banks in the country. The first private bank of the reform era was the UTI Bank. Since then a few dozens Indian and foreign private banks have been opened in the country.

Thus, since 1993–94 onwards, we see a reversal of the policies governing banks in the country. As a general principle, the public sector and the nationalised banks are to be converted into private sector entities. What would be the minimum government holding in them is still a matter of debate and yet to be decided.[17] The policy of bank consolidation is still being followed by the government, so that these banks could broaden their capital base and emerge as significant players in the global banking competition.[18] Every delay in it will hamper their interests, as per the experts.

3. Emergence of the RRBs

The Regional Rural Banks (RRBs) were first set up on October 2, 1975 (only 5 in numbers) with the aim to take banking services to the doorsteps of the rural masses specially in the remote areas with

17. As per the ***Strategic Disinvestment Statement of 1999,*** the Government had decided to cut its holding in them to 26 percent. The policy was put on hold once the UPA Government came to power.
18. Y.V. Reddy, ***Lectures on Economic and Financial Sector Reforms in India,*** Oxford U. Press, N. Delhi, 2002, pp. 137–57.

no access to banking services with twin duties to fulfill:

(i) to provide credit to the weaker sections of the society at concessional rate of interest who previously depended on private money lending and

(ii) to mobilise rural savings and channelise them for supporting productive activities in the rural areas.

The GoI, the concerned state government and the sponsoring nationalised bank contribute the share capital of the RRBs in the proportion of 50 per cent, 15 per cent and 35 per cent, respectively. The area of operation of the RRB is limited to notified few districts in a state.

Following the suggestions of the *Kelkar Committee*, the government stopped opening new RRBs in 1987—by that time their total number stood at 196. Due to excessive leanings towards social banking and catering to the highly economically weaker sections, these banks started incurring huge losses by early 1980s. For restructuring and strengthening of the banks, the governments set up two committees—the *Bhandari Committee* (1994–95) and the *Basu Committee* (1995–96). Out of the total, 171 were running in losses in 1998–99 when the government took some serious decisions:

(i) The obligation of concessional loans abolished and the RRBs started charging commercial interest rates on its lendings.

(ii) The target clientele (rural masses, weaker sections) was set free now to lend to any body.

After the above-given policy changes, the RRBs started coming out of the red/losses. The CFS has recommended to get them merged with their managing nationalised or public sector banks and finally make them part of the would-be three-tier banking structure of India. At present there are 56 RRBs (after amalgamation) functioning in India even though the amalgamation process is going on *(RBI, April 2015)*.

FINANCIAL SECTOR REFORMS

The process of economic reforms initiated in 1991 had redefined the role of government in the economy—in coming times the economy will be dependent on the greater private participation for its development.[19] Such a changed view to development required an overhauling in the investment structure of the economy. Now the private sector was going to demand high investible capital out of the financial system. Thus, an emergent need was felt to restructure the whole financial system of India.

The three decades after nationalisation had seen a phenomenal expansion in the geographical coverage and financial spread of the banking system in the country. As certain weaknesses were found to have developed in the system during the late eighties, it was felt that these had to be addressed to enable the financial system to play its role ushering in a more efficient and competitive economy.[20] Accordingly, a ***high level*** committee on Financial System (CFS) was set up on August 14, 1991 to examine all aspects

19. Repeated by the GoI many times i.e. the ***New Industrial Policy 1991; the Union Budget 1992–93; Eighth Five Year Plan (1992–97) Draft Approach;*** etc.

20. Announced by the Government while setting up the M. Narasimham ***Committee on Finacial System*** on August 14, 1991. See also ***India 2001,*** Pub. Div., GoI, N. Delhi.

relating to ***structure, organisation, function*** and ***procedures*** of the financial system—based on its recommedations, a comprehensive reform of the banking system was introduced in the fiscal 1992–93.[21]

The CFS based its recommendations on certain ***assumptions*** [22] which are basic to the banking industry. And the suggestions of the committee became logical in light of this assumption, there is no second opinion about it. The assumption says that ***"the resources of the banks come from the general public and are held by the banks in trust that they are to be deployed for maximum benefit of the depositors".*** This assumption automatically implied:

(i) That even the government had no business to endanger the solvency, health and efficiency of the nationalised banks under the pretext of using banks, resources for ***economic planning, social banking, poverty alleviation,*** etc.

(ii) Besides, the government had no right to get hold of the funds of the banks at low interest rates and use them for financing its consumption expenditure (i.e., revenue and fiscal deficits) and thus defraud the depositors.

The recommendations of the CFS (**Narasimham Committee I**) were ***aimed*** at:

(i) ensuring a degree of operational ***flexibility;***

(ii) ***internal autonomy*** for public sector banks (PSBs) in their decision making process; and

(iii) greater degree of ***professionalism*** in banking operation.

Recommendation of CFS

The CFS recommondation[23] could be summed up under five sub-titles:

1. On Directed Investment

The RBI was advised not to use the CRR as a principal instrument of monetary and credit control, in place it should rely on open market operations (OMOs) increasingly. Two proposals advised regarding the CRR:

(i) CRR should be progressively reduced from the present high level of 15 per cent to 3 to 5 per cent; and

(ii) RBI should pay interest on the CRR of banks above the basic minimum at a rate of interest equal to the level of banks, one year deposit.

Concerning the SLR it was advised to cut it to the minimum level (i.e., 25 per cent) from the present high level of 38.5 per cent in the next 5 years (it was cut down to 25 per cent in October 1997). The government was also suggested to progressively move towards market-based borrowing programme so that banks get economic benefits on their SLR investments.

These suggestions were directed to the goal of making more funds available to the banks, converting idle cash for use, and cutting down the interest rates banks charge on their loans.

2. On Directed Credit Programme

Under this sub-title the suggestions revolved around the compulsion of priority sector lending (PSL) by the banks:

(i) Directed credit programme should be phased out gradually. As per the

21. The Narasimham Committee handed over its report in record time within 3 months after it was set up.
22. *CFS,* op. cit.
23. Ibid.

committee, agriculture and small scale industries (SSIs) had already grown to a mature stage and they did not require any special support; two decades of interest subsidy were enough. Therefore, concessional rates of interest could be dispensed with.

(ii) Directed credit should not be a regular programme—it should be a case of extraordinary support to certain weak sections—besides, it should be temporary, not a permanent one.

(iii) Concept of PSL should be redefined to include only the weakest sections of the rural community such as marginal farmers, rural artisans, village and cottage industries, tiny sector, etc.

(iv) The "redefined PSL" should have 10 per cent fixed of the aggregate bank credit.

(v) The composition of the PSL should be reviewed after every 3 years.

3. On the Structure of Interest Rates

The major recommendations on the structure of interest rates are:

(i) Interest rates to be broadly determined by market forces;

(ii) All controls of interest rates on deposits and lending to be withdrawn;

(iii) Concessional rates of interest for PSL of small sizes to be phased out and subsidies on the IRDP loans to be withdrawn;

(iv) Bank rate to be the anchor rate and all other interest rates to be closely linked to it; and

(v) The RBI to be the sole authority to simplify the structure of interest rates.

4. On Structural Reorganisation of the Bank

For the structural reorganisation of banks some major suggestions were given:

(i) Substantial reduction in the number of the PSBs through mergers and acquisitions—to bring about greater efficiency in banking operations;

(ii) Dual control of RBI and Banking Division (of the Ministry of Finance) should go immediately and RBI to be made the primary agency for the regulation of the banking system;

(iii) The PSBs to be made free and autonomous;

(iv) The RBI to examine all the guidelines and directions issued to the banking system in the context of the independence and autonomy of the banks;

(v) Every PSB to go for a radical change in work technology and culture, so as to become competitive internally and to be at par with the wide range of innovations taking place abroad; and

(vi) Finally, the appointment of the Chief Executive of Bank (CMD) was suggested not to be on political considerations but on professionalism and integrity. An independent panel of experts was suggested which should recommend and finalise the suitable candidates for this post.

5. Asset Reconstruction Companies/Fund

To tackle the menace of the higher non-performing assets (NPAs) of banks and financial institutions, the committee suggested setting up of asset reconstruction companies/funds (taking clue from the US experience).

The committee directly blamed the Government of India (GoI) and the Ministry of Finance for the sad state of affairs of the PSBs. These banks were used and abused by the GoI, the officials, the bank employees and the trade unions, the report adds. The recommendations were revolutionary in many respects and were

opposed by the bank unions and the leftist political parties.

There were some other major suggestions of the committee which made it possible to get the following[24] things done by the government:

(i) opening of new private sector banks permitted in 1993;
(ii) prudential norms relating to income recognition, asset classification and provisioning by banks on the basis of objective criteria laid down by the RBI;
(iii) introduction of capital adequacy norms (i.e., CAR provisions) with international standard started;
(iv) simplification in the banking regulation (i.e., via board for financial supervision in 1994); etc.

BANKING SECTOR REFORMS

The government commenced a comprehensive reform process in the financial system in 1992–93 after the recommendations of the CFS in 1991. In December 1997 the government did set up another committtee on the banking sector reform under the chairmanship of M. Narasimham.[25] The objective of the committee is objectively clear by the ***terms of reference*** it was given while setting up:

"To review the progress of banking sector reforms to date and chart a programme of financial sector reforms necessary to strengthen India's financial system and make it internationally competitive"

The **Narasimham Committee-II** (popularly called by the Government of India) handed over its reports in April 1998 which included the following major suggestions:[26]

(i) Need for a stronger banking system for which mergers of the PSBs and the financial institutions (AIFIs) were suggested—stronger banks and the DFIs (development financial institutions, i.e., AIFIs) to be merged while weaker and unviable ones to be closed.
(ii) A 3-tier banking structure was suggested after mergers:
   (a) ***Tier-1*** to have 2 to 3 banks of international orientation;
   (b) ***Tier-2*** to have 8 to 10 banks of national orientation; and
   (c) ***Tier-3*** to have large number of local banks.

   The first and second tiers were to take care of the banking needs of the corporate sector in the economy.
(iii) Higher norms of Capital-to-Risk—Weighted Adequacy Ratio (CRAR) suggested—increased to 10 per cent.
(iv) Budgetary recapitalisation of the PSBs is not viable and should be abandoned.
(v) Legal framework of loan recovery should be strengthened (the government passed the *SARFAESI (Act, 2002*).
(vi) Net NPAs for all banks suggested to be cut down to below 5 per cent by 2000 and 3 per cent by 2002.
(vii) Rationalisation of branches and staffs of the PSBs suggested.
(viii) Licencing to new private banks (domestic as well as foreign) was suggested to continue with.
(ix) Banks' boards should be depoliticised under RBI supervision.

24. Based on Y.V. Reddy, 2002, op. cit.
25. ***Economic Survey 1998–99,*** MoF, GoI, N. Delhi.
26. Based on the Report of the ***Committee on Banking Sector Reforms,*** April, 1998 (Chairman: M. Narasimham).

(x) Board for financial Regulation and Supervisions (BFRS) should be set up for the whole banking, financial and the NBFCs in India.[27]

DRI

The differential rate of interest (DRI) is a lending programme launched by the government in April 1972 which makes it obligatory upon all the public sector banks in India to lend 1 per cent of the total lending of the preceding year to ***'the poorest among the poor'*** at an interest rate of 4 per cent per annum. The total lending in 2005–06 was Rs. 351 crores.

Priority Sector Lending

All Indian banks have to follow the compulsory target of priority sector lending (PSL). The priority sector in India are at present the sectors—agriculture, small and medium enterprises (SMEs), road and water transport, retail trade, small business, small housing loans (not more than Rs. 10 lakhs), software industries, self help groups (SHGs), agro-processing, small and marginal farmers, artisans, distressed urban poor and indebted non-institutional debtors besides the SCs, STs and other weaker sections of society.[28] In 2007, the RBI included five minorities—Buddhists, Christians, Muslims, Parsis and Sikhs under the PSL. In its ***new guidelines*** of March 2015, the RBI added *'medium enterprise, sanitation and renewable energy'* under it.[29] The PSL target must be met by the banks operating in India in the following way:

(i) ***Indian Banks*** need to lend 40 per cent to the priority sector every year (public sector as well as private sector banks, both) of their total lending. There is a sub-target also—18 per cent of the total lending must go to agriculture and 10 per cent of the total lending or 25 per cent of the priority sector lending (whichever be higher) must be lent out to the weaker sections. Other areas of the priority sector to be covered in the left amount, i.e., 12 per cent of the total lending.

(ii) ***Foreign Banks*** (having less than 20 branches) have to fulfil only 32 per cent PSL target which has sub-targets for the exports (12 per cent) and small and medium enterprises (10 per cent). It means they need to disburse other areas of the PSL from the remaining 10 per cent of their total lending (***lesser burden***).

The committee on financial System (CFS, 1991) had suggested to immediately cut it down to 10 per cent for all banks and completely phasing out of this policy for the betterment of the banking industry in particular and the economy in general. The committee also suggested to shuffle the sectors covered under PSL every three years. No follow up has been done from the government except cutting down PSL target for the foreign banks from 40 per cent to 32 per cent. Meanwhile some new areas have been added to the PSL.

Revision in PSL

The Reserve Bank of India (RBI) panel on priority sector lending on February 21, 2012 proposed that the target (priority sector) for foreign banks to be increased to 40 per cent of net bank credit from the current level of 32 per cent with sub-targets of 15 per cent for exports and 15 per cent for the medium and small

27. An integrated system of regulation and supervision was suggested by the Committee so that soundness of the financial system could be ensured—the concept of a financial ***super-regulator*** gets vindicated, as opines Y. V. Reddy, 2002, op. cited, p. 38.
28. ***India 2007,*** Pub. Div., GoI, N. Delhi and the further announcements by the RBI.
29. **RBI,** *New Guidelines on the PSL*, March 2, 2015.

enterprises (MSE) sector, within which 7 per cent may be earmarked for micro enterprises. The target of domestic scheduled commercial banks for lending to the priority sector to be retained at 40 per cent of net bank credit. The ***Nair Committee,*** (under the Chairmanship of M. V. Nair, Chairman, Union Bank of India), has re-examined the existing classification and suggested revised guidelines with regard to priority sector lending and related issues. Major suggestions by the committee are as given below:

(i) The committee suggested that the sector ***'agriculture and allied activities'*** may be a composite sector within the priority sector, by doing away with the distinction between *direct* and *indirect* agriculture. However, the targets for agriculture and allied activities would be at 18 per cent.

(ii) A *sub-target for* ***small*** and ***marginal farmers*** within agriculture and allied activities is recommended, equivalent to 9 per cent, which would be achieved in stages by 2015–16.

(iii) The ***MSE*** sector may continue to be under the priority sector. Within the MSE sector, a sub-target for micro enterprises is recommended, equivalent to 7 per cent, which would also be achieved in stages by 2013–14.

(iv) The loans to ***housing*** sector may continue to be under the priority sector. Loans for construction or purchase of one dwelling unit per individual up to Rs. 25 lakh; loans up to Rs. 2 lakh in rural and semi-urban areas and up to Rs. 5 lakh in other centres for repair of damaged dwelling units may be granted under the priority sector.

(v) To encourage construction of dwelling units for economically weaker sections and low income groups, housing loans granted to these individuals may be included in the weaker sections category.

(vi) All loans to ***women*** under the priority sector may also be counted under loans to weaker sections.

(vii) The loans to ***education*** sector may continue to be under the priority sector. The limit under the priority sector for loans for studies in India may be increased to Rs. 15 lakh and Rs. 25 lakh in case of studies abroad, from the existing limit of Rs. 10 lakh and Rs. 20 lakh, respectively.

(viii) The committee has also recommended allowing non-tradable priority sector lending certificates on a pilot basis with domestic scheduled commercial banks, foreign banks and regional rural banks as market players.

NON-PERFORMING ASSETS

Non-Performing Assets (NPAs) are the *bad loans* of the banks. The criteria to identify such assets have been changing over the time. In order to follow international best practices and to ensure greater transparency, the RBI shifted to the current policy in 2004. Under it, a loan is considered NPA if it has not been serviced for ***one term*** (i.e., 90 days). This is known as *'90 day' overdue norm*. For agriculture loans the period is tied with the period of the concerned crops—ranging from two crop seasons to one year overdue norm.[30]

NPAs were classified into three types:

(a) Sub-standard: remaining NPAs for less than or equal to 18 months;

30. **Reserve Bank of India,** *'Master Circular - Income Recognition, Asset Classification, Provisioning and Other Related Matters'*, July, 2013.

(b) **Doubtful:** remaining NPAs for more than 18 months; and

(c) **Loss assets:** where the loss has been identified by the bank or internal/external auditors or the RBI inspection but the amount has not been written off.

CURRENT SCENARIO

Asset quality of the ublic sector banks (PSBs) has come under stress in recent times. As per the RBI's *Financial Stability Report-December 2014*, the situation of was—

- The gross non-performing assets (GNPAs) of scheduled commercial banks as a percentage of the total gross advances increased to **4.5** per cent in September 2014 from 4.1 per cent in March 2014.
- Stressed advances increased to 10.7 per cent of the total advances from 10.0 per cent between March and September 2014.
- Five sub-sectors—infrastructure, iron & steel, textiles, mining (including coal), and aviation—hold **54** per cent of total stressed advances of PSBs as on June 2014.
- Among bank groups, exposure of PSBs to infrastructure stood at 17.5 per cent of their gross advances as of September 2014. This was significantly higher than that of private-sector banks (9.6 per cent) and foreign banks (12.1 per cent).
- The PSBs continue to be under stress on account of their past lending. Taking GNPAs and restructured advances together, the stress on PSBs is 12.57 per cent of total advances as on September 2014.

As per the *Economic Survey 2014–15,* the stress tests suggest that the asset quality of banks may improve in the near future under expected positive developments in the macroeconomic environment and banks may be able to meet expected losses with their existing level of provisions.

The main ***reasons*** for increase in NPAs, in recent times, are as given below (*Economic Survey 2013–14 & 2014–15*):

(i) Switchover to system-based identification of NPAs;

(ii) Current macroeconomic situation in the country;

(iii) Increased interest rates in the recent past;

(iv) Lower economic growth; and

(v) Aggressive lending by banks in the past, especially during good times.

The RBI came out with a **new guidelines**[31] to resolve the NPA issue by ealry 2014. The steps taken under it are :

(a) Banks have to start acting as soon as a sign of stress is noticed in a borrower's actions and not wait for it to become an NPA. Banks to carve out as special category of assets termed special mention accounts (SMAs) in which *early signs* of stress are visible.

(b) Flexibility brought in project loans to infrastructure and core industry projects, both existing and new.

(c) *Non-cooperative* borrowers in NPAs resolution will have to pay higher interest for any future borrowing. Banks will also be required to make higher provisions for further loans extended to borrowers who are considered to be 'non-cooperative'.

31. **RBI**, *Early Recognition of Financial Distress, Prompt steps for Resolution and Fair Recovery for Lenders: Framework for Revitalizing Distressed Assets in the Economy*, January 2014.

(d) Towards strengthening recovery from *non-cooperative borrowers*, the norms for asset reconstruction companies (ARC) have been tightened, whereby the minimum investment in security receipts should be 15 per cent, as against the earlier norm of 5 per cent.

(e) Independent evaluation of large-value restructuring (above Rs. 500 crore) made mandatory.

(f) If a borrower's interest or principal payments are overdue by more than 60 days, a *Joint Lenders' Forum* to be formed by the bankers for early resolution of stress.

(g) The RBI has set up a central repository of information on large credits to collect, store and disseminate credit data to lenders. For this, banks need to furnish credit information on all their borrowers with an exposure of Rs.5 crore and above.

(h) Incentives to banks to quickly and collectively agree to a resolution plan.

SARFAESI Act, 2002

GoI finally cracked down on the **wilful defaulters** by passing the *Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002.*

The Act gives far reaching powers to the banks/FIs concering NPAs:

1. Banks/FIs having 75 per cent of the dues owed by the borrower can collectively proceed on the following in the event of the account becoming NPA:

(A) Issue notice of default to borrowers asking to clear dues within 60 days.

(B) On the borrower's failure to repay:

(i) Take possession of security and/or

(ii) take over the management of the borrowing concern and/or

(iii) appoint a person to manage the concern.

(C) If the case is already before the BIFR, the proceedings can be stalled if banks/FIs having 75 per cent share in the dues have taken any steps to recover the dues under the provisions of the ordinance.

2. The banks/FIs can also sell the security to a securitisation or Asset Reconstruction Company (ARC), established under the provisions of the Ordinance. [The ARC is sought to be set up on the lines similar to the USA, few years ago.]

Debt Recovery Tribunals (DRTs)

Earlier, the government had set up Debt Recovery Tribunals (DRTs) in 1993 which failed to bring about the desired change in the scenario due to:[32]

(i) DRTs are also clogged up with many cases and the judgement takes time (many months, if not years):

(ii) The sale of property can be made only through court appointed officials, adding delays;

(iii) The tribunals cannot take up the medium- or large-sized firms if they are under consideration of the BIFR due to sickness.

The praiseworthy step regarding recovery of the NPAs and allowing the setting up of the Asset Reconstruction Companies (ARCs) had an impact. Improved industrial climate and new options available to banks for dealing with bad loans helped in recovering a substantial amount of

32. ***Economic Survey 2001-02*** & ***India 2002,*** Pub. Div., GoI, N. Delhi.

NPAs. The NPAs of scheduled commercial banks (SCBs) were at 2.3 per cent of total assets as on end December 2011.[33]

WILLFUL DEFAULTER

There are many people and entities who borrow money from lending institutions but fail to repay. However, not all of them are called wilful defaulters. As is embedded in the name, a wilful defaulter is one who does not repay a loan or liability, but apart from this there are other things that define a wilful defaulter. According to the RBI, a wilful defaulter is one who—

(i) is financially capable to repay and yet does not do so;

(ii) or one who diverts the funds for purposes other than what the fund was availed for;

(iii) or with whom funds are not available in the form of assets as funds have been siphoned off;

(iv) or who has sold or disposed the property that was used as a security to obtain the loan.

Diversion of fund includes activities such as using short-term working capital for long-term purposes, acquiring assets for which the loan was not meant for and transferring funds to other entities. *Siphoning of funds* means that funds were used for purposes that were not related to the borrower and which could affect the financial health of the entity.

However, a lending institution cannot term an entity or an individual a wilful defaulter for a one-off case of default and needs to take into account the repayment track record. The default should be established to be intentional and the defaulter should be informed about the same. The defaulter should also be given a chance to clarify his stand on the issue. Also, the default amount needs to be at least Rs.25 lakh to be included in the category of wilful defaults.

If an entity's or individual's name figures in the list of wilful defaulters, the following restrictions get in action on them—

(a) Barred from participating in the capital market.

(b) Barred from availing any further banking facilities and to access financial institutions for five years for the purpose of starting a new venture.

(c) The lenders can initiate the process of recovery with full vigour and can even initiate criminal proceedings, if required.

(d) The lending institutions may not allow any person related to the defaulting company to become a board member of any other company as well.

CAPITAL ADEQUACY RATIO

At first sight bank is a business or industry a segment of the service sector in any economy. But the failure of a bank may have far greater damaging impact on an economy than any other kind of business or commercial activity. Basically, modern economies are heavily dependent on banks today than in the past—banks are today called the backbone of economies. Healthy functioning of banks is today essential for the proper functioning of an economy. As credit creation (***i.e., loan disbursals***) of banks are highly risky business, the depositors' money depends on the banks' quality of lending. More importantly, the whole payment system, public as well as private, depends on banks. A bank's failure has the potential of creating chaos in an economy. This is why governments of the world pay special attention to the regulatory aspects of the banks. Every regulatory provision for banks tries to achieve a simple equation, i.e.,

33. ***Economic Survey 2011–12,*** MoF, GoI, N. Delhi.

"how the banks should maximise their credit creation by minimising the risk and continue functioning permanently". In the banking business risks are always there and cannot be made 'zero'—as any loan forwarded to any individual or firm (irrespective of their credit-worthiness) has the risk of turning out to be a bad debt (***i.e., NPA in India***)—the probability of this being 50 per cent. But banks must function so that economies can function. Finally, the central banks of the world started devising tools to minimise the risks of banking at *one hand* and providing cushions (shock-absorbers) to the banks at the *other hand* so that banks do not go bust (i.e., shut down after becoming bankrupt). Providing cushion/shock-absorbers to banks has seen three major developments:[34]

(i) The provision of keeping a ***cash ratio*** of total deposits mobilised by the banks (known as the CRR in India);

(ii) the provision of maintaining some assets of the deposits mobilised by the banks with the banks themselves in ***non-cash form*** (known as the SLR in India); and

(iii) The provision of the capital adequacy ratio (CAR) norm.

The capital adequacy ratio (CAR) norm has been the last provision to emerge in the area of regulating the banks in such a way that they can sustain the probable risks and uncertainties of lending. It was in 1988 that the central banking bodies of the developed economies agreed upon such a provision, the CAR—also known as the **Basel Accord.**[35] The accord was agreed upon at Basel, Switzerland at a meeting of the Bank for International Settlements (BIS).[36] It was at this time that the **Basel-I** norms of the capital adequacy ratio were agreed upon—a requirement was imposed upon the banks to maintain a certain amount of free capital (***i.e., ratio***) to their ***assets***[37] (i.e., loans and investments by the banks) as a cushion against probable losses in investments and loans. In 1988, this ratio capital was decided to be 8 per cent. It means that if the total investments and loans forwarded by a bank amounts to Rs. 100, the bank needs to maintain a ***free capital***[38] of Rs. 8 at that particular time. ***The capital adequacy ratio is the percentage of total capital to the total risk—weighted assets*** (see reference 39).

CAR, a measure of a bank's capital, is expressed as a percentage of a bank's risk weighted credit exposures:

CAR= Total of the Tier 1 & Tier 2 capitals ÷ Risk Weighted Assets

Also known as 'Capital to Risk Weighted Assets Ratio (CRAR)' this ratio is used to protect depositors and promote the stability and efficiency of financial systems around the world. Two types of capital were measured as per the **Basel II** norms

34. Through various legislations since the ***RBI Nationalisation Act, 1949*** and the ***Banking Regulation Act, 1949*** were enacted – and further ***Amendments*** to the Acts, MoF, GoI, New Delhi.

35. Simon Cox (ed.), ***Economics,*** The Economist, 2007, op. cit., p. 145.

36. The ***BIS*** is today a central bank for central bankers set up in 1930 in a round tower near Basel railway station in Switzerland as a private company owned by a number of central banks, one commercial bank (Citibank) and some private individuals. Today it functions as a meeting place for the bank regulators of many countries, a multilateral regulatory authority and a ***clearing house*** for many nations' ***reserves*** (i.e. foreign exchange). See ***Tim Hindle,*** Pocket Finance, The Economist, 2007, pp. 35–36.

37. Investments made and loans forwarded by banks are known as risky assets.

38. The capital of a bank was classified into Tier-I and Tier-II. While Tier-I comprises share capital and disclosed reserves, Tier-II includes revaluation reserves, hybrid capital and subordinated debt of a bank. As per the provision Tier-II capital should not exceed the Tier I capital. The risk-weighting depends upon the type of assets—for example it is 100 per cent on private sector loans while only 20 per cent for short-term loans.

– *Tier 1* capital, which can absorb losses without a bank being required to cease trading, and *Tier 2* capital, which can absorb losses in the event of a winding-up and so provides a lesser degree of protection to depositors. The new norms (**Basel III**) has devised a third category of capital, i.e., *Tier 3* capital.

The RBI introduced the ***capital-to-risk weighted assets ratio*** (CRAR) system for the banks operating in India in 1992 in accordance with the standards of the BIS—as part of the financial sector reforms.[39] In the coming years the Basel norms were extended to term-lending institutions, primary dealers and non-banking financial companies (NBFCs), too. Meanwhile the BIS came up with another set of CAR norms, popularly known as **Basel-II**. The RBI guidelines regarding the CAR norms in India have been as given below:

(i) **Basel-I** norm of the CAR was to be achieved by the Indian banks by March 1997.

(ii) The CAR norm was raised to 9 per cent with effect from March 31, 2000 (*Narasimham Committee-II had recommended to raise it to 10 per cent in 1998*).[40]

(iii) Foreign banks as well as Indian banks with foreign presence to follow ***Basel-II norms,*** w.e.f. March 31, 2008 while other scheduled commercial banks to follow it not later than March 31, 2009. The Basel-II norm for the CAR is 12 per cent.[41]

Why to Maintain CAR?

The basic question which comes to mind is as to why do the banks need to hold capital in the form of CAR norms? ***Two* reasons**[42] have been generally forwarded for the same:

(i) Bank capital helps to prevent bank failure, which arises in case the bank cannot satisfy its obligations to pay the depositors and other creditors. The low capital bank has a negative net worth after the loss in its business. In other words, it turns into insolvent capital, therefore, acts as a cushion to lessen the chance of the bank turning insolvent.

(ii) The amount of capital affects returns for the owners (equity holders) of the bank.

Basel Accords

The Basel Accords (i.e., Basel I, II and now III) are a set of agreements set by the Basel Committee on Bank Supervision (BCBS), which provides recommendations on banking regulations in regards to capital risk, market risk and operational risk. The purpose of the accords is to ensure that financial institutions have enough capital on account to meet obligations and absorb unexpected losses. They are of paramount importance to the banking world and are presently implemented by over 100 countries across the world. The BIS Accords were the outcome of a long-drawn-out initiative to strive for greater international uniformity in prudential capital standards for banks' credit risk. The objectives of the accords could be summed up[43] as:

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39. The RBI is a member of the Board of the BIS. The financial sector reforms commenced in India in the fiscal 1992–93 after the report submitted by the Narasimham Committee on Financial system (CFS).
40. ***Committee on Banking Sector Reforms*** (M Narasimhan Committee-II), MoF, GoI, New Delhi, April 1998.
41. ***Economic Survey 2006–07,*** MoF, GoI, N. Delhi.
42. D. M. Nachane, Partha Ray and Saibal Ghosh, ***India Development Report 2004–05,*** Oxford University Press, N. Delhi, 2005, p. 171.
43. ***IDR 2004-05,*** op. cit., p. 172.

(i) to strengthen the international banking system;
(ii) to promote convergence of national capital standards; and
(iii) to iron out competitive inequalities among banks across countries of the world.

The Basel Capital Adequacy Risk-related Ratio Agreement of 1988 (**i.e., Basel I**) was not a legal document. It was designed to apply to internationally active banks of member countries of the Basel Committee on Banking Supervision (BCBS) of the BIS at Basel, Switzerland. But the details of its implementation were left to national discretion. This is why Basel I looked G10-centric.[44]

The first Basel Accord, known as **Basel I** focuses on the capital adequacy of financial institutions. The capital adequacy risk (the risk a financial institution faces due to an unexpected loss), categorises the assets of financial institution into five risk categories (0 per cent, 10 per cent, 20 per cent, 50 per cent, 100 per cent). Banks that operate internationally are required to have a risk weight of 8 per cent or less.

The second Basel Accord, known as **Basel II**, is to be fully implemented by 2015. It focuses on three main areas, including minimum capital requirements, supervisory review and market discipline, which are known as the *three pillars*. The focus of this accord is to strengthen international banking requirements as well as to supervise and enforce these requirements.

The third Basel Accord, known as **Basel III** is a comprehensive set of reform measures aimed to strengthen the regulation, supervision and risk management of the banking sector. These measures aim[45] to:

(i) improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source be;
(ii) improve risk management and governance; and
(iii) strengthen banks' transparency and disclosures.

The capital of the banks has been classified into ***three tiers*** as given below:

Tier 1 Capital: A term used to describe the capital adequacy of a bank—it can absorb losses without a bank being required to cease trading. This is the **core measure** of a bank's financial strength from a regulator's point of view (this is the *most reliable* form of capital). It consists of the types of financial capital considered the most reliable and liquid, primarily stockholders' equity and disclosed reserves of the bank—equity capital can't be redeemed at the option of the holder and disclosed reserves are the liquid assets available with the bank itself.

Tier 2 Capital: A term used to describe the capital adequacy of a bank—it can absorb losses in the event of a winding-up and so provides a lesser degree of protection to depositors. Tier II capital is secondary bank capital (the *second most reliable* forms of capital). This is related to Tier 1 Capital. This capital is a measure of a bank's financial strength from a regulator's point of view. It consists of accumulated after-tax surplus of retained earnings, revaluation reserves of fixed assets and long-term holdings of equity securities, general loan-loss reserves, hybrid (debt/equity) capital instruments, and subordinated debt and undisclosed reserves.

Tier 3 Capital: A term used to describe the capital adequacy of a bank—considered the

44. G-10 comprises Belgium, Canada, France, Germany, Italy, Japan, The Netherlands, Sweden, UK, and USA; later the group incorporated Luxembourg, Switzerland and recently Spain in its fold.
45. ***Bank of International Settlemets,*** Basel, Switzerland, May 15, 2012.

tertiary capital of the banks which are used to meet/support market risk, commodities risk and foreign currency risk. It includes a variety of debt other than Tier 1 and Tier 2 capitals. Tier 3 capital debts may include a greater number of subordinated issues, undisclosed reserves and general loss reserves compared to Tier 2 capital. To qualify as Tier 3 capital, assets must be limited to 250 per cent of a bank's Tier 1 capital, be unsecured, subordinated[46] and have a minimum maturity of two years.

Disclosed Reserves are the total liquid cash and the SLR assets of the banks that may be used any time. This way they are part of its *core capital* (Tier 1). *Undisclosed Reserves* are the unpublished or hidden reserves of a financial institution that may not appear on publicly available documents such as a balance sheet, but are nonetheless real assets, which are accepted as such by most banking institutions but cannot be used at will by the bank. That is why they are part of its *secondary capital* (Tier 2).

Basel III Provisions[47]

The new provisions have defined the capital of the banks in different way. They consider common equity and retained earnings as the predominant component of capital (as the past) but they restrict inclusion of items such as deferred tax assets, mortgage-servicing rights and investments in financial institutions to no more than 15 pen cent of the common equity component. These rules aim to improve the *quantity* and *quality* of the capital.

While the key capital ratio has been raised to 7 per cent of risky assets, according to the new norms, Tier-I capital that includes common equity and perpetual preferred stock will be raised from 2 to 4.5 per cent starting in phases from January 2013 to be completed by January 2015. In addition, banks will have to set aside another 2.5 per cent as a *contingency* for future stress. Banks that fail to meet the buffer would be unable to pay dividends, though they will not be forced to raise cash.

The new norms are based on renewed focus of central bankers on 'macro-prudential stability'. The global financial crisis following the crisis in the US sub-prime market has prompted this change in approach. The previous set of guidelines, popularly known as *Basel II* focused on 'macro-prudential regulation'. In other words, global regulators are now focusing on financial stability of the system as a whole rather than micro regulation of any individual bank.

Banks in the West, which are market leaders for the most part, face low growth, an erosion in capital due to sovereign debt exposures and stiffer regulation. They will have to reckon with a permanent decline in their returns on equity thanks to enhanced capital requirements under the new norms. In contrast, Indian banks—and those in other emerging markets such as China and Brazil—are well-placed to maintain their returns on capital consequent to Basel III. Financial experts have opined that Basel III looks changing the economic landscape in which banking power shifts towards the emerging markets.

BASEL III COMPLIANCE OF THE PSBs & RRBs

The capital to risk weighted assets ratio (CRAR) of the scheduled commercial banks of India was 13.02 per cent by March 2014 (Basel-III) falling to 12.75 per cent by September 2014. The

46. Subordinated debt ranks below other debts with regard to claims on assets or earnings (also known as a 'junior debt'). In the case of default, such creditors get paid out until after the senior debtholders were paid in full. Thus, such capitals of banks are more risky than unsubordinated debt.

47. ***Reserve Bank of India,*** MoF, GoI, New Delhi, May 5, 2012.

regulatory requirement for CRAR is **9** per cent for 2015. The decline in capital positions at aggregate level, however, was on account of deterioration in capital positions of PSBs. While the CRAR of the scheduled commercial banks (SCB) at 12.75 per cent as of September 2014 was satisfactory, going forward the banking sector, particularly PSBs will require substantial capital to meet regulatory requirements with respect to additional capital buffers.

In order to make the PSBs and RRBs compliant to the *Basel III* norms,[48] the government has been following a recapitalisation programme for them since 2011–12. A *High Level Committee* on the issue was also set up by the government which has suggested the idea of 'non-operating holding company' (HoldCo) under a special Act of Parliament (action is yet to come regarding this).

Meanwhile, the government has infused ***three tranches*** of capital into the banks (infused funds go to the RRBs, too through the PSBs under whom they fall) upto March 2015:

(i) Rs. 12,000 crore infused during 2011–12 in seven PSBs.

(ii) Rs. 12,517 crore infused in 2012–13 in 8 PSBs.

(iii) Rs.6,990 crore infused in **nine** PSBs by February 2015. But this capital infusion is based on a new criteria—efficiency parameters such as return on assets and return on equity. Efficient banks are rewarded with extra capital for their equity so that they can further strengthen their position.

In **March 2015**, the GoI specified its intention to bring down its stake in state run banks to 52 per cent to give them more avenues to raise funds, most banks are expected to approach the market to raise capital only next fiscal once the share market get some synergy.

STOCK OF MONEY

In every economy it is necessary for the central bank to know the stock (amount/level) of money available in the economy only then it can go for suitable kind of credit and monetary policy. Saying simply, credit and monetary policy of an economy is all about changing the level of the money flowing in the economic system. But it can be done only when we know the real flow of money. That's why it is necessary to first assess the level of money flowing in the economy.

Following the recommendations of the *Second Working Group on Money Supply (SWG)* in 1977, RBI has been publishing four *monetary aggregates* (component of money)– M_1, M_2, M_3 and M_4 (are basically short terms for Money-1, Money-2, Money-3 and Money-4) besides the Reserve Money. These components used to contain money of differing liquidities:

M_1 = Currency & coins with people + Demand deposits of Banks (Current & Saving Accounts) + Other deposits of the RBI.

M_2 = M_1+ Demand deposits of the post offices (i.e., saving schemes' money).

M_3 = M_1+ Time/Term deposits of the Banks (i.e., the money lying in the Recurring Deposits & the fixed Deposits).

48. **Basel III** norms prescribe a minimum regulatory capital of 10.5 per cent for banks by January 1, 2019. This includes a minimum of 6 per cent ***Tier I*** capital, plus a minimum of 2 per cent ***Tier II*** capital, and a 2.5 per cent capital conservation buffer. For this buffer, banks are expected to set aside profits made during good times so that it can be drawn upon during periods of stress.

M_4 = M_3 + total deposits of the post offices (both, Demand and Term/Time Deposits).

Now the RBI has started[49] publishing a set of new monetary aggregates following the recommendations of the *Working Group on Money Supply: Analytics and Methodology of Compilation* (Chairman, Dr. Y. V. Reddy) which submitted its report in June 1998. The Working Group recommended compilation of four monetary aggregates on the basis of the balance sheet of the banking sector in conformity with the norms of progressive liquidity: M_0 (monetary base), M_1 (narrow money), M_2 and M_3 (broad money). In addition to the monetary aggregates, the Working Group had recommended compilation of three liquidity aggregates namely, L_1, L_2 and L_3, which include select items of financial liabilities of non-depository financial corporations such as development financial institutions and non-banking financial companies accepting deposits from the public, apart from post office savings banks. The **New Monetary Aggregates** are as given below:

Reserve Money (M_0) = Currency in circulation + Bankers' Deposits with the RBI + 'Other'[50] deposits with the RBI.

Narrow Money (M_1) = Currency with the Public + Demand Deposits with the Banking System + 'Other' deposits with the RBI.

M_2=M_1 + Savings Deposits of Post-office Savings Banks.

Broad Money (M_3) = M_1 + Time Deposits with the Banking System.

M_4 = M_3 + All deposits with Post Office Savings Banks (excluding National Savings Certificates).

While the Working Group did not recommend any change in the definition of reserve money and M_1, it proposed a new *intermediate monetary aggregate* to be referred to as **NM_2** comprising currency and residents' short-term bank deposits with contractual maturity up to and including one year, which would stand in between narrow money (which includes only the non-interest-bearing monetary liabilities of the banking sector) and broad money (an all-encompassing measure that includes long-term time deposits). The new broad money aggregate (referred to as **NM_3** for the purpose of clarity) in the Monetary Survey would comprise, in addition to NM_2, long-term deposits of residents as well as call/term borrowings from non-bank sources, which have emerged as an important source of resource mobilisation for banks. The critical *difference* between M_3 and NM_3 is the treatment of non-resident repatriable fixed foreign currency liabilities of the banking system in the money supply compilation.

There are **two basic changes** in the new monetary aggregates. *First,* since the post office bank is not a part of the banking sector, ***postal deposits*** are no longer treated as part of money supply, as was the case in the extant M_2 and M_4. *Second,* the residency criterion was adopted to a limited extent for compilation of monetary aggregates. The Working Group made a recommendation in favour of compilation of monetary aggregates on residency basis. Residency essentially relates to the country in which the holder has a centre of economic interest. Holdings of currency

49. The working group was set up in December 1997 under the chairmanship of Y. V. Reddy (the then Deputy Governor, RBI) which submitted its report in June 1998.
50. 'Other' deposits with RBI comprise mainly: (i) deposits of quasi-government; other financial institutions including primary dealers, (ii) balances in the accounts of foreign Central Banks and Governments, and (iii) accounts of international agencies such as the International Monetary Fund.

and deposits by the non-residents in the rest of the world sector, would be determined by their portfolio choice. However, these transactions form part of balance of payments (BoP). Such holdings of currency and deposits are not strictly related to the domestic demand for monetary assets. It is therefore argued that these transactions should be regarded as external liabilities to be netted from foreign currency assets of the banking system. However, in the context of developing countries such as India, which have a large number of expatriate workers who remit their savings in the form of deposits, it could be argued that these non-residents have a centre of economic interest in their country of origin. Although in a macro-economic accounting framework all non-resident deposits need to be separated from domestic deposits and treated as capital flows, the underlying economic reality may point otherwise. In the Indian context, it may not be appropriate to exclude all categories of non-resident deposits from domestic monetary aggregates as non-resident rupee deposits are essentially integrated into the domestic financial system. The new monetary aggregates, therefore, exclude only non-resident repatriable foreign currency fixed deposits from deposit liabilities and treat those as external liabilities. Accordingly, from among the various categories of non-resident deposits at present, only Foreign Currency Non-Resident Accounts (Banks) [FCNR(B)] deposits are classified as external liabilities and excluded from the domestic money stock. Since the bulk of the FCNR(B) deposits are held abroad by commercial banks, the monetary impact of changes in such deposits is captured through changes in net foreign exchange assets of the commercial banks. Thus, now the new monetary aggregates NM_2 and NM_3 as well as liquidity aggregates L_1, L_2, and L3 have been introduced, the components of which are elaborated as follows:

NM_1 = Currency with the Public + Demand Deposits with the Banking System + 'Other' Deposits with the RBI.

NM_2 = NM_1 + Short Term Time Deposits of Residents (including the contractual maturity of one year).

NM_3=NM_2 + Long-term Time Deposits of Residents + Call/Term Funding from Financial Institutions.

L_1 = NM_3 + All Deposits with the Post Office Savings Banks (excluding National Savings Certificates)

L_2 = L_1 + Term deposits with Term Lending Institutions and Refinancing Institutions (FIs) + Term Borrowing by FIs + Certificates of Deposit issued by FIs

L_3 = L_2 + Public Deposits of Non-Banking Financial Companies.

Data on M_0 are published by the RBI on *weekly* basis, while those for M_1 and M_3 are available on *fortnightly* basis. Among liquidity aggregates, data on L_1 and L_2 are published *monthly,* while those for L_3 are disseminated *quarterly*. The working group advised for the quarterly publication of **Financial Sector Survey** to capture the dynamic linkages between banks and rest of the organised financial sector.

LIQUIDITY OF MONEY

As we move from M_1 to M_4 the liquidity (inertia, stability, spendability) of the money goes on decreasing and in the opposite direction, the liquidity increases.

NARROW MONEY

In banking terminology, M_1 is called narrow money as it is highly liquid and banks cannot run their lending programmes with this money.

BROAD MONEY

The money component M_3 is called broad money in the banking terminology. with this money (which lies with banks for a known period) banks run their lending programmes.

MONEY SUPPLY

In general discussion we usually use money supply to mean money circulation, money flow in the economy. But in banking and typical monetary management terminology the level and supply of M_3 is known as money supply. The growth rate of broad money (M_3), i.e., *money supply*, was not only lower than the indicative growth set by the Reserve Bank of India but it also witnessed continuous and sequential deceleration in the last 7 quarters and moderated to 11.2 per cent by December 2012. Aggregate deposits with the banks were the major component of broad money counting for over 85 per cent remaining almost stable. The sources of broad money are net bank credit to the government and to the commercial sector. These two together accounted for nearly 100 per cent of the broad money in 2012–13, compared to 89 percent in 2009–10.

MINIMUM RESERVE

The RBI is required to maintain a reserve equivalent of Rs. 200 crores in gold and foreign currency with itself, of which Rs. 115 crores should be in gold. Against this reserve, the RBI is empowered to issue currency to any extent. This is being followed since 1957 and is known as the Minimum Reserve System (MRS).

RESERVE MONEY

The gross amount of the following six segments of money at any point of time is known as Reserve Money (RM) for the economy or the government:

(i) RBI's net credit to the Government;
(ii) RBI's net credit to the Banks;
(iii) RBI's net credit to the commercial banks;
(iv) net forex reserve with the RBI;
(v) government's currency liabilities to the public;
(vi) net non-monetary liabilities of the RBI.

RM = 1 + 2 + 3 + 4 + 5 + 6

As per the *Economic Survey 2014–15,* the rate of growth of reserve money comprising currency in circulation and deposits with the RBI (bankers and others) decelerated from an average of 17.8 per cent in 2014–15 to 4.3 per cent in 2013–14. Almost the entire increase in the reserve money of Rs. 3.258 billion between the period consisted of increase in *currency in circulation*. As sources of reserve money, net RBI credit to the government and increase in net financial assets of the RBI contributed to the growth of *base money*.

MONEY MULTIPLIER

At end March 2012, the *money multiplier* (ratio of M_3 to M_0) was 5.2, higher than end-March 2015, due to cumulative 125 basis point reduction in CRR. During 2012–13, the money multiplier generally stayed high reflecting again, the CRR cuts. As on **December 31, 2014**, the money multiplier was 5.5 compared with 5.2 on the corresponding date of the previous year *(Economic Survey 2014–15)*.

CREDIT COUNSELLING

Advising borrowers to overcome their debt burden and improve money management skills is credit counselling. The first such well-known agency was created in the USA when credit granters created National Foundation for Credit Counselling (NFCC) in 1951.[51]

India's sovereign debt is usually rated by six

51. Y. V. Reddy, the RBI Gonvernor, ***The Economic Times,*** N. Delhi, September 11, 2006.

major sovereign credit rating agencies (SCRAs) of the world which are :

(i) Fitch Ratings,
(ii) Moody's Investors Service,
(iii) Standard and Poor's (S&P),
(iv) Dominion Bond Rating Service (DBRS),
(v) Japanese Credit Rating Agency (JCRA), and
(vi) Rating and Investment Information Inc., Tokyo (R&I).

As on *January 15, 2013* most of these rating agencies have put India under 'stable' category in foreign and local currencies barring Fitch and S&P which have put its foreign currency in 'negative' category. The government is taking a number of steps to improve its interaction with the major SCRAs so that they make informed decisions as the *Economic Survey 2012–13* says.

CREDIT RATING

To assess the credit worthiness (credit record, integrity, capability) of a prospective (would be) borrower to meet debt obligations is credit rating. Today it is done in the cases of individuals, companies and even countries. There are some world-renowned agencies such as the Moody's, S & P. The concept was first introduced by **John Moody** in the USA (1909). Usually equity share is not rated here. Primarily, ratings are an investor service.

Credit rating was introduced in India is 1988 by the ICICI and UTI, jointly. The major credit rating agencies of India are:

(i) *CRISIL* (Credit Rating Information of India Ltd.) was jointly **promoted** by ICICI and UTI with share capital coming from SBI, LIC, United India Insurance Company Ltd. to rate debt instrument—**debenture.** In April 2005 its 51 per cent equity was acquired by the US credit rating agency S & P—a McGraw Hill Group of Companies.
(ii) *ICRA* (Investment Information and Credit Rating Agency of India Ltd.) was set up in 1991 by IFCI, LIC, SBI and select banks as well as financial institutions to rate debt instruments.
(iii) *CARE* (Credit Analyses and Research Ltd.) was set up in 1993 by IDBI, other financial institutions, nationalised banks and private sector finance companies to rate all types of debt instruments.
(iv) *ONICRA* (Onida Individual Credit Rating Agency of India Ltd.) was set up by ONIDA finance (a private sector finance company) in 1995 to rate credit-worthiness of non-corporate consumers and their debt instruments, i.e., credit cards, hire-purchase, housing finance, rental agreements and bank finance.
(v) *SMERA* (Small and Medium Enterprises Rating Agency) was set up in September 2005, to rate the overall strength of small and medium enterprises (SMEs)—the erstwhile SSIs. It is not a credit rating agency precisely, but its ratings are used for this purpose, too. A joint venture of SIDBI (the largest share-holder with 22 per cent stake), SBI, ICICI Bank, Dun & Bradstreet (an international credit information company), five public sector banks (PNB, BOB, BOI, Canara Bank, UBI with 28 per cent stake together) and CIBIL (Credit Information Bureau of India Ltd.).

A general credit rating service not linked to any debt issue is also availed by companies—already offered in India by rating agencies—CRISIL calls such ratings as **Credit Assessment.**[52] International rating agencies such as Moody's, S &

52. S. Sundararajan, ***Book of Financial Terms,*** Tata McGraw-Hill, N. Delhi, 2004, p. 44.

P also undertake sovereign ratings, i.e., of countries—highly instrumental in external borrowings of the countries.

Individuals are also covered by credit appraisal which is on useful information for the consumer credit firms. To maintain a database on the credit records of individuals the credit Information Bureau of India Limited (CIBIL) was set up in May 2004 which makes credit informations available to banks and financial institutions about prospective individual borrowers.[53]

NON-RESIDENT INDIAN DEPOSITS

Foreign Exchange Management (Deposit) Regulations, 2000 permits Non-Resident Indians (NRIs) to have deposit accounts with authorised dealers and with banks authorised by the Reserve Bank of India (RBI) which include:[54]

(i) Foreign Currency Non-Resident (Bank) Account [FCNR(B) Account]

(ii) Non-Resident External Account (NRE Account)

(iii) Non-Resident Ordinary Rupee Account (NRO Account)

FCNR(B) accounts can be opened by NRIs and Overseas Corporate Bodies (OCBs) with an authorised dealer. The accounts can be opened in the form of term deposits. Deposits of funds are allowed in Pound Sterling, US Dollar, Japanese Yen and Euro. Rate of interest applicable to these accounts are in accordance with the directives issued by RBI from time to time.

NRE accounts can be opened by NRIs and OCBs with authorised dealers and with banks authorised by RBI. These can be in the form of savings, current, recurring or fixed deposit accounts. Deposits are allowed in any permitted currency. Rate of interest applicable to these accounts are in accordance with the directives issued by RBI from time to time.

NRO accounts can be opened by any person resident outside India with an authorised dealer or an authorised bank for collecting their funds from local bonafide transactions in Indian Rupees. When a resident becomes an NRI, his existing Rupee accounts are designated as NRO. These accounts can be in the form of current, savings, recurring or fixed deposit accounts.

There were two more NRI deposit accounts in operation, viz., *Non-Resident (Non-Repatriable) Rupee Deposit Account* and *Non-Resident (Special) Rupee Account*—an amendment to Foreign Exchange Management (Deposit) Regulations, in 2002, discontinued the acceptance of deposits in these two accounts from April 2002 onwards.

Repatriation of funds in FCNR(B) and NRE accounts is permitted. Hence, deposits in these accounts are included in India's *external debt* outstanding. While the principal of NRO deposits is non-repatriable, current income and interest earning is repatriable. Account-holders of NRO accounts are permitted to annually remit an amount up to US$ 1 million out of the balances held in their accounts. Therefore, deposits in NRO accounts too are included in India's *external debt*.

GUIDELINES FOR LICENSING OF NEW BANKS

The RBI on *February 22, 2013* released the Guidelines for *'Licensing of New Banks in the Private Sector'*. Key features of the guidelines are:

(i) *Eligible Promoters:* A private sector/public sector/NBFCs/entity/group eligible to set up a bank through a wholly-owned "Non-

53. Ibid.
54. As per the latest update by the ***RBI***, May 11, 2012.

Operative Financial Holding Company (NOFHC)".

(ii) *'Fit and Proper' criteria:* A past record of sound credentials, integrity and sound financial background with a successful track record of 10 years will be required.

(iii) *Corporate structure of the NOFHC:* The NOFHC to be wholly owned by the promoter/promoter group which shall hold the bank as well as all the other financial services entities of the group.

(iv) *Minimum voting equity capital requirements for banks and shareholding by NOFHC:* The initial minimum *paid-up voting equity capital*[55] for a bank shall be Rs. 5 billion. The NOFHC shall initially hold a minimum of 40 per cent 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. Bank's shares to be listed on the stock exchanges within *three years* of the business commencement.

(v) *Regulatory framework:* The bank to be regulated by the relevant Acts/Statutes/ Directives, issued by the RBI and other regulators. The NOFHC shall be *registered as* an NBFC with the RBI and will be governed by a separate set of directions issued by the RBI.

(vi) *Foreign shareholding in the bank:* Foreign shareholding upto 49 per cent for the first 5 years after which it will be as per the extant policy.

(vii) *Corporate governance of NOFHC:* At least 50 per cent of the Directors of the NOFHC should be independent directors. The corporate structure should not impede effective supervision of the bank and the NOFHC by RBI.

(viii) *Prudential norms for the NOFHC:* The *prudential norms* will be applied to NOFHC on similar lines as that of the bank.

(ix) *Exposure norms:* The Bank/NOFHC allowed no *exposure* to the Promoter Group—the bank shall not invest in the equity/debt capital instruments of any financial entities held by the NOFHC.

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

(xi) *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.

(xii) *Other conditions for the bank:*

(a) To open at least 25 per cent of its branches in un-banked rural centres (with population of upto 9,999 as per the latest census).

(b) To comply with the *priority sector lending* targets applicable to the existing domestic banks.

(c) 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 Rs. 10 billion.

(d) Any non-compliance of terms and conditions will attract penal measures including cancellation of licence of the bank.

55. The part of 'Authorised Capital' (the limit upto which a company can issue shares) which has been actually 'paid' by the shareholders is known as the 'Paid-up Capital' of a company. [for detailed analysis of different kind of 'Capitals' of a company refer the *Chapter 14: Security Market in India*].

Two new banks get licence: The RBI by early April, 2014 granted *'in-principle'* approval to two applicants, IDFC Limited and Bandhan Financial Services Private Limited, to set up banks—'in-principle' approval granted will be valid for 18 months during which the applicants have to comply with the requirements and fulfil other conditions. Both are leading non-banking finance companies, while IDFC deals in infrastructure finance, Bandhan is in microfinance business. A High Level Advisory Committee headed by former RBI Governor Bimal Jalan recommended these two applicants out of a list of 25 applications. The case of India post will be decided by the RBI in consultation with the Government of India. The RBI also announced to work on giving licences more regularly, that is virtually 'on-tap'. As per the RBI, those applicants who have been denied licences can apply for the 'differentiated licences' (once RBI invites applications for it)—some of them may be better off applying for a differentiated licence rather than for a full licence. The so-called differentiated banks will be specialised institutions such as the 'payment banks' suggested by an RBI panel (headed by **Nachiket Mor**) on financial inclusion, to widen the spread of *payment services* and *deposit products* to small businesses and low-income households.

LABELS OF ATM

The automated teller machine (ATM) enetered India by late 1980s and have evolved into three of its types by now—

(i) *Bank's own ATMs:* These are owned and operated by the concerned bank and carry the bank's 'logo'. They are the costliest way to provide such service to bank's customers.

(ii) *Brown Label ATMs (BLAs):* These are owned by third party (a non-banking firm). The concerned banks only handle part of the process that is 'cash handling' and 'back-end server' connectivity. They carry 'logo' of the bank which outsources their service.

(iii) *White Label ATMs (WLAs):* These are 'owned' and 'operated' by a third party (a non-banking firm). They do not bear 'logo' of the banks they serve (that is why such a name). In place, they carry logo of the firm which own them. They serve customers of all banks and are interconnected with the entire ATM network in the country. The role of the concerned bank is only limited to provide account information and back-end money transfers to the third parties managing these ATM machines. These entities have a mandate to deploy 67 per cent of ATMs in rural locations (Tier III-VI) and 33 per cent in urban locations (Tier I and II cities). The Tata Communications Payment Solutions became the first such firm to get permission of the RBI (by mid-2013) to set up such ATMs – its brand name is 'Indicash'.

The main objectives of the Brown/White Label ATMs are cutting operation cost of running them and financial inclusion.

NON-OPERATIVE FINANCIAL HOLDING COMPANY (NOFHC)[56]

The difference between an *operating company* and a *holding company* lies in the fundamental structures of the two, in their management and their interactions with one another. Business goals are often different, and both business types are after profits, but holding companies can still benefit from operating company losses under certain conditions.

56. Though this sub-topic originally belongs to the *Chapter 14: Security Market in India*, it has been discussed here to make the new guidelines of setting-up banks an 'easy-to-understand' thing for the readers.

The primary function of a ***holding company*** is to invest in other companies, commonly known as subsidiaries. Holding companies are usually not involved in day-to-day operations of the operating company, but lend initial or ongoing financial support via cash reserves or stock sales, and may assist in restructuring the operational model to ensure profits. Holding companies are normally structured as *corporations* (limited liability firms i.e., known as a **Ltd.** company in India) to protect assets and absorb financial losses.

Operating companies are owned by the holding company, but are responsible for all day-to-day operations of the company. When a holding company creates or purchases an operating company, they are sometimes allowed to conduct business as usual – especially, if they are profitable. Net profits after expenses are then handed over to the holding company.

Ownership of operating companies, even when purchased, revert to the holding company. Former owners who are kept on-board are often given control of the operating company in the form of executive management responsibility, but have no ownership rights. All major decisions that may affect profitability or involve large expenditures must first be approved by the holding company.

Although operating company's *profitability* should make sense for the holding company, this is not always the case. Especially for larger holding companies with heavy tax burdens, owning one or more operating companies that lose money can benefit the parent company in the form of a business loss when tax time rolls around. This does not benefit the operating company, as it is responsible for operating income to run the business. If the losses become too great, operating companies can go out of business, but the holding company can still benefit because the operating company can help to balance overall profits and stock prices.

There are *three basic types* of holding companies:

(i) A *pure holding company* that is non-operating and exists solely to invest in and hold the voting shares of its subsidiaries. This type of holding company derives its income from the dividends earned from its ownership of the shares of its subsidiaries and from any gains realised from other investments.

(ii) A *general* or *operating holding company* that earns its income from selling goods and services in addition to the income derived from its ownership of subsidiaries.

(iii) A *pyramid holding company* that owns controlling interest in its subsidiaries with less invested capital than the two other categories.

NIDHI

Nidhi in the Indian context means 'treasure'. However, in the Indian financial sector it refers to any *mutual benefit society*[57] notified by the

57. **Mutual Benefit Society** (also known globally as 'benefit society' or 'mutual aid society') is an organization, or voluntary association formed to provide mutual aid, benefit, or insurance for relief from common difficulties. Such organizations may be formally organized with charters and established customs, or may arise ad hoc to meet unique needs of a particular time and place. They may be organized around a shared ethnic background, religion, occupation, geographical region or other basis. Benefits may include money or assistance for sickness, retirement, education, birth of a baby, funeral and medical expenses, unemployment. Often benefit societies provide a social or educational framework for members and their families to support each other and contribute to the wider community.

A benefit society may have some common features – members having equivalent opportunity in the organization; members having equivalent benefits; aid goes to needy (stronger helping the weaker); payment of benefits by collection of funds from the members; educating others about a group's interest; preserving cultural traditions; and mutual defence.

Examples of benefit societies include trade unions, self-help groups, etc. It is believed that such societies predate human culture are found around the world.

Central / Union Government as a Nidhi Company. They are created mainly for cultivating the habit of *thrift* and *savings* amongst its members. The companies doing Nidhi business, viz., borrowing from members and lending to members only, are known under different names such as *Nidhi, Permanent Fund, Benefit Funds, Mutual Benefit Funds* and *Mutual Benefit Company.*

Nidhis are more popular in ***South India*** and are highly localised single office institutions. They are mutual benefit societies, because their dealings are restricted only to the members; and membership is limited to individuals. The principal source of funds is the contribution from the members. The loans are given to the members at relatively reasonable rates for purposes such as house construction or repairs and are generally secured. The deposits mobilised by Nidhis are not much when compared to the organised banking sector.

Nidhis are companies registered under the Companies Act, 1956 and are regulated by the Ministry of Corporate Affairs (MCA). Even though Nidhis are regulated by the provisions of the Companies Act, 1956, they are exempted from certain provisions of the Act, as applicable to other companies, due to limiting their operations within members.

Nidhis are also included in the definition of ***NBFCs,*** which operate mainly in the *unorganised money market.* However, since 1997, NBFCs have been brought increasingly under the regulatory ambit of the RBI. Non-banking financial entities partially or wholly regulated by the RBI include:

(i) NBFCs comprising equipment leasing (EL), hire purchase finance (HP), loan (LC), investment (IC) [including primary dealers (PDs] and residuary non-banking companies RNBC;

(ii) Mutual benefit financial company (MBFC), i.e., *nidhi company*;

(iii) Mutual benefit company (MBC), i.e., potential nidhi company; i.e., a company which is working on the lines of a Nidhi company, but has not yet been so declared by the Central Government; has minimum net owned fund (NOF) of Rs.10 lakh, has applied to the RBI for certificate of registration and also to the Department of Company Affairs (DCA) for being notified as a Nidhi company and has not contravened directions / regulations of RBI/DCA.

(iv) Miscellaneous non-banking company (MNBC), i.e., *chit fund company.*

Since Nidhis come under one class of NBFCs, RBI is empowered to issue directions to them in matters relating to their deposit acceptance activities. However, in recognition of the fact that these Nidhis deal with their shareholder-members only, RBI has exempted the notified Nidhis from the core provisions of the RBI Act and other directions applicable to NBFCs. As on date *(February 2013)* RBI does not have any specified regulatory framework for Nidhis.

The Central Government in March 2000 constituted a committee to examine the various aspects of the functioning of Nidhi Companies. There was no government notification defining the word 'Nidhi'. Taking into consideration the manner of functioning of Nidhis and the recommendations of the *P. Sabanayagam Committee* in its report and also to prevent unscrupulous persons using the word 'Nidhi' in their name without being incorporated by the Department of Company Affairs (DCA) and yet doing Nidhi business, the committee suggested the following ***definition*** for Nidhis (a part of this definition is appearing in the new *Companies Bill 2012 (Section 406):*

"Nidhi is a company formed with the exclusive object of cultivating the habit of thrift, savings and functioning for the mutual benefit of members by

receiving deposits only from individuals enrolled as members and by lending only to individuals, also enrolled as members, and which functions as per Notification and Guidelines prescribed by the DCA. The word Nidhi shall not form part of the name of any company, firm or individual engaged in borrowing and lending money without incorporation by DCA and such contravention will attract penal action."

CHIT FUND

Recently, Chit Fund was in centre of news after the Kolkata-based *Saradha Chit Fund* scam came to light. Most of the media people were themselves not very clear about the 'finer' points related to the idea of 'chits' in India, but they kept on highlighting chits as they needed to report on the scam. Let us try understand what 'chits' are and some other similar concepts in India:

Chit funds (also known by their other names such as – *Chitty, Kuri, Miscellaneous Non-Banking Company*) are essentially saving institutions. They are of various forms and lack any standardised form. Chit funds have regular members who make periodical subscriptions to the fund. The periodic collection is given to some member of the chit funds selected on the basis of previously agreed criterion. The beneficiary is selected usually on the basis of bids or by draw of lots or in some cases by auction or by tender. In any case, each member of the chit fund is assured of his turn before the second round starts and any member becomes entitled to get periodic collection again. Chit funds are the Indian versions of 'Rotating Savings and Credit Associations' found across the globe.

Chit fund business is regulated under the Central *Chit Funds Act, 1982* and the rules framed under this Act by the various state governments for this purpose. The Central Government has not framed any rules of operation for them. Thus, registration and regulation of chit funds are carried out by *state governments* under the rules framed by them. Functionally, chit funds are included in the definition of NBFCs by the RBI under the sub-head *miscellaneous non-banking company*(MNBC). But RBI has not laid out any separate regulatory framework for them.

Official Definition: As per the Chit Funds Act, 1982, chit means "a transaction whether called *chit, chit fund, chitty, kuri* or by *any other name* by or under which a person enters into an agreement with a specified number of persons that every one of them shall subscribe a certain sum of money (or a certain quantity of *grain* instead) by way of periodical installments over a definite period and that each such subscriber shall, in his turn, as determined by lot or by auction or by tender or in such other manner as may be specified in the chit agreement, be entitled to the prize amount". A transaction is not a chit, if in such transaction :

(i) Some alone, but not all, of the subscribers get the prize amount without any liability to pay future subscriptions; or

(ii) All the subscribers get the chit amount by turns with a liability to pay future subscriptions.

URJIT PATEL COMMITTEE

An expert committee headed by Urjit R. Patel, Deputy Governor of the RBI was appointed in September 2013 to *Revise and Strengthen the Monetary Policy Framework*. The **main objective** of the committee was to recommend what needs to be done to revise and strengthen the current monetary policy framework with a view to making it transparent and predictable. The panel submitted its report (January, 2014) made the following recommendations:

1. CPI (combined) should be used as the nominal anchor for a flexible inflation targeting (FIT) framework. The choice of CPI as nominal anchor was mainly on account of the fact that the CPI closely

reflects cost of living and has larger influences on inflationary expectations than other anchors.

2. Target rate of inflation should be 4 per cent with a tolerance band of 2 per cent to be achieved in a two-year time frame.
3. The transition path to the target zone should be graduated to bring down inflation from the current level of around 10 per cent to 8 per cent over a period not exceeding 12 months and to 6 per cent over a period not exceeding the next 24 months.
4. Administered prices and interest rates should be eliminated as they act as impediments to monetary policy transmission and achievement of price stability.
5. The monetary policy decision-making should be vested with a monetary policy committee (MPC)—the RBI Governor as its Chairman and Deputy Governor as the Vice-Chairman, the Executive Director in charge of monetary policy could be its member and two external members.
6. All fixed income financial products should be treated on a par with bank deposits for the purposes of taxation and TDS. With a sharp rise in the ratio of agricultural credit to agricultural GDP, the need for subventions on interest rate for lending to certain sectors would have to re-visited.
7. In view of the cross-country and Indian experience with *global spillovers* driving episodes of large and volatile capital inflows as well as outflows, the committee felt that a flexible setting of monetary policy by the RBI in the short-run was warranted. This presages readiness to use range of instruments at its command.

   With regard to inflows that are excessive in relation to external financing requirements and the need for sterilised intervention, the RBI should build a *sterilisation reserve* out of its existing and evolving portfolio of GoI securities across the range of maturities, but accentuated towards a 'strike capability' to rapidly intervene at the short-end. The central bank should introduce a remunerated standing deposit facility, which would effectively empower it with unlimited sterilisation capability. As a buffer against outflows, the RBI's strategy should be to build an adequate level of foreign exchange reserves.
8. The committee asked the Central Government to ensure that the fiscal deficit as a ratio to GDP (gross domestic product) is brought down to 3.0 per cent by 2016–17.

In view of the elevated level of current CPI inflation and hardened inflation expectations, supply constraints and weak output performance, the committee said the transition path to the target zone should be graduated to bringing down inflation from the current level of 10 per cent to 8 per cent over a period not exceeding the next 12 months and to 6 per cent over a period not exceeding the next 24 month period before formally adopting the recommended target of 4 per cent inflation with a band of +/- 2 per cent.

Since food and fuel account for more than **57** per cent of the CPI on which the direct influence of monetary policy is limited, the commitment to the nominal anchor would need to be demonstrated by timely monetary policy response to risks from second-round effects and inflation expectations in response to shocks to food and fuel, the committee pointed out.

NACHIKET MOR COMMITTEE

The RBI set up the *Committee on Comprehensive Financial Services for Small Businesses and Low-Income Households* (CCFS) in September 2013 under the Chairmanship of Dr Nachiket Mor. The Committee's Report was released on 7 January 2014.

At its **core**, the Committee's recommendations are that in order to achieve the task of *financial inclusion* in a manner that enhances both financial inclusion and stability, there is need to move away from an exclusive focus on any one model to an approach where multiple models and partnerships are allowed to thrive, particularly between national full-service banks, regional banks of various types, NBFCs, and financial markets. The common theme of all the recommendations made by the Committee is that instead of focusing only on large generalist institutions, specialization and partnerships between specialists must be encouraged. Such an approach, in its view, would be far more effective at delivering high quality financial inclusion, without compromising financial stability or responsibility towards customers. Some of the *key recommendations* of the CCFS include:

1. *Universal Electronic Bank Account* for every resident to be made available at the time of issuing the Aadhaar number.
2. *Licensing*, with lowered entry barriers but otherwise equivalent treatment, more functionally focused banks, including payment banks, wholesale consumer banks, and wholesale investment banks.
3. *Developing risk-based supervision* processes for regional banks and strengthening existing ones before creating new regional banks.
4. *Reorienting the focus* of NABARD, SIDBI, and NHB to be market-makers and providers of risk-based credit enhancements.
5. *Consolidating NBFC definitions* into two categories: Core investment companies and other NBFCs. Restore permission of NBFCs-ND to act as business correspondents.
6. *On priority sector lending*, while the Committee acknowledged that the current focus of the policy, on small farmers, small businesses, and weaker sections, was well placed, it recommended an approach that incentivizes each provider to specialise in one or more sectors of the economy and regions of the country. Government subsidies to be channelled as direct benefit transfers (DBTs) rather than as subventions or waivers.
7. All *financial firms* regulated by the RBI be required to have an internal process to assess suitability of products prior to advising clients with regard to them.

SMALL & PAYMENT BANKS

By mid-July 2014, the RBI issued the *draft guidelines* for setting up small banks and payment banks. The guidelines said that both are 'niche' or 'differentiated' banks with the common objective of furthering *financial inclusion*. It is in pursuance of the announcement made in the *Union Budget 2014–15 (Full)*. The details regarding the provisions to set up such banks and their operational criteria are as given below:

The ***guidelines*** to set up both the banks are same—

- The minimum capital requirement would be Rs 100 crore.
- Promoter contribution would be at least 40 per cent for the first five years. Excess shareholding should be brought down to 40 per cent by the end of fifth year, to 30 per cent by the end of 10th year and to

26 per cent in 12 years from the date of commencement of business.

- Foreign shareholding in these banks will be as per current FDI policy.
- Voting rights to be line with the existing guideline for private banks.
- Entities other than promoters will not be permitted to have shareholding in excess of 10 per cent.
- The bank should comply with the corporate governance guidelines, including 'fit and proper' criteria for Directors as issued by RBI.
- Operations of the bank should be fully networked and technology driven from the beginning.

SMALL BANKS

The purpose of the small banks will be to provide a whole suite of basic banking products such as *deposits* and supply of *credit*, but in a *limited area of operation*. The **objective** of the Small Banks to increase financial inclusion by provision of savings vehicles to under-served and unserved sections of the population, supply of credit to small farmers, micro and small industries, and other unorganised sector entities through high technology low-cost operations. Other features of the small banks are as follows:

- Resident individuals with 10 years of experience in banking and finance, companies and Societies will be eligible as promoters to set up small banks. NFBCs, microfinance institutions (MFIs), and Local Area Banks (LABs) can convert their operations into those of a small bank. Local focus and ability to serve smaller customers will be a key criterion in licensing such banks.
- For the initial three years, prior approval will be required for branch expansion.
- The area of operations would normally be restricted to contiguous districts in a homogenous cluster of states or union territories so that the Small Bank has a 'local feel' and culture. However, if necessary, it would be allowed to expand its area of operations beyon contiguous districts in one or more states with reasonable geographical proximity.
- The bank shall primarily undertake *basic banking activities* of accepting deposits and lending to small farmers, small businesses, micro and small industries, and unorganised sector entities. It cannot set up subsidiaries to undertake non-banking financial services activities. After the initial stabilisation period of five years, and after a review, the RBI may liberalise the scope of activities for Small Banks.
- The promoters' other financial and non-financial services activities, if any, should be distinctly ring-fenced and not co-mingled with banking business.
- A robust risk management framework is required and the banks would be subject to all prudential norms and RBI regulations that apply to existing commercial banks, including maintenance of CRR and SLR.
- In view of concentration of area of operations, the Small Bank would need a diversified portfolio of loans, spread over it area of operations.
- The maximum loan size and investment limit exposure to single/group borrowers/ issuers would be restricted to 15 per cent of capital funds.
- Loans and advances of up to Rs 25 lakhs, primarily to micro enterprises, should constitute at least 50 per cent of the loan portfolio.

- For the first three years, 25 per cent of branches should be in unbanked rural areas.

Payments Banks

The **objective** of payments banks is to increase financial inclusion by providing small savings accounts, payment/remittance services to migrant labour, low income households, small businesses, other unorganised sector entities and other users by enabling high volume-low value transactions in deposits and payments/remittance services in a secured technology-driven environment.

- Those who can promote a payments banks can be a non-bank PPIs, NBFCs, corporate's, mobile telephone companies, super market chains, real sector cooperatives companies and public sector entities. Even banks can take equity in Payments Banks.
- Payments Banks can accept demand deposits (only current account and savings accounts). They would initially be restricted to holding a maximum balance of Rs 100,000 per customer. Based on performance, the RBI could enhance this limit.
- The banks can offer payments and remittance services, issuance of prepaid payment instruments, internet banking, functioning as business correspondent for other banks.
- Payments Banks cannot set up subsidiaries to undertake NBFC business.
- As in the case of Small Banks, other financial and non-financial services activities of the promoters should be ring-fenced.
- The Payments Banks would be required to use the word 'Payments' in its name to differentiate it from other banks.
- No credit lending is allowed for Payments Banks.
- The float funds can be parked only in less than one year G-Secs.

Meanwhile, the RBI has received 72 applications for small banks and 41 applications for payments banks. The applications are, at present, under consideration of the RBI. It is expected that soon some of them will get the nod for setting up these niche banks.

FINANCIAL INCLUSION

Financial inclusion is an important priority of the government. The objective is to ensure the excluded sections, i.e. weaker sections and low income groups, access to various financial services such as a basic savings bank account, need-based credit, remittance facility, insurance and pension. The government has recently launched an effective scheme to promote the cause of financial inclusion—the PMJDY:

Pradhan Mantri Jan-DhanYojana

To achieve the objective of financial inclusion by extending financial services to the large hitherto unserved population of the country and to unlock its growth potential, the Pradhan Mantri Jan-DhanYojana (PMJDY) was launched on 28 August 2014. The Yojana envisages—

(i) Universal access to banking facilities with at least one basic banking account for every household,

(ii) Financial literacy, access to credit and insurance.

(iii) The beneficiaries will receive a *RuPay* Debit Card having inbuilt accident insurance cover of Rs1 lakh.

(iv) In addition, there is a life insurance cover of Rs. 30,000 to those who opened their bank accounts for the first time between

15 August 2014 and 26 January 2015 and meet other eligibility conditions of the Yojana.

The Yojana has entered the *Guinness World Records* for opening most bank accounts during the week starting August 23, 2014 as part of the financial campaign. As on 28 January 2015, 12.31 crore bank accounts have been opened, of which 7.36 crore are in rural areas and 4.95 crore inurban areas. Under the PMJDY, 67.5 per cent of the accounts as on January 28, 2015 are with zero balance.

ALM OF BANKS

Banks have been faced with *Asset-Liability Management (ALM)* problems in recent times due to their existing long-term loans forwarded to certain sectors, viz., infrastructure, core sector and real estate sector. Again, raising new funds for new projects in these sectors had become quite difficult for the banks. These sectors constitute the major portion of banks' non-performing assests.

Banks have been seeking permission for longer tenor amortisation of the loan with periodic *refinancing* of balance debt. Banks have been raising resources in a significant way, issuance of long-term bonds for funding loans to infrastructure sector has not picked up at all. Infrastructure and core industries projects are characterised by long gestation periods and large capital investments. The long maturities of such project loans consist of the initial construction period and the economic life of the asset/underlying concession period (usually 25–30 years).

In pursuance of the *Union Budget 2015-16,* the RBI announced 'eased' norms in *July 2015* for the banks to take care of the Asset-Liability Management iisues of the banks, which are as follows:

(i) Banks allowed to raise fund through long-term bonds (with maturity period of not less than 7 years),

(ii) Such bonds exempted the mandatory regulatory norms such as the CRR, SLR and PSL.

(iii) Such funds to be used to finance long-term projects in infrastructure, core sector and affordable housing. Affordable housing means loans eligible under the priority sector lending (PSL), and loans up to Rs.50 lakh to individuals for houses costing up to Rs.65 lakh located in the six metropolitan centres. For other areas, it covers loans of Rs.40 lakh for houses with values up to Rs.50 lakh.

(iv) Banks can extend long term loans with flexible structuring to absorb potential adverse contingencies, known as the *5/25 structure*. Under the 5/25 structure, bank may fix longer amortisation period (25 years) with periodic refinancing (every 5 years.

India is looking at investing US $1 trillion in infrastructure development by 2017, half of which is expected to come from the private sector. The instructions announced by the RBI are in pursuance of the *Union Budget 2015–16* announcement.

NEW INITIATIVES IN THE BANKING SECTOR

In order to strengthen the banking industry , imparting greater transparency and accountability together with providing speedier and effective legal framework, the GoI took several important steps, in the recent times. Major steps, as per the *Economic Survey 2014–15,* are as follows:

(a) The RBI issued guidelines for licensing of new banks in the private sector on

22 February 2013, and in April 2014 two applicants have been granted 'in principle' approval to set up new banks in the private sector within a period of eighteen months.

(b) Pursuant to the *Union Budget 2014–2015* announcement for setting up of differentiated banks serving niche interests such as local area banks and payment banks, the RBI has formulated and released guidelines in November 2014 for licensing of payments banks and small finance banks in the private sector. Subsequently, the RBI has invited applications for setting up of small banks and payments banks.

(c) *Payment and Settlement Systems (Amendment) Bill 2014*: The Payment and Settlement Systems Act 2007 (PSS Act) was enacted with a view to providing sound legal basis for the regulation and supervision of payment systems in India by the RBI. For establishing a legal framework for regulation of trade repositories and legal entity identifier issuer, amendments have been considered necessary to make the PSS Act more effective.

The proposed amendments will provide finality to the determination of the payment obligations and settlement instructions between a central counter party (the system provider) and system participants in the event of insolvency, dissolution, or winding up of a central counter party.

(d) *Capital requirement of PSBs*: The GoI, in December 2014, approved aproposal allowing PSBs to raise capital from public markets through FPO (follow on public offer) or QIP (qualified institutional placement) by diluting Government of India holding upto 52 per cent in a phased manner based on their capital requirement, stock performance, liquidity, market appetite and subject to certain conditions.

CHAPTER

13

INSURANCE IN INDIA

- Definition
- Insurance Industry
- Insurance Reforms
- Reinsurance
- Deposit Insurance and Credit Guarantee Corporation (DICGC)
- Export Credit Guarantee Corporation (ECGC)
- National Export Insurance Account (NEIA)
- The Challenge Ahead
- Insurance Penetration
- New Reform Initiatives

*Insurance is a kind of gambling in reverse–a major form of 'risk spreading'–one person's risk which would be large, is spread around to make it small for a large number of people–in this process it serves two purposes–provides social security net to people and helps in nation-building by making available investible capital.**

** See Paul A. Samuelson and William D. Nordhaus, **'Economics'**, The McGraw-Hill Company, N. York, USA, 2005, pp. 210-212. Also see the LIBNA, 1956 and GIBNA, 1971 of the GoI.*

DEFINITION

In economic terms, anything used to cut down the risk is known as ***insurance***. But in familiar terms, insurance is provided by an insurance company which covers a person's life (called life segment) or covers loss of assets, property (called non-life or general segment). The insurance policies are purchased at fixed premiums.

INSURANCE INDUSTRY

Insurance has a deep-rooted history in India. It finds mention in the writings of Manu *(Manusmrithi),* Yagnavalkya *(Dharmasastra)* and Kautilya *(Arthasastra).* The writings talk in terms of **pooling of resources** that could be re-distributed in times of calamities such as fire, floods, epidemics and famine. This was probably a pre-cursor to modern day insurance. Ancient Indian history has preserved the earliest traces of insurance in the form of marine trade loans and carriers' contracts. Insurance in India has evolved over time heavily drawing from other countries, England in particular.

LIC

The life insurance business/industry in the country was nationalised by the Government of India in 1956 and a fully government-owned company, the life Insurance Corporation of India (LIC) was set up (at that time 245 Indian and foreign companies were playing in the life segment of insurance). Opening of private life insurance companies was prohibited at the same that time. The LIC was called an investment institution by the government.

The nationalisation was motivated by twin objectives—*first,* to spread the message of life insurance for greater social security and *secondly,* to mobilise people's savings (collected as premiums) for nation building. The LIC had been the biggest investor in the government's procces of planned development purchasing government securities (G-Secs.) and equities of the big asset public sector undertaking (PSUs).

GIC

In 1971, the government nationalised the private sector companies (107 Indian and foreign companies) playing in the general insurance segment and a government company the General Insurance Corporation of India (GIC) was formed in 1972. The GIC started operation on January 1, 1973 with its four holding companies:

(i) National Insurance Company Ltd.
(ii) New India Assurance Company Ltd.
(iii) Oriental Fire and Insurance Comany Ltd.
(iv) United India Insurance Company Ltd.

In the era of economic reforms, two major changes took place in this area—

(i) In november 2000 the GIC was notified as the Indian Reinsurer[1]
(ii) In March 2002 the GIC was withdrawn from holding company status of the four public sector general insurance companies. Now these four companies are directly owned by the Government of India.[2]

INSURANCE REFORMS

Under the process of economic reforms an Insurance Reforms Committee (IRC) was set up in April 1993 under the chairmanship of the ex-RBI Governor R. N. Malhotra. The committee

1. ***India 2002,*** Pub. Div., GoI, N. Delhi
2. ***Economic Survey 2002–03,*** MoF, GoI, N. Delhi.

handed over its report (January 1994) with the following major suggestions:[3]

(i) Decontrolling insurance sector, i.e., allowing Indian as well as foreign private sector insurance companies to enter the sector (the government did it in 1999 passing the *IRDA Act*).

(ii) Restructuring the LIC and the GIC and cutting down the government's holding in them to 50 per cent (no follow up still, but the private insurance companies demanding it anxiously. The NDA government had taken steps in this area, but the UPA government has no such plans.) Late 2012, the government started sale of the LIC shares but to public sector undertakings—seen as a welcome move.

(iii) Delinking GIC and its four subsidiaries (which was done in 2000).

(iv) Discarding the system of licensing of surveyors by the controller of Insurance.

(v) Restructuring the Tariff Advisory Committee.

(vi) Setting up a regulatory anthority for the insurance industry (the IRDA set up in 2000).

IRDA

The Insurance Regulatory and Development Authority (IRDA) was set up in 2000 (the Act was passed in 1999) with one chairman and five members (two as full time and three as part-time members) appointed and nominated by the government. The authority is responsible for the regulation, development and supervision of the Indian insurance industry.

There are 29 insurance companies in India (15 in life segment and 14 in the non-life segment) which have been able to cover 40 million lives in the country. Out of the local life and non-life segment, insurance coverage in the rural areas have a share of 17 per cent and 14 per cent respectively, still too much needs to be done for the development of insurance in the country. (See the Select Model Answers on the topic.)

AICIL

The Agricultural Insurance Company of India Ltd. (AICIL) was set up in 2002 in the public sector to look after the National Agricultural Insurance Schemes (NAIS) of 1999.[4] Till its arrival, the responsibility was on the GIC whose losses were supposed to be reimbursed by the Central Government. Now the GIC does not play this role.

Public Sector Insurance Companies

There are six public sector insurance companies operating in the country—one in life segment (LIC), four in the non-life segment and one in the agriculture sector (AICIL).

REINSURANCE

When an insurance company gets insurance coverage on its insurance policies, it is considered a case of reinsurance. For the development of insurance in an economy the presence of reinsurance companies is a precondition. It becomes an essential precondition if the economy is trying to develop and expand insurance with the active participation of the private sector insurance companies. This made the government convert the GIC into a re-insurance company in 2000—this is the sole re-insurer in India, that too in the public sector. (Nobody can be a better insurer or reinsurer than the government itself!)

3. R. N. Malhotra headed ***Insurance Reforms Committee,*** GoI, N. Delhi, January 1994.
4. ***Economic Survey 2002–03,*** MoF, GoI, N. Delhi.

DEPOSIT INSURANCE AND CREDIT GUARANTEE CORPORATION (DICGC)

DICGC was set up by merging the Deposit Insurance Corporation (1962) and the Credit Guarantee Corporation (1971) in 1978. While Deposit Insurance had been introduced in India out of concerns to protect depositors, ensure financial stability, instill confidence in the banking system and help mobilise deposits, the establishment of the Credit Guarantee Corporation was essentially in the realm of affirmative action to ensure that the credit needs of the hitherto neglected sectors and weaker sections were met. The essential concern was to persuade banks to make available credit to not so creditworthy clients. After the merger, the focus of the DICGC had shifted onto credit guarantees. This owed in part to the fact that most large banks were nationalised. With the financial sector reforms undertaken in the 1990s, credit guarantees have been gradually phased out and the focus of the Corporation is veering back to its core function of Deposit Insurance with the objective of averting panics, reducing systemic risk and ensuring financial stability.

EXPORT CREDIT GUARANTEE CORPORATION (ECGC)

The overseas projects undertaken by the Indian companies face many ***political*** and ***commercial risks*** in the importing countries. To provide adequate credit insurance cover to such firms, the government has set up the Export Credit Guarantee Corporation of India Ltd. (ECGC) under the Ministry of Commerce and Industry, for medium- and long-term exports. But owing to its own limitations, at times it is difficult for ECGC to cover pure commercial risks in issues like long repayment period, the large value of contracts, difficult economic and political conditions of the importing country, together with the fact that ***reinsurance*** cover is generally not available for such projects.[5] Many times such projects look necessary considering the economic and political relationship of India with the proposed importing country. It means that in the absence of credit insurance cover, the ability of Indian exporters to go for such export projects is hampered. It should be noted that in many developed economies such projects are covered and underwritten on government account[6].

NATIONAL EXPORT INSURANCE ACCOUNT (NEIA)

For facilitating the service of the ECGC (discussed above) the Government of India did set up the National Export Insurance Account (NEIA) in March 2006 to promote medium- and long-term export by providing credit insurance support in the cases where ECGC was not able to provide credit cover on its own because of purely commercial reasons:[7]

(i) The corpus given to the account was Rs. 66 crore, raised to Rs. 246 crore by 2007–08 and was enhanced to Rs. 2000 crore in the Eleventh Plan (2007–12).

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5. Due to its underwriting constraint, the ECGC is unable to cover such projects on its own.
6. As for example the USA, France, the UK and many other Euro-American economies underwwrite such medium and long term projects in the governments' account. The SEIA also covers only medium- and long-term export projects only.
7. Announced while setting up the NEIA, Ministry of Commerce and Industry, GoI, N. Delhi, March 9, 2006.

(ii) Resources of the NEIA will be the corpus, the premium income, interest income and recovery of all the claims paid.

(iii) As per the provision, an exposure equal to ten times corpus can be taken by the NEIA.

The NEIA can cover projects which fulfil the following criteria:[8]

(i) The project by itself should be commercially viable;

(ii) The project should be strategically important for India, with regard to economic and political relationship of India with the importing country; and

(iii) The exporter should be capable of executing the contract, as evident from his previous track record.

The use and benefits of the NEIA need to be publicised among its beneficiaries. Meanwhile, many export projects pertaining to Indonesia, Vietnam, Iran, Sudan, etc., are under way. The NEIA will facilitate potential project exporters to enter the international trade area, as it is expected[9] to be so. In the era of globalisation it has been praised as a welcome development by the experts and the trade people alike.

THE CHALLENGE AHEAD

Since the opening up of the insurance sector, the number of participants in the insurance industry has gone up from seven insurers (including the Life Insurance Corporation of India [LIC], four public-sector general insurers, one specialised insurer, and the General Insurance Corporation as the national re-insurer) in 2000 to 52 insurers as on 30 September 2012 operating in the life, non-life, and re-insurance segments (including specialised insurers, namely the Export Credit Guarantee Corporation and Agricultural Insurance Company [AIC]). Four of the general insurance companies, viz., Star Health and Alliance Insurance Company, Apollo Munich Health Insurance Company, Max BUPA Health Insurance Company, and Religare Health Insurance Company function as standalone health insurance companies. Of the 23 insurance companies that have set up operations in the life segment post opening up of the sector, 21 are in joint ventures with foreign partners. Of the 21private insurers who have commenced operations in the non-life segment, 18 are in collaboration with foreign partners.

After the state monopoly in the insurance sector was dismantled and private players' entry allowed, the IRDA has played a crucial role in the development and expansion of the sector, there is no doubt in it. But still the sector faces many challenges which, if only tackled well may one say that insurance is serving the interests of the insuring companies and the covered alike. As per the concerned experts, the major challenges Indian insurance is facing today may be seen as given below:

(i) As per various estimates, only 20 per cent of the insurable Indian population is life-insured; the share of India in global life insurance is just 0.66 per cent; and life insurance penetration is at present 2.53 per cent (2004) in the country.[10]

8. Ibid.
9. S. Prabhakaran, Executive Director, ECGC, Mumbai in ***Survey of Indian Industry 2007,*** The Hindu, p. 84.
10. S. Krishnamurthy, CEO & MD, SBI Life Insurance Co. Ltd. ***Survey of Indian Industry 2007,*** op.cit., p. 91

The message of life insurance needs to be publicised among the population, specially in the rural areas. Moreover, social security schemes should be expanded to cover the poor masses who lack the premium-paying capacity.

(ii) Experts suggest that health insurance could emerge among the most important factors of improving human development in the country if expanded in a focussed way and via an ***action plan.*** It is estimated that around 15 per cent of the Indian population is covered under some form of pre-payment on healthcare which includes employees and beneficiaries covered under ESIS, CGHS, Armed forces, Central Police organisations, Railways, employer self-funded schemes, the PSUs and pensions covered under health insurance.[11] The health insurance penetration is at present at 1.536 per cent only (2005–06). Besides the LIC, the private players should be promoted to enter the foray, specially in the rural areas.

(iii) After the general insurance industry was opened up (2000) for the private sector participation, the experience has been positive.[12] Its growth compares favourably with that of many other emerging markets and is in line with global benchmark of two to three times the growth in GDP.[13] As the economy is on a strong growth path and the capital expenditure planned across industries is estimated to be over Rs. 9,00,000 crore over the next four to five years, a better scope for the general insurance expansion is probable.[14] The growth in both commercial and personal lines of general insurance business reflects positive trends. Over 70 per cent of India's population lives in rural areas and along with organised financial services, general insurance companies are also expanding into these sectors.

(iv) People in their lives experience financial difficulties that can affect the entire family negatively, this is more true about the poor masses in India.

This is why experts suggested for the provision of **micro insurance.** A relatively new concept, micro insurance is today provided to the beneficiaries of micro finance covering the finance amount, reducing the risk of the clients as well as the micro finance institutions (MFIs).[15]

The concept of micro insurance has been developed by the private insurance company Aviva Life Insurance (in partnership with MFIs) which has forged alliances with banks like Canara Bank, P&SB, RRBs, 23 cooperatives, etc., to promote micro finance.

Micro insurance has evolved in the past two decades of research in micro finance and has seen growth in countries like Sri Lanka, Philippines in the last decade.[16] Here NGOs and people's

11. Aloke Gupta, Health Insurance Consultant, ***Survey of Indian Industry,*** op. cit., p. 94.
12. Sandeep Bakhshi, CEO & MD, ICICI Lombard General Insurance Company, Mumbai, ***Survey of Indian Industry 2007***, op. cit., p. 99.
13. Ibid.
14. Ibid.
15. Vivek Khanna, Director, Aviva India, ***Survey of Indian Industry 2007,*** op. cit., p. 102.
16. Ibid.

organisations are allowed to register themselves as micro insurance companies which sell such insurance. As they cover the risk themselves, they are allowed to ***reinsure*** with one of the large global companies like Swiss Re or Munich Re. Same model is suggested for India but for this to happen drastic changes in the existing insurance rules are required.[17]

(v) Many of the experts believe that insurance industry should benefit the insurers, reinsurers as well as the insured. The ***social purpose*** of the insurance sector is never praiseworthy to be marginalised by the corporate interests (be domestic or foreign)—at least it does never taste good in India which needs a strong social safety net.[18]

(vi) Almost all of the private insurance companies in India have been demanding that the government-owned insurance companies (i.e., LIC and the four general insurance companies) should be converted into private sector companies. Their reasons are logical as in comparison with the government-owned insurance companies, private companies are always ready with highly attractive and lucrative insurance schemes, but they have not been able to attract the clients for them. Therefore, the private insurance companies have been fetching huge operational losses due to lack of the desired level of their expansion and the overhead expenditure.[19]

INSURANCE PENETRATION

The growth in the insurance sector is internationally ***measured*** based on the standard of insurance penetration. Insurance penetration is defined as the ratio of premium underwritten in a given year to the gross domestic product (GDP). Likewise, insurance density is another well recognised benchmark and is defined as the ratio of premium underwritten in a given year to total population (measured in US dollars for convenience of comparison). The Indian insurance business has in the past remained under-developed with low levels of insurance penetration.

In India, insurance penetration has grown from 2.3 per cent (life 1.8 per cent and non-life 0.7 per cent) in 2000 to **3.9** per cent (life 3.1 per cent and non-life 0.8 per cent) in 2013. In the comparable period, insurance density has improved from US$ 11 to US$ 52.[20]

The life insurance penetration level compares well with the emerging market economies. During 2013–14, the life insurance industry recorded a premium income of Rs. 3,14,283 crore registering a growth of 9.4 per cent over the previous year. While private-sector insurers posted 1.4 per cent decline in their premium income, LIC recorded 13.5 per cent growth during the period. On the basis of total premium income, the market share of LIC increased from 72.7 per cent in 2012–13 to 75.4 per cent in 2013–14.

POLICY INITIATIVES

Committed to expand and strengthen, the insurance industry in the country (following the

17. It has been beautifully shown taking example of the Self-employed Women's Association (SEWA) by Renana Jhabvala and Ravi Kanbur in the Kaushik Basu edited ***India's Emerging Economy,*** Oxford Univ. Press, N. Delhi, 2005, pp. 309–11.
18. Biplab Dasgupta, ***Globalisation: India's Adjustment Experience,*** Sage Publication, N. Delhi, 2005, pp. 221–931.
19. G. V. Rao, CMD, Oriental Insurance Co. Ltd., ***Survey of Indian Industry 2007,*** The Hindu, pp. 87–90.
20. ***Annual Report 2012–13,*** IRDA, GoI, N. Delhi and the ***Economic Survey 2014–15,*** Vol. 2, p.48, GoI, MoF, N. Delhi.

recommendations of the Malhotra Committee Report, 1993), the GoI has taken the following policy initiatives[21] in recent years:

(i) **Health Insurance:** The Insurance Regulatory Development Authority (IRDA) has been taking a number of proactive steps as part of the initiatives for the spread of health insurance. It had set up a National Health Insurance Working Group in 2003, which provided a platform for the various stakeholders in the health insurance industry to work together and suggest solutions on various relevant issues in the sector. The IRDA is also co-ordinating with and supporting insurance industry initiatives in standardising certain key terminology used in health insurance documents, for better comprehension and in the interest of policyholders. The ***General Insurance Council,*** comprising all non-life insurers, evolved a consensus on a uniform definition of 'pre-existing diseases' and its exclusion wording, which has earlier been an expression with many definitions, still more interpretations, and certainly a whole lot of grievances. Such standardisation, effective June 1, 2008 will help the insured by minimising ambiguity and also by better comparability of health insurance products. Also, with effect from October 1, 2011, portability in health insurance has been started in which an insured, if not happy with services or the product of the existing insurer, can change to another insurer whilst enjoying the benefits (especially that of pre-existing diseases) of her/his existing policy.

(ii) **Micro Insurance:** Micro insurance regulations issued by the IRDA have provided a fillip to propagating micro insurance as a conceptual issue. With the positive and facilitative approach adopted under the micro insurance regulations, it is expected that all insurance companies would come out with a progressive business approach and carry forward the spirit of regulations thereby extending insurance penetration to all segments of the society. Presently, there are 10,482 micro–insurance agents operating in the micro–insurance sector.

NEW REFORM INITIATIVES

With a view to removing archaic and redundant provisions in the insurance laws, empowering the Insurance Regulatory and Development Authority (IRDA) to enable more effective regulation, and enhancing the foreign equity investment cap in an Indian insurance company with the safeguard of Indian ownership and control, the government has implemented the Insurance Laws (Ammendment) Act, 2015.

The Act paved the way for **major reform** related amendments in the Insurance Act, 1938, the General Insurance Business (Nationalization) Act, 1972 and the Insurance Regulatory and Development Authority (IRDA) Act, 1999. It provides greater powers to the IRDAI by which the insurance regulatory framework is supposed to become more flexibile, effective and efficient. Major changes as per the Act are given below:

1. *Promotion of Foreign Investment:*in an Indian Insurance Company increased from to 49 per cent (from 26 per cent) with the safeguard of Indian ownership and control.

   Greater availability of capital for the capital intensive insurance sector would lead to greater distribution reach to

21. ***Economic Survey 2011–12,*** op. cit., pp. 128–129.

under/un-served areas, more innovative product formulations to meet diverse insurance needs of citizens, efficient service delivery through improved distribution technology and enhanced customer service standards.

2. *Capital Requirement in Government Companies:* The public sector general insurance companies (four), presently required as per the General Insurance Business (Nationalisation) Act, 1972 to be 100 per cent government owned, are now allowed to raise capital. This will enable them to have additional capital for the purposes of business expansion in the rural/social sectors and enhanced competitiveness. The GoI ownership to be mainatained minimum at 51 per cent.
3. *Consumer Welfare:* It will enable the interests of consumers to be better served through provisions like those enabling penalties on intermediaries/ insurance companies for misconduct and disallowing multi-level marketing of insurance products in order to curtail the practice of mis-selling—
   (i) The amended Law has several provisions for levying higher penalties ranging from up to Rs. 1 Crore to Rs. 25 Crore for various violations including mis-selling and misrepresentation by agents/insurance companies.
   (ii) With a view to serve the interest of the policy holders better, the period during which a policy can be repudiated on any ground, including mis-statement of facts etc., will be confined to three years from the commencement of the policy and no policy would be called in question on any ground after three years.
   (iii) The amendments provide for an easier process for payment to the nominee of the policyholder, as the insurer would be discharged of its legal liabilities once the payment is made to the nominee.
   (iv) It is now obligatory in the law for insurance companies to underwrite third party motor vehicle insurance as per IRDAI regulations. Rural and social sector obligations for insurers are retained in the amended laws.
4. *Empowerment of IRDAI:* The Act will entrust responsibility of appointing insurance agents to insurers and provides for IRDAI to regulate their eligibility, qualifications and other aspects—
   (i) It enables agents to work more broadly across companies in various business categories; with the safeguard that conflict of interest would not be allowed by IRDAI through suitable regulations.
   (ii) IRDAI is empowered to regulate key aspects of Insurance Company operations in areas like solvency, investments, expenses and commissions and to formulate regulations for payment of commission and control of management expenses.

(iii) It empowers the Authority to regulate the functions, code of conduct, etc., of surveyors and loss assessors. It also expands the scope of insurance intermediaries to include insurance brokers, re- insurance brokers, insurance consultants, corporate agents, third party administrators, surveyors and loss assessors and such other entities, as may be notified by the Authority from time to time.

(iv) Further, properties in India can now be insured with a foreign insurer with prior permission of IRDAI; which was earlier to be done with the approval of the Central Government.

5. *Health Insurance:* The Act defines 'health insurance business' inclusive of travel and personal accident cover and discourages non-serious players by retaining capital requirements for health insurers at the level of Rs. 100 Crore, thereby paving the way for promotion of health insurance as a separate vertical.
6. *Promoting Reinsurance Business in India:* It enables foreign reinsurers to set up *branches* in India and defines 're-insurance' to mean 'the insurance of part of one insurer's risk by another insurer who accepts the risk for a mutually acceptable premium', and thereby excludes the possibility of 100 per cent ceding of risk to a re-insurer, which could lead to companies acting as front companies for other insurers.
7. *Strengthening of Industry Councils:* The Life Insurance Council and General Insurance Council have now been made *self-regulating bodies* by empowering them to frame bye-laws for elections, meetings and levy and collect fees, etc., from its members. Inclusion of representatives of *self-help groups* and *insurance cooperative societies* in insurance councils has also been enabled to broad base the representation on these Councils.
8. *Robust Appellate Process:* Appeals against the orders of IRDAI are to be preferred to SAT as the amended law provides for any insurer or insurance intermediary aggrieved by any order made by IRDAI to prefer an appeal to the Securities Appellate Tribunal (SAT).

Thus, the amendments incorporate enhancements in the insurance laws in keeping with the evolving insurance sector scenario and regulatory practices across the *globe*. The amendments will enable the regulator to create an operational framework for greater innovation, competition and transparency, to meet the insurance needs of citizens in a more complete and subscriber-friendly manner. The amendments are expected to enable the sector to achieve its full growth potential and contribute towards the overall growth of the economy and job creation.

CHAPTER

14

SECURITY MARKET IN INDIA

- Definition
- Primary and Secondary Markets
- Stock Exchange
- SEBI
- Commodity Trading
- Spot Exchanges
- Important Terms of Stock Market
- Foreign Financial Investors
- Angel Investor
- QFIs Scheme
- RFPIs
- Participatory Notes (PNs)
- Short Selling
- RGESS
- Credit Default Swap (CDS)

*Had there been no security market–undoubtedly, the most facinating segment of the financial market–there won't have been the big MNCs and TNCs in the world. Once the world moves towards the process of globalisation, the potential of this market has increased exponentially–its capacity of resource mobilization is just anybody's guess!**

* As many documents of the WTO, World Bank and OECD have accepted many times.

- Securitisation
- Corporate Bond in India
- Inflation-Indexed Bonds
- Gold Exchnage Traded Funds
- CPSE ETF
- Pension Sector Reforms
- Real Estate & Infrastructure Investemnt Trusts

DEFINITION

The segment of a financial market of an economy from long-term capital is raised via instruments such as shares, securities, bonds, debentures, mutual funds, and is known as the security market of that economy.

A security market has components such as a security regulator (SEBI in India), stock exchanges, different share indices, brokers, FIIs, jobbers, etc. There are different kinds of transactions which take place in a security market such as badla, reverse badla, future trading, insider trading (not allowed), private placement, etc.

PRIMARY AND SECONDARY MARKETS

Every security market has two complementary markets—primary and the secondary. The market in which the instruments of security market are traded (procured) directly between the capital-raiser and the instrument purchaser is known as the primary market. As for example, a share being directly purchased by anybody from the issuer which may be the company itself. The person is known as the primary shareholder. The market where the instruments of security market are traded among the primary instrument holders is known as the *secondary market*. Such transactions need an institutionalised floor for their trading which is made available by the stock exchanges.

STOCK EXCHANGE

A physically existing institutionalised set-up where instruments of security stock market (shares, bonds, debentures, securities, etc.) are traded. It serves the following major functions:

(i) Makes a floor available to the buyers and sellers of stocks and liquidity comes to the stocks. It is the single most important institution in the secondary market for securities.

(ii) Makes available the prices of trading as an important piece of information to the investors.

(iii) By following institutionalised rules and procedures, it ensures that the participants in the stock market live up to their commitments.

(iv) Passes updated informations to the enlisted companies about their present stockholders (so that they can pass on dividends etc., to them).

(v) By publishing its 'Index', it fulfils the purpose of projecting the moods of the stock market.

World's first stock exchange was established in Antwerp, Belgium (then part of the Netherlands) in 1631, the London Stock Exchange opened in 1773 and then Philadelphia Stock Exchange (the first in the New World) opened in 1790.[1] The first stock exchange in India, the Bombay Stock Exchange known as *The Native share and stock Brokers' Association* was set up in 1870 (under a tree!).[2]

Top five largest stock exchanges (on the basis of market capitalisation) of the world in their decreasing order are—the New York Stock Exchange, the NASDAQ, the Tokyo Stock Exchange, the London Stock Exchange and the Bombay Stock Exchange.[3]

Trading in the stock exchanges takes place via the mediators known as the *brokers*, the *jobbers*, the *market-maker* (discussed later in this chapter).

As per the latest information,[4] presently, there are a total number of 26 stock exchanges operating in India—7 at the national level and

1. Marc Levinson, ***Guide to Financial Markets,*** The Economist, London, 2006, p. 152.
2. V. Raghunathan, ***Stock Exchanges and Investments,*** Tata McGraw-Hill, N. Delhi, 1994, p. 4.
3. Marc Levinson, 2006, op. cit., pp. 153–54; Ministry of Finance, ***Economic Survey 2005–06,*** GoI, N. Delhi.
4. MoF, GoI, dated 22 April, 2013.

rest 19 at the regional level (one of it, Coimbatore Stock Exchange recently sought for withdrawal of recognition, the matter is sub-judice under SEBI). A brief account of the 'national level stock exchanges' is given below.

NSE

The National Stock Exchange of India Ltd. (NSE) was set up in 1992 and became operationalised in 1994. The sponsors of the exchange are financial institutions, including IDBI, LIC and GIC with IDBI as its promotor.

It has a 50 share index and a 500 share index known as S&P CNX-50 (Nifty Fifty) and S&P CNX-500, respectively.

OTCEI

Though the Over the Counter Exchange of India Ltd (OTCEI) was set up in 1989, it could commence trading only in 1992. India's first fully computerised stock exchange was promoted by the UTI, ICICI, SBI Cap among others, in order to overcome problems such as lack of transparency and delays in settlements prevalent in the older stock exchanges. Another important goal of the exchange was to allow stock market exposure to comparatively smaller companies (companies with paid-up capital from Rs. 30 lakh to Rs. 25 crore are enlisted here). Trading in this exchange takes place via market-makers and commission is fixed.

ISE

The Interconnected Stock Exchange of India (ISE) is basically a single floor of India's 15 regional stock exchanges (RSEs), set up in 1998. The RSEs were provided increased reach through this. It is a web-based exchange.

BSE

The Bombay Stock Exchange Ltd. (BSE), earlier a regional stock exchange, converted into a national one in 2002. The *biggest* in India, it accounts for almost 75 per cent of total stocks traded in India and is the *fifth* largest in the world (on the basis of market capitalisation).

There are at present four indices connected with the BSE:

(i) *Sensex:* The sensitive index (i.e., Sensex) is a 30 stocks index of the BSE which was enlarged to include 50 stocks in 2000 but soon was cut down to the original level. This index represents the Indian stock market.

(ii) *BSE-200:* This is a 200 stock share index of the BSE (including the 30 stocks of the Sensex) which has its Dollar version too—*the Dollex.*

(iii) *BSE-500:* In mid-1999, the BSE came up with a 500-stock index representing major industries and many sub-sectors of the economy with information technology getting a significant weightage.

(iv) *National Index:* An index of 100 stocks being quoted nationwide (Bombay, Delhi, Kolkata, etc.) was developed to give broader/wider representation of the stock market since the Sensex consists of only 30 stocks. The 30 stocks of the sensex are included in the National Index.

This index is computed by the Statistics Department of the BSE hence it is called the BSE National Index (BSENI).

Indo Next

A new stock exchange to promote liquidity to the stocks of the small enterprises (SMEs) was launched in 2005 jointly and medium the BSE and the FISE (Federation of Indian Stock Exchanges, representing 18 regional stock exchanges).

It is better known as the *BSE Indo Next.* It was also an effort to rejuvenate the RSEs which were facing falling volumes of trading on their floors.

Due to absence of trading at the RSEs, the stocks of the SME, has become illiquid.

The BSE will transfer all its B1 and B2 groups to this exchange. The RSEs also transfer their enlisted companies to the new exchange.

Now the RSEs will be able to use the BSE network online—the 'Webex'.

SME EXCHANGES: BSESME AND EMERGE [5]

SME exchange is a stock exchange dedicated for trading the shares of small and medium scale enterprises (SMEs) who, otherwise, find it difficult to get listed in the main exchanges. The concept originated from the difficulties faced by SMEs in gaining visibility or attracting sufficient trading volumes when listed along with other stocks in the main exchanges.

To be listed on the SME exchange, the post-issue paid-up capital of the company should not exceed Rs. 25 crores. This means that the SME exchange is not limited to the small and medium scale enterprises (which are defined under the 'Micro, Small And Medium Enterprises Development Act, 2006' as enterprises where the investment in plant and machinery does not exceed Rs. 10 crores). As of now, to get listed in the main boards like, National Stock Exchange, the minimum paid-up capital required is Rs. 10 cr and that of the BSE is Rs. 3 cr. Hence, those companies with paid-up capital between Rs. 10 cr to Rs. 25 cr have the option of migrating to the Main Board/or to the SME exchange. The companies listed on the SME exchange are allowed to migrate to the Main Board as and when they meet the listing requirements of the Main Board. There shall be compulsory migration of the SMEs from the SME exchange, in case the post-issue paid-up capital is likely to go beyond the Rs 25 crore limit.

World over, trading platforms/exchanges for the shares of SMEs are known by different names such as Alternate Investment Markets or Growth Enterprises Market, SME Board etc. Some of the known markets for SMEs are *AIM* (Alternate Investment Market) in UK, *TSX Ventures* in Canada, *GEM* (Growth Enterprise's Market) in Hong Kong, *MOTHERS* (Market of the High-Growth and Emerging Stocks) in Japan, *Catalist* in Singapore and *Chinext*, the latest initiative in China [see 'World Federation of Exchanges' for latest comparative idea].

Globally, most of these SME exchanges are still at an evolving stage considering the many hurdles they face —

(i) Declining prices of listed stocks and their illiquidity,

(ii) A gradual reduction in new listings and decline in profits of the exchanges etc., (for instance, *AIM* had three predecessors; *CATALIST* succeeded *SESDAQ* with new regulations and listing requirements).

(iii) In most jurisdictions, idea of a separate exchange for SMEs have become unviable and hence tend to be platforms of existing exchanges, perhaps cross-subsidised by the main board/exchange.

In India, similarly, after the two previous attempts—***OTCEI*** (Over the Counter Exchange of India, 1989) and ***Indonext***—the market regulator, SEBI, on May 18, 2010 permitted setting up of a dedicated stock exchange or a trading platform for SMEs. The existing bourses/stock exchanges in India, BSE and NSE went live on March 13, 2012 with a separate trading platform for small and medium enterprises (SMEs). BSE has named

5. This section is based on various sources – the, SEBI, NSE, BSE, 'World Federation of Exchanges', select issues of *The Economist* and news reportings of *The HT Live Mint, The Business Line and The Economic Times.*

its SME platform as **BSESME**, while NSE has named it as **Emerge**.

Unlike in India, many of these SME exchanges in various countries operate at a global level, due to smallness of the market, allowing for listing by both domestic as well as foreign companies. Though the names suggest that they are set up for SMEs, these exchanges hardly follow the definition of SMEs in their respective jurisdictions. Also, many of them follow a 'Sponsor-supervised' market model, where sponsors or nominated advisors decide if the listing applicant is suitable to be listed or not, i.e., generally no quantitative entry criteria like track record on profitability or minimum paid-up capital or net worth, etc., are specified to be listed in these exchanges. Instead, they are designed as 'buyers beware' markets for informed investors. SEBI has also designed the SME exchanges in a similar format with provisions for ***'market making'*** for the specified securities listed on the SME exchange.

As is the case globally, certain relaxations are also provided to the issuers whose securities are listed on the SME exchange in comparison to the listing requirements in the Main Board (such as in BSE and NSE, in the case of India), which include:

(i) Publication of financial results on 'half yearly basis', instead of 'quarterly basis', making it available on their websites rather than publishing it.

(ii) Option of sending a statement containing the salient features of all the documents instead of sending a full Annual Report.

(iii) No continuous requirement of minimum number of shareholders, though at the time of IPO there needs to be a minimum of 50 investors, etc.

(iv) The existing eligibility norms like track record on profits, net worth/net tangible assets conditions, etc., have been fully relaxed for SMEs as is the case globally.

(v) However, no compromise has been made to corporate governance norms.

Common Facts about the National Stock Exchanges

Before the arrival of national level stock exchanges, India was not having any exchange of national status—better say there was no Indian stock market, but stock markets showing only regional pictures. Besides, the national stock exchanges did solve some major problems of stock market, we may also call their arrivals as part of the stock market reforms in India. The common features of these exchanges are:

(i) all are situated in Mumbai;

(ii) all do screen-based trading (SBT);

(iii) all have their trading terminals in the major cities of the country;

(iv) all are web-enabled;

(v) all are limited liability companies;

(vi) the brokers registered here have no say in either the ownership or the management of the exchanges;

(vii) all are counted among the best and the most technology-equipped stock exchanges in the world.[6]

PLAYERS IN THE STOCK EXCHANGES

Broker

Broker is a registered member of a stock exchange who buys or sells shares/securities on his client's behalf and charges a commission on the gross value of the deal—such brokers are also known as *commission brokers*.

Brokers who offer services such as investment advice, clients' portfolio planning, credit when a client is buying on margin other than their

6. P. Chidambaram while presenting the ***Union Budget 2006–07,*** N. Delhi.

traditional commission job are known as *full service brokers*. In India such brokers are just coming up.

Jobber

A jobber is a broker's broker or one who specialises in specific securities catering to the need of other brokers—in India also known as '*Taravaniwallah*' (in the BSE).[7] A jobber is located at a particular trading post on the floor of the stock exchange and does buying and selling for small price differences, called the *spread*. He has no contact with the investing public.

In the London Stock Exchange he is called a *market-maker* while in the New York Stock Exchange he is called a *specialist*. The Bombay Stock Exchange has made it mandatory for every company with a share capital of over Rs. 3 crore to appoint jobbers or market-makers if it seeks enlistment. Such an arrangement enables investors to buy and sell shares on the stock exchange and thus liquidity increases.

Market-Maker

Functions as an intermediary in the market ready to buy and sell securities. He simultaneously quotes two-way rates—like a jobber basically with the only difference that he quotes two-way rates, for buying and selling at the same time.[8]

On the floor of India's OTCEI, only market-makers are allowed to play. In the money market of India, the Discount and Finance House of India (DFHI) is the chief market-maker.[9]

Since he quotes the selling price while buying a particular share, he makes market for that share, hence such a name.

The NASDAQ of the USA is a market-maker's stock exchange where they are connected by the web-enabled trading terminals.

SEBI

The regulator of Indian stock market, set up under the *Security and Exchange Board of India Act, 1992* (as a non-statutory body set on April 12, 1988 through a government resolution in an effort to give the Indian stock market an organised structure) with its head office in Mumbai. Its initial paid-up capital was Rs. 50 crore provided by the promoters—the IDBI, the IFCI and the ICICI.

The Board of SEBI comprises nine members excluding the chairman—one member each from the Ministries of Finance and Law, one member from the RBI and two other members appointed by the central government. It has four full-time members (including the chairman).

Main functions/powers of the Board as per the *SEBI Act, 1992* are:

(i) Registering and stock exchanges, merchant banks, mutual funds, underwriters, registrars to the issues, brokers, sub-brokers, transfer agents and others.

(ii) Levying various fees and other charges (as 1 per cent of the issue amount of every company issuing shares are kept by it as a caution money in the concerned stock exchange where the company is enlisted).

(iii) Promoting investor education.

(iv) Inspection and audit of stock exchanges and various intermediaries.

7. Surendra Sundararajan, ***Book of Financial Terms,*** Tata Mc Graw-Hill, N.Delhi, 2004, p. 117.
8. Tim Hindle, op. cit., p. 129.
9. Surender Sundararajan, op. cit., p. 134.

(v) Performing other concerned functions as may be prescribed from time to time.

COMMODITY TRADING

Commodity trading happens similar to 'stocks' (shares, securities, debentures, bonds) trading in the stock market. However, commodities are actual physical goods such as corn, silver, gold, crude oil, etc. Futures are contracts for commodities that are traded at a futures exchange like the Chicago Board of Trade (CBOT). Futures contracts have expanded beyond just commodities, now there are futures contracts on financial markets like foreign currencies, interest rates, etc.

Commodity futures serve a great purpose in any economy. As we see in the case of agricultural commodity—their prices play a key role in determining the fortune of the agriculture and food processing industry in India. These prices undergo a *large degree of fluctuation*. Reasons for price fluctuation are crop failure, bad weather, demand-supply imbalance, etc. This fluctuation, in turn, leads to a 'price risk'. This price risk is largely borne by the farmer and the industries where agricultural commodities are used as raw material. Commodity exchanges are associations that determine and enforce rule, and set procedures for trading of commodities. The main objective of the exchange is to protect the participants from adverse movement in prices by facilitating futures trading in commodities.

If the participants *hedge* themselves against this price risk, then they would be able to insulate themselves against the inherent price fluctuations associated with agricultural commodities. One of the methods of doing this would be by using commodity exchanges as a trading platform. Apart from hedging against price risk, a commodity exchange helps in production and procurement planning as one can buy in small lots. Further as the exchange consists of various informed industry participants, *price discovery* is more efficient and discounts the local and global factors.

Let us take a very simple example to understand how trading on commodity exchanges help industry participants. A farmer who is producing wheat can sell 'wheat futures' on a commodity exchange. This will help him lock in a sale price of a specified quantity of wheat at a future date. Hence the farmer would now be able to get an assured price for his produce in future and any decline in the price of wheat would not impact his earnings. On the other hand, a user industry (e.g., a flour mill) could purchase the wheat futures from the exchange. Hence the flour mill would now be able to fix its future purchase cost for a specified quantity of wheat. Therefore, any increase in the price of wheat in future would not impact its cost of production.

However, what needs to be kept in mind is that farmers do not largely operate in the futures market. This is partly due to operational difficulties and lack of knowledge. Though, they observe the price trends emerging from a futures market and then decide what commodity in what proportion to cultivate.

In case of user industries, commodity exchanges help them to plan their production and determine their cost of production. Commodity exchanges are an effective tool to hedge price risk. However, the government needs to improve infrastructure, put in place vigilant governing systems, etc., to encourage trading on these exchanges.

Big money started flowing into commodity futures with the advent of online multi-commodity exchange. The boom, which began when the stock market was sluggish, has surprisingly not waned even after the Sensex crossed 20,000 (by 2004–06). High stakes, long trading hours and comparatively little knowledge about the derivative products have underscored the role of

a regulator. The Forward Markets Commission (FMC), which for decades was entrusted with the job to curb forward trades, now has the job to develop and regulate the commodity futures market.

FMC

The Forward Markets Commission is a statutory body set up under the *Forward Contracts (Regulation) Act, 1952*. It functions under the administrative control of the Department of Consumer Affairs, Ministry of Consumer Affairs, Food & Public Distribution. In 2014, the commission was transferred to the Ministry of Finance. Headquartered at Mumbai with one regional office at Kolkata, the commission comprises a Chairman, and two members. The commission provides ***regulatory oversight*** in order to ensure—

(i) Financial integrity (i.e., to prevent systematic risk of default by one major operator or group of operators);

(ii) Market integrity (i.e., to ensure that futures prices are truly aligned with the prospective demand and supply conditions), and

(iii) Protection and promotion of the interest of consumers/non-members.

After assessing the market situation and taking into account the recommendations made by the *Board of Directors of the Commodity Exchange*, the Commission approves the rules and regulations of the ***Commodity Exchanges*** in accordance with which trading is to be conducted. It accords permission for commencement of trading in different contracts, monitors market conditions continuously and takes remedial measures wherever necessary by imposing various regulatory measures. At present, 113 commodities are notified for future trading and there are 21 commodity exchanges in India including three ***'national level'*** exchanges (other being regional) recognised for conducting futures/forward trading. The three national exchanges are:

(i) Multi-commodity Exchange of India Ltd. (MCX), Mumbai. The FTIL, its main promoter, has been asked by the FMC to exit its ownership in it after the firm was found involved in financial irregularities mid-2013 (it has 24 per cent stake in MCX).

(ii) National Commodity and Derivatives Exchange Ltd. (NCDEX), Mumbai.

(iii) National Multi-commodity Exchange of India Ltd. (NMCE), Ahmedabad.

In US, which has the *largest* commodity futures market, there are separate regulators for equities and commodities. Single regulator exists in China, UK, Australia, Hong Kong and Singapore. Japan has a different model for its derivatives market, with multiple product type based regulators.

The GoI decided to merge the FMC with the SEBI (the *Union Budget 2015–16*).

SPOT EXCHANGES

In India, Spot Exchanges refer to electronic trading platforms which facilitate purchase and sale of specified commodities, including agricultural commodities, metals and bullion by providing *spot delivery contracts* in these commodities.

This market segment functions like the equity segment in the main stock exchanges. Alternatively, this can be considered as a guaranteed direct marketing by sellers of the commodities. Spot Exchanges leverage on the latest technology available in the stock exchange framework for the trading of goods. This is an innovative Indian experiment in the trading of goods and is distinct from what is commonly known as 'commodity exchanges' which trade in *futures contracts* in commodities.

Spot exchange has been **defined** by the Warehousing Development and Regulatory Authority (Electronic Warehouse Receipts) Regulations, 2011 as "a body corporate incorporated under the Companies Act, 1956 and engaged in assisting, regulating or controlling the business of trading in electronic warehouse receipts." However, present day spot exchange deals not just with warehouse receipts—this is an electronic market where a farmer or a trader can *discover* the prices of commodities on a national level and can buy or sell goods *immediately* (i.e., on the 'spot') to anyone across the country. All contracts on the exchange are *compulsory delivery contracts*—it means that all outstanding positions at the end of the day are marked for delivery, which implies that seller has to give delivery and buyer has to take the delivery.

The facilities provided by the spot exchange, like a normal stock exchange, include clearing and settlement of trades. Trades are settled on guaranteed basis (i.e., in case of default by any person exchange arranges for the payment of money/good) and the exchange collects various margin payments, to ensure this. The exchange also offers various other services, such as, quality certification, warehousing, warehouse receipt financing, etc.

Spot Exchanges in India: At present, there are **four** spot exchanges operating in the country:

(i) The National Spot Exchange Ltd. (NSEL), set up in 2008, is a national level commodity spot exchange promoted by the Financial Technologies India Ltd (FTIL) and National Agricultural Cooperative Marketing Federation of India Limited (NAFED). After the FTIL was found involved in irregularities, the FMC (Forward Market Commission), by *end-March 2014* asked it to exit the spot exchange.

(ii) NCDEX Spot Exchange Ltd (established in October 2006 by NSE).

(iii) Reliance Spot Exchange Ltd. (R-Next).

(iv) Indian Bullion Spot Exchange Ltd. (an online over the counter spot exchange).

Advantages of Spot Exchanges: Spot exchange provides various advantages over the traditional way of trading in commodities:

(i) Efficient price determination as price is determined by a wider cross-section of people from across the country, unlike the traditional 'mandis' where price discovery for commodities used to happen only through local participation.

(ii) Ensures transparency in price discovery—anonymity ensures convergence of different price perceptions, as the buyer or seller merely expresses their desire to trade without even meeting directly.

(iii) Ensures participation in large numbers by farmers, traders and processors across the country and eliminate the possibility of cartelisation and other such unhealthy practices prevalent in the commodity markets.

(iv) It brings in some best practices in commodity trading like, system of grading for quality, creating network of warehouses with assaying facilities, facilitating trading in relatively smaller quantities, lower transaction cost, etc.

(v) Bank finance available against the goods in the warehouse on easier terms improves holding capacity and can actually incentivise farm production and hence reduce rural poverty.

(vi) Since the trades are guaranteed (by the exchange), counter party risk is avoided.

Raising Capital in the Primary Market

There are three ways in which a company raises capital in the primary market—

Public Issue

A public offer is open for all Indian citizens, the most broad-based method of raising capital and the most prestigious, too (The Reliance Industries Ltd. is the biggest company of India in this category).

Rights Issue

Raising capital from the existing shareholders of a company, it means it is a preferential kind of issue restricted to a certain category of the public only.

Private Placement

Raising capital by selling shares to a select group of investors, usually financial institutions (FIs) but may be to individuals also. This is done through a process of direct negotiations (completely opposite to the public issue). The advantage of this route is the substantial saving a share issuing company makes on marketing expenses (but the risk of shifting loyalties of the investors in this route is also the highest).

Recent times have seen such capital raising by many companies privately placing their shares to the foreign institional investors (FIIs) as a route to source foreign exchange in India, and that too quickly.

IMPORTANT TERMS OF STOCK MARKET

Scrip Share

A share given to the existing shareholders without any charge—also known as *bonus share.*

Sweat Share

A share given to the employees of the company without any charge.

Rolling Settlement

An important reform measure started in the Indian stock market in mid-2001 under which all commitments of sale and purchase result into payment/delivery at the end of the 'X' days later (where 'X' stands for 5 days. Some shares have X as one, two or three days, too). Today, all shares are covered under this provision.

Badla

When the buyers want postponement of the transaction—in Western world called *Contango.*

Undha Badla

When the sellers want postponement of the transaction—also known as the *reverse badla* or *backwardation.*

Futures

A trading allowed in shares where a future price is quoted for the shares and the payment and delivery takes place on the pre-determined dates.

Depositories

Started in 1996 under which stocks are converted into ***'paperless form'*** (dematerialisation of shares shortly known as the 'demat'). At present, two public sector depositaries (Mumbai) are functioning in India set up under the *Depositories Act, 1996*—

(i) NSDL (National Securities Depositories Ltd.)

(ii) CDSL (Central Depositories Services Ltd.)

Spread

The difference between the buying and selling prices of a share is called spread. Higher the liquidity of a share lower its spread and vice versa. Also known as Jobber's ***Turn* or *Margin* or *Hair cut.***

Kerb Dealings

The transactions of stocks which take place outside the stock exchanges—unofficially and take place after the normal trading hours.

NSCC

The National Securities Clearing Corporation (NSCC), a public sector company set up in 1996 takes the *counter party risk* of all transactions done at the NSE just as an intermediary guarantees all trades.

Demutualisation

A process started (2002) by SEBI under which ownership, management and trading membership was to be segregated from each other. No broker was to be on the Board of Directors or an office-bearer in a stock exchange.

This has been done in the case of all stock exchanges except three regional stock exchanges (RSEs) in India.

Authorised Capital

The limits upto which shares can be issued by a company—also known as the *nominal* or *registered* capital. This is fixed in the Memorandum of Association (MoA) and the article of association (AoA) of a company as required by the *Companies Act (Law)*.

Paid-up Capital

The part of the authorised capital of a company that has actually been paid by shareholders. A difference may arise because all shares authorised might not be *issued* or issued shares are only partly paid-up.

Subscribed Capital

The amount actually paid by the shareholders or have been committed by them for contribution.

Issued Capital

The amount which is sought by a company to be raised by issuing shares which cannot exceed the authorised capital of the company.

Greenshoe Option

A provision under which a company issuing shares for the first time is allowed to sell some additional shares to the public—usually 15 per cent, is also known as ***over-allotment provision***. It gets its name from the first company (Greenshoe Company, USA) which was allowed such an option.

Penny Stocks

The share which remains low-priced at a stock exchange for a comparatively longer period. Speculators may start hoarding them for hefty margins, this was seen in India in mid-2006. And since such stocks get hoarded, ultimately their market prices increase. The speculators earn profit after offloading (selling) these shares at high prices and others who purchase these shares ultimately might fetch huge losses because price rise of these stocks are unintentional or each intentional manipulation and nothing else.

ESOP

The Employee stock Ownership plan (ESOP) enables a foreign company to offer its shares to employees overseas. It was allowed in India (February 2005) provided that the MNC has minimum 51 per cent holding in its Indian

company. Earlier a permission from the RBI was required for such an option.

SBT

Screen Based Trading (SBT) is trading of stock based on the electronic medium, i.e., with the help of computer monitor, internet, etc. First such trading was introduced in New York in 1972 by the bond broker ***Cantor Fitzgerald.*** India introduced it in 1989 at the OTCEI. Now it is carried out at all exchanges.

OFCDs

Debentures are the debt instruments which may be issued by a listed or non-listed firm to raise funds in a security market. They are of many types, viz., *Redeemable, Non-redeemable, Partially Convertible* and *Fully Convertible.* In case of 'fully convertible debentures' an 'option' (that is why the name OFCDs, i.e., Optionally Fully Covertible Debentures) is given to the debenture-holders who may wish to convert their OFCDs into shares (after expiry of the period fixed by the debenture issuing firm—known as 'lock-in' period). But the 'rate', will be decided by the company (e.g., how many shares against how many debentures). For debenture-holders the 'option' to convert debenture into shares is profitable and/or safer once either of the following situations are correct:

(i) The firm is likely to make high profit (so the shareholder can earn higher dividend), or
(ii) Firm's share-price is likely to rise in the share market (profit can be made by selling shares).

But suppose the firm has weak balance sheet (going bankrupt), then it is better to keep hold on the debenture rather than converting them into shares, because when a company is liquidated (i.e., its assets sold off), the debenture holders get *primacy* over shareholders in payment. It means OFCD is a bit **tricky** thing and is the only suitable route to invest in the security market for the investors who have some knowledge and understanding of share prices, company performance, etc.

Recently, the OFCDs issued by **Sahara** (an NBFC under regulatory control of the RBI) were in news due to some irregularities – it was a simple case of certain loopholes in the regulation of OFCDs and some violations by Sahara:

(i) Actually, an OFCD issue process has to be completed within 10 working days (Sahara continued for over two years).
(ii) If the OFCD is being issued through the 'Private Placement' route only 50 individuals/ institutions can subscribe to it (Sahara issued it to over 23 million people and raised over Rs. 24,000 crores). Such a tricky instruments being issued to novice public was a clear case of financial irregularities.
(iii) Unlisted companies do not come under the regulatory control of SEBI. In place they are regulated by the Ministry of Corporate Affairs (both the Sahara firms which issued OFCDs are unlisted). But SEBI contended that it can regulate even an unlisted firm if it issues OFCD, as the SEBI Act, 1992 contains the term OFCDs. There was really some regulatory confusion. This is why the government added a 'clause' in the recently passed *Companies Act, 2012* which gives SEBI **undisputed jurisdiction** over any investment scheme involving more than 50 investors whether the company is listed or unlisted. Menawhile, Sahara has been ordered to return the total capital it raised through OFCDs with an interest of 15 per cent per annum.

DERIVATIVES

Derivative is a product whose value is derived from the value of one or more basic variables,

called bases (underlying asset, index or reference rate), in a contractual manner.

The underlying asset can be equity, forex, commodity or any other asset. For example, wheat farmers may wish to sell their harvest at a future date to eliminate the risk of a change in prices by that date. Such a transaction is an example of a derivative. The price of this derivative is driven by the spot price of wheat which is the "underlying".

In the Indian context the *Securities Contracts (Regulation) Act, 1956* [SC(R)A] **defines derivative** to include :

(i) A security derived from a debt instrument, share, loan whether secured or unsecured, risk instrument or contract for differences or any other form of security.

(ii) A contract, which derives its value from the prices, or index of prices, of underlying securities.

Derivatives are securities under the SC(R)A and hence the trading of derivatives is governed by the regulatory framework under the SC(R)A and are allowed to be traded on the floors of the stock exchanges.

Indian Depository Receipts (IDRs)

As per the **definition** given in the *Companies (Issue of Indian Depository Receipts) Rules, 2004,* IDR is an instrument in the form of a depository receipt created by the Indian depository in India against the underlying equity shares of the issuing company. In an IDR, foreign companies would issue shares, to an Indian depository [say the National Security Depository Limited (NSDL)], which would in turn issue depository receipts to investors in India. The actual shares underlying IDRs would be held by an Overseas Custodian, which shall authorise the Indian depository to issue of IDRs.

Just try to understand in a simple way. An IDR is a mechanism that allows investors in India to invest in listed foreign companies, including multinational companies, in Indian rupees. IDRs give the holder the opportunity to hold an interest in equity shares in an overseas company. IDRs are denominated in Indian Rupees and issued by a Domestic Depository in India. They can be listed on any Indian stock exchange. Anybody who can invest in an IPO (Initial Public Offer) is/are eligible to invest in IDRs. *In other words, what ADRs/GDRs are for investors abroad with respect to Indian companies, IDRs are for Indian investors with respect to foreign companies.*

But one question comes in mind. How does investing in IDRs differ from investing in shares of foreign company listed on foreign exchanges? Indian individuals can invest in shares of foreign companies listed on foreign exchanges only upto $200,000 and the process is costly and cumbersome as the investor has to open a bank account and demat account outside of India and comply with Know Your Customer (KYC) norms of respective companies. It also involves foreign currency risks. IDR subscription and holding is just like any equity share trading on Indian exchanges and does not involve such hassels.

StanChart is the **first** and the **only** issuer of IDRs in Indian markets which came out with its IDR issue in May 2010 through which it had raised Rs. 2,500 crore on high demand from institutional investors and was listed on the Bombay Stock Exchange and National Stock Exchange. Ten StanChart IDRs represent one underlying equity of the UK-listed bank. StanChart IDRs were due to come up for redemption on June 11, 2011.

SEBI came out with the new guidelines in June 2011which ruled that after the completion of one year from date of issuance of IDRs, redemption of the IDRs will be permitted only if the IDRs are infrequently traded on the stock exchange in India. Sebi rules make it clear that if the annual trading turnover in IDRs in the preceding six calendar months before redemption is less than

5 per cent, then only the company could go into for redemption of IDRs. The regulator had said that the company issuing IDRs would have to test the frequency of trading the instrument on the bourses on a half-yearly basis ending June and December every year.

Shares 'at Par' and 'at Premium'

An ordinary share in India, in general, is said to have a ***par value (face value)*** of Rs. 10, though some shares issued earlier still carry a par value of Rs. 100. Par value implies the value at which a share is originally recorded in the balance sheet as 'equity capital' (this is the same as 'ordinary share capital'). SEBI guidelines for *public issues* by new companies established by individual promoters and entrepreneurs, require all new companies to offer their shares to the public *at par,* i.e., at Rs 10. However, a new company set up by existing companies (and of course existing companies themselves) with a track record of *at least five years* of consistent profitability are allowed to issue shares at a **premium.**

When a company issues shares at a premium, it is able to raise the required amount of capital from the public by issuing a fewer number of shares. For example, while a *new company* promoted by first time entrepreneurs intending to raise say, Rs. 1 crore, has to offer 10 lakh ordinary shares at Rs. 10 each (at par), an *existing company* may raise the same amount by offering only 2 lakh shares at Rs. 50 each (close to the market value of its shares). The latter is said to have issued its share at a '*subscription price*' of Rs. 50 (Rs. 10 in the case of the former company), at a premium of Rs. 40 (being the excess of subscription price over par value). In such a situation in India, the company's books of accounts will show Rs. 10 towards *share capital account* and Rs. 40 towards *share premium account*. It means that the higher the premium, the fewer will be the number of shares a company will have to service. For this very reason, following the policy of free pricing of issues in 1993, many companies came out with issues at prices so high that in many cases they were higher than their market prices, leading to under-subscription of such issues. The companies are, however, learning fast about the pitfalls of high pricing of shares and it is only a matter of time before the issue prices become more realistic.

In India, no company is allowed to issue shares at a *discount*, i.e., at a price below par. Again, in India, once a company has issued the shares, it cannot easily reduce its capital base, (i.e., *buy back* or *redeem*) its own shares.

This means that ordinary share capital is a more or less permanent source of capital, which normally a company is never under an obligation to return to the investors, because a shareholder who wishes to *disinvest* (i.e., get back the invested capital) can always do so by selling the shares to other buyers in the secondary market. Also, in India, a company receives no tax benefits for the dividends distributed. In other words, dividends are paid by the companies out of the earnings left after taxes and they get taxed once again at the hands of the investors.

FOREIGN FINANCIAL INVESTORS

Through the Portfolio Invesment Scheme (PIS), the foreign financial investors (FIIs) were allowed to invest in the Indian stock market—the FIIs having good track record register with SEBI as brokers. FIIs make investments in markets on the basis of their *perceptions* of expected returns from such markets. Their perceptions among other things are influenced by :

(i) the prevailing macro-economic environment;
(ii) the growth potential of the economy; and
(iii) the corporate performance in competing countries.

Increased FII inflows into the country during the year 2012 helped the Indian markets become one of the best performing in the world in 2012, recovering sharply from their dismal performance in 2011. At the end of December 2012, **1,759** FIIs were registered with SEBI with their net FII flows to India at US$ 31.01 billion.[10] These flows were largely driven by equity inflows (80 per cent of total flows) which remained buoyant, indicating FII confidence in the performance of the Indian economy in general and Indian markets in particular. The economic and political developments in the *Euro zone area* and the *United States* had their impact on markets around the world including India. The resolution of the **fiscal cliff**[11] in the US had a positive impact on the market worldwide including in India. Further, reform measures recently initiated by the government have been well received by the markets.

New Rules for Foreign Investment

To promote the flow of foreign funds into the economy the RBI, on *January 24, 2013,* further liberalised the provisions of investment in India's security market—

(i) FIIs and ***long-term investors***[12] investment limit in Government Securities (G-Secs) enhanced by US $5 billion (to US $ 25 billion).

(ii) Investment limit in corporate bonds by the above-given entities enhanced by $5 billion (to $50 billion).

(iii) The RBI also relaxed some investment rules by removing the maturity restrictions for first time foreign investors on dated G-Secs (earlier a three-year residual maturity was must for first time foreign investors). But such investments will not be allowed in short-term paper like Treasury Bills.

(iv) Foreign investors restricted from investing in the 'money market' instruments —certificates of deposits (CDs) and commercial paper (CPs).

(v) In the total corporate debt limit of $50 billion, a sub-limit of $25 billion each for infrastructure and other than infrastructure sector bonds has been fixed.

(vi) Rules requiring FIIs to hold infrastructure debt for at least one year has been abolished.

(vii) The qualified foreign investors (QFIs) would continue to be eligible to invest

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10. As per the latest ***Economic Survey 2012-13,*** op. cit., p. 121.
11. **'Fiscal cliff'** is a term used to describe the crisis that the US government faced at the end of 2012, when the terms of the Budget Control Act of 2011 were scheduled to go into effect – a combination of – i). expiring tax cuts and ii). across-the-board government spending cuts scheduled to become effective December 31, 2012. The idea behind the fiscal cliff was that if the federal government allowed *these two* events to proceed as planned, they would have a detrimental effect on an already shaky economy, perhaps sending it back into an official *recession* as it cut household incomes, increased unemployment rates and undermined consumer and investor confidence [As per the conservative estimates by some US experts, it would have meant a tax increase to the size of which the country had never seen in the last in 60 years].

    Who did first use the term is not clear – some believe that it was first used by Goldman Sachs economist, *Alec Phillips*, while some others credit Federal Reserve Chairman *Ben Bernanke*, still others credit *Safir Ahmed*, a reporter for the *St. Louis Post-Dispatch*, who in 1989 used the term while writing a story detailing the state's education funding. ***Sources:*** The contemporary news reportings and articles which appeared during the time in *The Economist, The Guardian, The New York Times* and *The Newsweek.*
12. 'Long-term investors' include SEBI-registered 'sovereign wealth funds' (SWFs), multilateral agencies, endowment funds, insurance funds, pension funds and foreign central banks.

in *corporate debt securities* (without any lock-in or residual maturity clause) and *mutual fund debt schemes*, subject to a total overall ceiling of $1 billion (this limit of $1 billion shall continue to be over and above the revised limit of $50 billion for investment in corporate debt).

(viii) As a measure of further relaxation, it has been decided to dispense with the condition of one year lock-in period for the limit of $22 billion (comprising the limits of infrastructure bonds of $12 billion and $10 billion for non-resident investment in IDFs) within the overall limit of $25 billion for foreign investment in infrastructure corporate bond.

(ix) The residual maturity period (at the time of first purchase) requirement for the entire limit of $22 billion for foreign investment in the infrastructure sector has been uniformly kept at 15 months. The five-year residual maturity requirement for investments by QFIs within the $3 billion limit has been modified to three years original maturity.

SEBI has classified the foreign financial institutions (FIIs) into three broad categories – and they are allowed to issues PNs in accordance with the provision announced by the SEBI:

Category I: The government entities/ institutions investing in Indian security market on behalf of the Central Bank.

Category II: The financial institutions, mutual funds, etc., which duly regulated in the countries of their origin.

Category III: The financial institutions which do not fall either of the above-given categories.

ANGEL INVESTOR

A new term in India's financial market, introduced in the ***Union Budget 2013-14*** which announced that SEBI will soon prescribe the provisions by which the **angel investor** can be recognised as *Category I AIF* [13] *venture capital funds.*

Angel investor is an investor who provides financial backing to entrepreneurs for 'starting their business'. Angel investors are usually found among an entrepreneur's family and friends but they may be from outside also. The capital they provide can be a one-time injection of seed money or ongoing support to carry the company through difficult times—in exchange they may like owning share in the business or provide capital as loan (in case of a loan they lend at more favorable terms than other lenders, as they are usually investing in the *person* rather than the viability of the business). Other than investible capital, these investors provide technical advices and also help the 'start-up' business with their lucrative contacts.

They are focused on helping the business succeed, rather than reaping a huge profit from their investment. Angel investors are essentially the *exact opposite* of a venture capitalist in their 'intention' (who has high profit prospects as their prime focus). But in one sense both—an *angel investor* and a *venture investor*—serve the same purpose for the entrepreneur (who is in dire need of investible capital).

QFIs SCHEME

In Budget 2011—12, the government, for the first time, permitted qualified foreign investors (QFIs), who meet the know-your-customer (KYC) norms, to invest directly in Indian mutual funds.

13. As per the *SEBI (Alternative Investment Funds) Regulations, 2012 (AIF Regulations),* **Category I AIF** are – those AIFs with 'positive spillover effects' on the economy, for which certain incentives or concessions might be considered by SEBI or the Government of India or other regulators in India; and which shall include *Venture Capital Funds, SME Funds, Social Venture Funds, Infrastructure Funds* and such other *Alternative Investment Funds (AIFs)* as may be specified.

In January 2012, the government expanded this scheme to allow QFIs to directly invest in Indian equity markets. Taking the scheme forward, as announced in *Budget 2012—13*, QFIs have also been permitted to invest in corporate debt securities (CDSs) and MF debt schemes subject to a total overall ceiling of US $ 1 billion.

In *May 2012*, QFIs were allowed to open individual non-interest-bearing rupee bank accounts with authorized dealer banks in India for receiving funds and making payment for transactions in securities they are eligible to invest in. In *June 2012*, the definition of QFI was expanded to include residents of the member countries of the Gulf Cooperation Council (GCC) and European Commission (EC) as the GCC and EC are members of the Financial Action Task Force (FATF).

The speedier moves in the area of promoting higher foreign investment (FIs) in India should be seen in the light of two broad perspectives—

(i) India's rising current account deficit (which crossed an all-time high of 6.7 per cent by *March 2013*) which is creating heavy drain of foreign exchange; and
(ii) The objective of attracting more FIs while the Western economies are under the spell of recession (cashing in the opprtunity).

RFPIs

In *March 2014*, the RBI simplified foreign portfolio investment norms by putting in place an easier registration process and operating framework with an aim to attract inflows. Frow now onwards, the portfolio investor registered in accordance with the SEBI guidelines shall be called Registered Foreign Portfolio Investor (RFPI)—the existing portfolio investor class, namely, Foreign Institutional Investor (FII) and Qualified Foreign Investor (QFI) registered with SEBI shall be subsumed under it. The new guidelines for RFPIs are as given below:

(i) They may purchase and sell shares and convertible debentures of Indian companies through a registered broker on recognised stock exchanges in India as well as purchase shares and convertible debentures, which are offered to public in terms of relevant SEBI guidelines.
(ii) Such investors can acquire shares or convertible debentures in any bid for, or acquisition of, securities in response to an offer for *disinvestment* of shares made by the central government or any state government.
(iii) These entities would be eligible to invest in *government securities* and corporate debt, subject to limits specified by the RBI and SEBI from time to time.
(iv) Such investors would be permitted to trade in all exchange-traded derivative contracts on the stock exchanges, subject to the position limits as specified by SEBI from time to time.
(v) RFPI may offer cash or foreign sovereign securities with AAA rating or corporate bonds or domestic government securities, as collateral to the recognised stock exchanges for their transactions in cash as well as derivative segment of the market.

All investments made by that FIIs/QFIs in accordance with the regulations prior to registration as RFPI shall continue to be valid and taken into account for computation of aggregate limit.

PARTICIPATORY NOTES (PNs)

A Participatory Note (PN or P-Note) in the Indian context, in essence, is a *derivative* instrument issued in foreign jurisdictions, by a SEBI registered

foreign institutional investor (FII), against Indian securities—the Indian security instrument may be equity, debt, derivatives or may even be an index. PNs are also known as *Overseas Derivative Instruments*, *Equity Linked Notes*, *Capped Return Notes,* and *Participating Return Notes*, etc.

The investor in PN does not own the underlying Indian security, which is held by the FII who issues the PN. Thus, the investors in PNs derive the economic benefits of investing in the security without actually holding it. They benefit from fluctuations in the price of the underlying security since the value of the PN is linked with the value of the underlying Indian security. The PN holder also does not enjoy any voting rights in relation to security/shares referenced by the PN.

Reasons for the popularity of PNs

The reasons why PNs became such a popular ruote for foreign investors to invest in the Indian security market may be understood through the following points:

(i) One of the primary reasons for the emergence of the PN (an 'off-shore derivative instrument', i.e., an ODI) is the restrictions on foreign investments. For example, a foreign investor intending to make portfolio investments in India was required to seek FII registration for which he is required to meet certain eligibility criteria. Lack of full *Capital Account Convertibility* further enhances the entry barriers from the perspective of a foreign investor. However, Since *January 2012*, The Indian government has taken a decision to give direct access to such prospective 'foreign individual investors' who were hitherto banned to invest in equity of Indian companies.

(ii) The off-shore derivative market allows investors to gain exposure to the local shares without incurring the time and costs involved in investing directly. In return, the foreign investor pays the PN issuer a certain basis *point(s)* of the value of PNs traded by him as *costs*. For instance, directly investing in the Indian securities markets as an FII, has significant cost and time implications for the foreign investor. Apart from seeking FII registration, he is required to establish a domestic broker relationship, a custodian bank relationship, deal in foreign exchange and bear exchange rate fluctuation risk, pay domestic taxes and/or filing tax return, obtain or maintain an investment identity, etc. These investors would rather look for derivatives alternatives to gain a cost-effective exposure to the relevant market.

(iii) Besides reducing transactions costs, PNs also provide customised tools to manage risk, lower financing costs and enhance portfolio yields. For instance, PNs can also be designed for longer maturities than are generally available for exchange-traded derivative.

(iv) PNs also offer an important *hedging tool* to a foreign investor already registered as an FII. For example, an FII may wish to obtain 'long' exposure to a particular Indian security. The FII can hedge the downside exposure to the listed security, already purchased by purchasing a 'cash settled put option'. Although the Indian exchanges offer options contract, these contracts have a maximum life period of three months, beyond which the FII shall have to rollover its positions, i.e., purchase a fresh option contract. Alternatively, it can avail of a PN which can be customised to cater to its hedging requirements.

(v) Potential investors who would like to take direct Indian exposure in future, may make initial investments through the PN route so as to get a flavour of future anticipated returns.

(vi) Further, trading in ODI/PNs gives an opportunity to offshore entities to have a commission based business model. This route provides ease to subscribers as it bypasses the direct route which may be resource heavy for them.

(vii) And ***lastly***, it was a highly 'safe and lucrative route' to invest the 'unaccounted', 'even illegal' money into the Indian security market for huge profits (during the booming period). Experts even imagined that it may be allowing the 'black money' of India (stashed away from India through 'hawala' kind of illegal channels and deposited in the tax havens of the world in 'Swiss Bank' kind of financial institutions) to get invested back in the market. Again, 'terrorist organisations' might have been using this route, too.

PNs are ***thus*** issued, to provide access to a set of foreign investors who intend to reduce their overall costs and the time involved in making investments in India. In other words, the attraction of investing in PNs is primarily one of efficiency (from an infrastructure and time perspective) for which they are willing to forego certain benefits of directly holding the local securities (for example, title and voting rights), whilst also assuming other risks.

Regulation of PNs

PNs are market instruments that are created and traded overseas. Hence, Indian regulators cannot ban the issue of PNs. However, they can regulated, as SEBI does—when a PN is traded on an overseas exchange, the regulator in that jurisdiction would be the authority to regulate that trade. PNs have been used by FIIs, since FIIs were permitted to invest in the securities market (1994)—they were not specifically dealt with under the regulations until 2003. According to the *SEBI Regulation, 2004* (and further amended in 2008) with the ***objective*** of tightening regulations in this regard—

(i) PNs can be issued only to those entities which are regulated by the relevant regulatory authority in countries of their incorporation and are subject to compliance of 'know your client' (KYC) norms.

(ii) Down-stream issuance or transfer of the instruments can also be made only to a regulated entity.

(iii) Further, the FIIs who issue PNs against underlying Indian securities are required to *report* the issued and outstanding PNs to SEBI in a prescribed format.

(iv) In addition, SEBI can call for any information from FIIs concerning off-shore derivative instruments (ODIs) issued by it.

(v) In order to monitor the investment through these instruments, SEBI on *October 31, 2001*, advised FIIs to submit information regarding issuance of derivative instruments by them, on a monthly basis. These reports require the communication of details such as name and constitution of the subscribers to PNs, their location, nature of Indian underlying securities, etc.

(vi) FIIs cannot issue PNs to non-resident Indians (NRIs) and those issuing PNs are required to give an undertaking to the effect.

(vii) SEBI has also mandated that QFIs (qualified foreign investors), the recently allowed foreign investor class, shall not issue PNs.

SEBI in consultation with the government had decided in *October 2007*, to place certain restrictions on the issue of PNs by FIIs and their sub-accounts. This decision was taken with a view to moderate the surge in foreign capital inflows into the country and to address the 'know-your-client' concerns for PN holders. However, it was found that such restrictions were ineffective. Therefore, SEBI in October 2008 reviewed its earlier decision and decided to remove these restrictions in the light of the above factors. Rather, more attention is given to effective disclosures. As per a SEBI decision of October 2013, the Category III FIIs are not allowed to issue PNs.

The Concerns Related to PNs

Being derivative instruments and freely tradable, PNs can be easily transferred, creating multiple layers, thereby obfuscating the real beneficial owner. It is in this respect that concerns about the ***identity of ultimate beneficial*** owner and the source of funds arises.

For the reason that such instruments are issued outside of India, these transactions are outside the purview of SEBI's surveillance and it is the FII which acts as mini-exchange overseas. The actual transactions in the underlying securities are executed by the FIIs only at its discretion, as and when necessary and there is no one-to-one correspondence between transactions in the underlying instruments and issuance of PNs.

The ex-post reporting requirement enjoined upon the FII in respect of PNs on a monthly basis effectively keeps the transactions in PNs out of the real time market surveillance mechanism and beyond the enforceability jurisdiction of SEBI.

There are also concerns that some of the money coming into the market via PNs could be the ***'unaccounted wealth'*** camouflaged under the guise of FII investment. However, this has not been proved so far. SEBI has indeed been successful in taking action against the FIIs who were non-compliant and those who had misreported offshore derivatives [as happened when SEBI took actions against two FIIs—*Barclays* in December 2009 and *Societe Generale* in January 2010]

At present, PNs are issued by large financial sector conglomerates which not only have strong presence in the global investment banking arena but also have asset management arms which invest across a number of securities markets globally. These entities are originally incorporated in well-regulated and developed jurisdictions like the US, UK, etc. Further, these entities also possess the financial wherewithal to issue PNs, complemented by skilled personnel who are adept at risk management and financial engineering activities.

International Situation

PN like products are not necessarily used to invest in restricted markets, but also reported to be available in the open developed/advanced economies like Japan, Hong Kong, Singapore, Australia, the USA and UK. In response to market manipulation concerns, in December 1999, *Taiwan Securities and Futures Commission* had amended its FII regulations to require periodic disclosure by FIIs of all offshore derivative activities linked to local shares, but this requirement was subsequently removed in June 2000 (as the Ashok Lahiri Committee Report says). *China*'s *Securities Regulatory Commission* requires entities to file reports related to these products with minimal 'reporting requirements that emphasize only on the quota utilised by them'. *Other Asian countries* like Hong Kong, Singapore and Japan have reportedly 'no restrictions' or requirements on PNs. Malaysia, Indonesia and Philippines which are restricted markets though, are having no reporting requirements in this regard.

HEDGE FUND

This term has come up from another term ***hedging***, a process by which businesses insulate themselves from the risk of price changes.[14] Hedge funds are the lot of investible (free floating capital) capital which move very swiftly towards the more profitable sectors of an economy.

At present, such funds easily move from the stock market of one economy to the other—away from the low profit fetching to high profit fetching ones. As stock markets fall and rise such funds change markets accordingly. By nature they are temporary. The period for which they continue flowing into an economy there is naturally a boom time. But when they quit for a more attractive economy, the same economy might not be able to manage the accelerated foreign currency outflow and there are chances of imminent foreign currency crisis. This has been in news for the last two years in India where stock market has been in boom, riding on the FIIs inflow via Participatory Notes (PNs).

SHORT SELLING

Sale of a share which is not owned. This is done by someone after borrowing shares from stockbrokers promising to replace them at a future date on the hope (speculation) that the price will fall by then. He fetches profit if price of the share really fell down by the future date of replacement and sustains a loss if the price increased. Recently, short selling has been allowed in India by SEBI.

BEAR AND BULL

A person who speculates share prices to fall in future and so sells his shares and earns profit is a *bear*. He earns profit out of a falling market. Basically, here he is short selling the shares.

Opposite to bear, bull is a person who speculates share prices to go up in future so either stops selling the select group of shares for that time to be reached (he is basically taking long position on those shares) or starts purchasing that select group of shares.

Thus, a bear increases the number of shares in a stock market activating a general fall in the index—a bearish market. Opposite to it, a bull creates a scarcity of shares in the stock market activating a general rise in the share prices and the index—a bullish market.

Brokers play as a bear for some stocks and as a bull for some other stocks. while a bear broker is a non-entity, a bull is remembered for long time to come—Harshad Mehta was known as the Great Bull.

BOOK BUILDING

A provision allowed by SEBI to all Initial Public offers (IPOs) in which individual investors are reserved and allotted shares by the company. But the issuer has to disclose the price (at which shares have been allotted the size of the issue and the number of shares offered to the public).

IPO

Initial Public Offer (IPO) is an event of share issuing when a company comes up with its share/ securities issued for the first time.

PRICE BAND

A process of public issue where the company gives a price range (known as price band) and it is left upon the share applicants to quote their prices on it—the highest bidders getting the shares. This is a variant of share issue at premium but considered a safer choice.

14. Samuelson and Nordhaus, ***Economics***, op. cit., p. 207.

ECB POLICY

A prospective borrower can access external commercial borrowings (ECBs) under two routes, namely the 'automatic route' and the 'approval route'. ECBs not covered under the automatic route are considered on case-by-case basis by the RBI under the approval route. The High Level Committee on ECB took a number of decisions in *September 2011* to expand the scope of ECBs which include:

(i) High networth individuals (HNIs) who fulfil the criteria prescribed by SEBI can invest in IDFs.

(ii) IFCs have been included as eligible issuers for FII investment in the corporate bonds long-term infra category.

(iii) ECB would be permitted for refinancing of rupee loans of infrastructure projects on the condition that at least 25 per cent of such ECBs shall be used for repayment of the said rupee loan and 75 per cent invested in new projects in the infrastructure sector (but only under the approval route).

(iv) Refinancing of buyer's/supplier's credit through ECBs for the purchase of capital goods by companies in the infrastructure sector was approved. This would also be permitted only under the approval route.

(v) ECBs for interest during construction (IDC) that accumulates on a loan during the project execution phase for companies in the infrastructure sector would be permitted. This would be subject to the condition that the IDC is capitalised and is part of the project cost.

(vi) Renminbi (RMB)—the Chinese currency—was approved as an ***acceptable currency*** for raising ECBs subject to/ limit of US $ 1 billion within the existing ECB ceiling (allowed only through the approval route).

(vii) The existing ***ECB limits*** under the automatic route were enhanced from US $ 500 million to US$ 750 million for eligible corporates. For borrowers in the *services sector,* the limit has been enhanced from US$ 100 million to US$ 200 million and for *NGOs* engaged in *micro-finance* activities from the existing US$ 5 million to US$ 10 million.

(viii) INR (rupee) denominated ECBs would be permitted from foreign equity holders to 'all eligible borrowers' except in the case of ECBs availed of by NGOs under the automatic route.

During the financial year ***2014–15 and early 2015–16*** the external commercial borrowings (ECB) policy was further liberalised via the following steps :

(i) Enhancing the limit for refinancing rupee loans through ECB from 25 per cent to 40 per cent for Indian companies in the power sector;

(ii) Allowing ECB for capital expenditure on the maintenance and operation of toll systems for roads and highways so long as they are a part of the original project subject to certain conditions, and also for low cost housing projects;

(iii) Reducing the withholding tax from 20 per cent to 5 per cent for a period of three years (July 2012—June 2015) on interest payments on ECBs;

(iv) Introducing a new ECB scheme of US $10 billion for companies in the manufacturing and infrastructure sectors;

(v) Permitting the Small Industries Development Bank (SIDBI) as an eligible borrower for accessing ECB for on-lending to the micro, small and medium enterprises (MSMEs); and

(vi) Permitting the National Housing Bank (NHB)/Housing Finance Companies to avail themselves of ECBs for financing prospective owners of low cost /affordable housing units.

RGESS

On *November 23, 2012*, the government notified a new tax saving scheme called the Rajiv Gandhi Equity Savings Scheme (RGESS), ***exclusively for first-time retail investors*** in the securities market. This scheme provides 50 per cent deduction of the amount invested from taxable income for that year to new investors who invest up to Rs. 50,000 and whose annual income is below Rs. 10 lakh.The Rajiv Gandhi Equity Saving Scheme (RGESS) will give tax benefits to new investors whose annual income is up to Rs. 10 lakh for investments up to a maximum of Rs. 50,000. The investor will get 50 per cent deduction of the amount invested from taxable income for that year. Salient features of the scheme are as follows :

(i) The scheme is open to new retail investors identified on the basis of their permanent account numbers (PAN).

(ii) The tax deduction allowed will be over and above the Rs. 1 lakh limit permitted allowed under Section 80 C of the IncomeTax Act.

(iii) In addition to the 50 per cent tax deduction for investments, dividend income is also tax free.

(iv) Stocks listed under BSE 100 or CNX 100, or stocks of public-sector undertakings (PSUs) that are Navratnas, Maharatnas, and Miniratnas will be eligible under the scheme. Follow-on public offers (FPOs) of these companies will also be eligible.

(v) IPOs of PSUs, which are scheduled to get listed in the relevant financial year and whose annual turnover is not less than Rs. 4,000 crore for each of the immediate past three years, will also be eligible.

(vi) Exchange-traded funds (ETFs) and MFs that have RGESS-eligible securities have also been brought under the RGESS.

(vii) To benefit small investors, investments are allowed in instalments in the year in which tax claims are made.

(viii) The total lock-in period for investments will be three years including an initial blanket lock-in of one year. After the first year, investors will be allowed to trade in the securities.

The broad provisions of the scheme and the income tax benefits under it have already been incorporated as a new *Section-80CCG* of the Income Tax Act 1961, as amended by the Finance Act 2012. The operational guidelines were issued by SEBI on *December 6, 2012.*

CREDIT DEFAULT SWAP (CDS)

CDS is in operation in India since October 2011 – launched in only corporate bonds. The eligible participants are commercial banks, primary dealers, NBFCs, insurance companies and mutual funds.

CDS is a credit derivative transaction in which two parties enter into an agreement, whereby one party (called as the 'protection buyer') pays the other party (called as the 'protection seller') periodic payments for the specified life of the agreement. The protection seller makes no payment unless a credit event relating to a pre-determined reference asset occurs. If such an event occurs, it triggers the Protection Seller's settlement obligation, which can be either cash or physical (India follows physical settlement). It means, ***CDS is a credit derivative that can be used to transfer credit risk from the investor exposed to the risk*** (called protection buyer) ***to an investor willing to take risk*** (called protection seller).

It operates like an insurance policy. In an insurance policy, the insurance firm pays the loss amount to the insured party. Similarly, the buyer of the CDS—the bank or institution that has invested in a corporate bond issue—seeks to mitigate the losses it may suffer on account of a default by the bond issuer. Credit default swaps allow one party to 'buy' protection from another party for losses that might be incurred as a result of default by a specified reference instrument (a bond issue in India). The 'buyer' of protection pays a premium to the seller, and the 'seller' of protection agrees to compensate the buyer for losses incurred upon the occurrence of any one of the several specified 'credit events'. *Thus CDS offers the buyer a chance to transfer the credit risk of financial assets to the seller without actually transferring ownership of the assets themselves.*

Let us try to understand it by an example. Suppose Punjab National Bank (PNB) invests in Rs. 150 crore bond issued by TISCO. If PNB wishes to *hedge* losses that may arise from a default of TISCO, then PNB may buy a credit default swap from a financial institute, suppose, Templeton. PNB will pay fixed periodic payments to Templeton, in exchange for default protection (just like premium of an insurance policy).

CDS can be *used for different purposes* in a financial system, viz.,

(i) Protection buyers can use it to hedge their credit exposure while protection sellers can use it to participate in credit markets, without actually owning assets.

(ii) The protection buyer can transfer credit risk on an entity without transferring the under lying instrument, reap regular benefit in terms of lower capital charge, seek reduction of specific concentrations in credit portfolio and go short on credit risk.

(iii) The protection seller will be able to diversify his portfolio, create exposure to a particular credit, have access to an asset which may not otherwise be available, and increase the yield on his portfolio.

(iv) Banks can use it to transfer risk to other risk takers, create capital for more lending.

(v) Distribute risk widely throughout the system and prevent concentrations of risk.

Some analysts have serious **apprehensions** about CDS. *George Akerlof*, Nobel prize-winning economist, in 1993, predicted that the next meltdown will be caused by CDS. In 2003 investment legend *Warren Buffet* called them as 'weapons of mass destruction'. The former US Federal Reserve Chairman *Alan Greenspan*, who betted big on CDS said after the 'sub prime' crisis that 'CDS are dangerous'. A leading US weekly the *Newsweek* described CDS, 'the monster that ate Wall Street'. Many Indian experts had the opinion that 'CDS will not stabilise the economy rather could lead to destabilisation'.

CDS contract are dangerous because they can be manipulated for mischief. It's all about the insurable interest which is never there as it is used for *speculation*. A derivative that amounts to an insurance contract with no insurable interest is bad. But do the speculators have insurable interest? No they don't have any. The US 'sub prime' crisis was a fallout of such CDS contracts—one defaulting and another claiming the 'protection' finally resulting into the defaulter of the insuring company—overnight the biggest US insurance giant, AIG went bankrupt. So happened with many US banks also.

The most damaging aspect of CDS is that the credit risk of one country/region gets exported to another country/region very smoothly and silently – thus there is a serious chance of 'contagion effect'

suppose there are defaulters there – the thing which happened during the US 'sub prime' crisis.

SECURITISATION

This is the process of issuing 'marketable securities' backed by a pool of existing assets such as auto or home loans. After an asset is converted into a marketable security, it is sold to an investor who then receives interest and principal out of the cash flow generated from servicing of the loan. Financial institutions such as NBFCs and microfinance companies convert their loans into marketable securities and sell them to investors. This helps them get liquid cash out of assets that otherwise would be stuck on their balance sheets.

Global experience shows that if the value of the underlying asset falls then securitised assets lose value as it had happened during the US 'sub-prime crisis'—home loans against which securitised assets were sold to insurance companies and banks lost value, which in turn resulted in a crisis. To prevent such crises, the RBI has taken some precautionary steps in this regard. It has asked companies to hold securities for a certain minimum period:

(i) While NBFCs need to keep assets for six months, a minimum retention requirement of 5–10 per cent to ensure that they have a continuing stake in the performance of securitised assets.

(ii) Micro Finance Institutions (MFIs) need to hold them for three months.

Since it was allowed in India by the RBI, it has been in news – whether the 'securitisations trusts' will need to pay tax on it. Meanwhile, the *Union Budget 2013–14* has cleared the air on the issue. There should not be any additional income-tax if the income distributed by the trust is received by a person who is exempted from tax. This is expected to bring back mutual funds into the securitisation market.

CORPORATE BOND IN INDIA

Economic vibrancy coupled with sophisticated state–of–the–art financial infrastructure has contributed to rapid growth in the equity market in India. In terms of market features and depth, the Indian equity market ranks among the best in the world. In parallel, the government securities market has also evolved over the years and expanded, given the increasing borrowing requirements of the government. In contrast, the corporate bond market has languished both in terms of market participation and structure. NBCs are the main issuers and very small amounts of finance are raised by companies directly. The ***Economic Survey 2010–11*** (p. 116), cites many reasons for the less-developed bond market in India—

(i) Predominance of banks loans;

(ii) FII's participation is limited;

(iii) Pensions and insurance companies and household are limited participants because of lack of investor confidence; and

(iv) Crowding out by government bonds.

The ***Economic Survey 2011–12*** concluded[15] that there is now ample empirical research to corroborate Schumpeter's conjecture that financial

15. **Economic Survey 2011-12** (p.34) quotes many contemporary references to bring the point home –
a). R. Rajan, and L. Zingales (1998), 'Financial Dependence and Growth,' *American Economic Review*, vol. 88; **b).** S. Banerji, K. Gangopadhyay, I. Patnaik, and A, Shah (2012), 'New Thinking on Corporate Debt in India', mimeo.; **c).** C. K. G. Nair, (2012) 'Financial Sector Reforms: Refining the Architecture,' in R. Malhotra (ed.), *A Critical Decade: Policies for India's Development,* Oxford University Press, New Delhi; **d).** T. A. Bhavani, and N. R. Bhanumurthy (2012), *Financial Access in Post-Reform India,* Oxford University Press, New Delhi, Chapter 12; **e).** P. Bolton, and X. Freixas, 'How can Emerging Market Economies Benefit from a Corporate Bond Market?', in E. Borzenstein, K. Cowan, B. Eichengreen, and U. Panizza,(eds) (2008), *Bond Markets in Latin America*, MIT Press.

development facilitates real economic growth. The depth of the financial markets and availability of diverse products should, therefore, not be treated as mere adornment, but as critical ingredients of inclusive growth.

Banks in India accounted for 14.4 per cent of the financing of large firms in 2000–01, which rose further to 17.8 per cent in 2010–11. The *bond market*, on the other hand, has been miniscule in comparison. The thinness of the bond market has been somewhat compensated by foreign borrowing done by Indians, which rose sharply over the last decade. Further, India is characterised by a disproportionate amount of secured borrowing. The small size of unsecured borrowing may, at first sight, not seem to be a matter of concern, but it could be a reflection of the weakness of contract enforcement and lack of adequate information. If contracts were quickly enforced and lenders had information on borrowers, they would be more willing to give unsecured loans. This would give a nimbleness to the financial markets which they presently lack.

There are ***many reasons*** why bond markets are important for an emerging economy. Prominent among these is the fact that they lead to more efficient entrepreneurship and greater value creation. When an entrepreneur takes a loan or issues bonds, all additional profit over and above the pre-fixed repayment amount accrues to the entrepreneur. So he or she is better incentivised to take sharper decisions. By having a weak bond market, we may be foregoing this efficiency. And further, this efficiency gap may well mean that there is less lending and hence less investment and entrepreneurship in the economy than is feasible. Further, as India tries to garner 500 billion dollars from the private sector in the Twelfth Plan for investment in the infrastructure sector, having an active bond market would be a valuable avenue for raising money.

There can be many reasons why, despite these advantages, the bond market has not developed adequately. One reason has to do with what economists call 'multiple equilibria'. Consider a situation where the bond market is small. If someone buys bonds and later wish to sell these off, he anticipates difficulty. Since the bond market is not active, he may not easily be able to sell the bonds and thus he will hold simply because he cannot find a buyer. Hence, this may lead to discourage someone from buying the bonds in the first place. If everybody reasons like this, the bond market remains thin. Hence, the need is for a push that nudges the market to another equilibrium, where people readily buy bonds because they know that they can easily sell these off and this becomes a self-fulfilling prophesy and sustains the large bond market.

There is effort currently on to try to boost India's debt and bond markets, and success in this can give another fillip to growth. With the intervention of the ***Patil Committee*** recommendations, the corporate bond market is slowly evolving. With bank finance drying up for long term infrastructure projects, in view of asset liability problems faced by the banking system, the need for further development of a deep and vibrant corporate bond market can hardly be overemphasised. Recent initiatives for further development of corporate bond markets, taken in the year ***2012–13*** are as given below :

(i) Banks allowed to take limited membership in SEBI-approved stock exchanges for

the purpose of undertaking proprietary transactions in the corporate bond markets.

(ii) To enhance liquidity in the corporate bond markets, the IRDA has permitted insurance companies to participate in the repo market. The IRDA has also permitted insurance companies to become users of '*credit default swap*' (CDS).

(iii) The minimum **haircut**[16] (i.e., the difference between prices at which a market maker can buy and sell a security) requirement in corporate debt repo have been reduced from the existing 10 per cent; 12 per cent; 15 per cent to 7.5 per cent; 8.5 per cent; 10 per cent for AAA/AA+/AA-rated corporate bonds.

(iv) MFs have been permitted to participate in CDS in corporate debt securities, as users.

(v) Revised guidelines on CDS for corporate bonds by the RBI provide that in addition to listed corporate bonds, CDS shall also be permitted on *unlisted* but rated corporate bonds even for issues other than infrastructure companies.

(vi) Users shall be allowed to **unwind**[17] their CDS-bought position with the original protection seller at a mutually agreeable or FIMMDA (Fixed Income Money Market and Derivatives Association of India) price. If no agreement is reached, then unwinding has to be done with the original protection seller at FIMMDA price.

(vii) CDS shall be permitted on securities with original maturity up to *one year* like CPs, certificates of deposit, and non-convertible debentures with original maturity less than one year.

Economic Survey 2012–13 comments: A reasonably well-developed corporate bond market is very much required in any economy to supplement banking credit and the equity market and to facilitate the long-term funding requirement of corporate sector as well as infrastructure development in the country. Though, the development of the corporate bond market has been an important area and has received greater policy attention in recent times, it is yet to take off in a significant manner. Some of the issues that ***need to be addressed*** in this regard include:

(i) Drawing up a roadmap for a structural shift from a *bank-dominated* financial system to a more diverse financial system where top-rated corporates access finance from capital markets;

(ii) Strengthening of the *legal framework* for regulation of corporate debt by necessary amendments in rules/regulations, and

(iii) Relaxation of investment *guidelines* for pension, provident, and insurance funds

16. ***Haircut*** is the difference between prices at which a *market maker* can buy and sell a security. The term comes from the fact that market makers can trade at such a *thin spread*. It also means that the percentage by which an asset's market value is reduced for the purpose of calculating capital requirement, margin and collateral. When they are used as collateral, securities will generally be devalued since a cushion is required by the lending parties in case the market value falls.

17. ***Unwind*** is used to close out a position that has offsetting investments or the correction of an error. Unwinds occur when, for example, a broker mistakenly sells part of a position when an investor wanted to add to it. The broker would have to unwind the transaction by selling the erroneously purchased stock and buying the proper stock. One type of investing that features unwind trading is *arbitrage investing (as happens in the CDS)*. If, for the sake of illustration, an investor takes a long position in stocks, while at the same time selling puts on the same issue, he will need to unwind those trades at some point. Of course, this entails covering the options and selling the underlying stock. A similar process would be followed by a broker attempting to correct a buying or selling error.

to enable the participation of longterm investors in the corporate bond market.

Introduction of new products and making nascent products such as covered bonds, municipal bonds, credit default swaps, credit enhancements, and securitisation receipts more attractive may be considered for public issuance of bonds at reduced cost. Improving the market infrastructure for enabling liquidity, transparency in price discovery, and stimulating growth in trading volumes also need to be suitably addressed.

INFLATION-INDEXED BONDS

To protect the returns of investors from the vagaries of inflation, the Reserve Bank of India plans to introduce inflation-indexed bonds (IIBs)—it was proposed by the ***Union Budget 2013–14***. The government hopes this will help increase *financial savings instead of buying gold*. In the recent years, the rate of return on debt investments has often been below inflation, which effectively means that inflation was eroding savings. Inflation indexed bonds provide returns that are always in excess of inflation, ensuring that price rise does not erode the value of savings.

In 2013–14, RBI launched two such bonds —the first one in June 2013 linked with the WPI which had a very weak retail response and second one in *December 2013* linked with CPI. The latter one is called as **Inflation Indexed National Savings Securities-Cumulative (IINSS-C)** with a 10 years tenure. These are internationally known as *inflation-linked securities* or simply *linkers*. Interest rate on these securities would be linked to final combined consumer price index [CPI (Base: 2010=100)]. Interest rate would comprise two parts: fixed rate (1.5 per cent) and inflation rate, based on three-month lag to CPI – thus, if a bond is being valued in December, the reference rate will be CPI of September. The new offering should attract higher attention from savers, especially due to its link to CPI instead of wholesale price index (WPI), which is a less accurate gauge of inflation. CPI is considered a more accurate gauge of the impact of inflation on consumers because it takes into account increases in the cost of education, food, transportation, housing and medical care; in WPI, the emphasis is on measuring the prices of traded goods and services.

It was in 1997 that the IIBs were issued for the first time in India—named as the *Capital Indexed Bonds (CIBs)*. But there remains a difference between these two bonds. While the CIBs provided inflation protection only to principal the new product IIBs provides inflation protection to both the components—principal and interest payments.

GOLD EXCHNAGE TRADED FUNDS

Gold Exchange Traded Funds (ETFs) are *open-ended mutual fund schemes* that closely track the price of physical gold. Each unit represents *one gram* of gold having 0.995 purity, and the ETF is listed on stock exchanges. The net asset value of each unit is calculated based on the prices of physical gold prevailing on that day and is designed to provide returns that would closely track the returns from physical gold.

E-GOLD

e-Gold is another purchase option, involving investments in units traded on the National Stock Exchange (NSEL). Here, the investor is required to have a demat account with an affiliate of NSEL. e-Gold's brokerage and transaction charges are lower than *gold ETFs* as there are no fund management charges. One can take delivery of gold or sell it in the exchange.

But there is also a *negative point* here from the tax angle—under e-Gold, one has to hold the yellow metal for 36 months to enjoy *long-term capital gain* benefits, and this is taxed at 20 per cent. For ETFs (Exchange Traded Funds) and

gold funds, the holding period to be classified as long-term is only one year. After a year, ETF and gold funds will suffer 10 per cent tax without indexation and 20 per cent after indexation. For a small investor, gold ETF would appear to be the best option, as it meets his needs without difficulties in terms of creating a separate demat account, tax implications and wealth tax.

CPSE ETF

The Central Public Sector Enterprises Exchange Traded Fund (CPSE ETF) comprising the shares of 10 blue chip PSUs was listed on the BSE and NSE platforms on April 4, 2014. The Government of India expected to raise a corpus of Rs. 3,000 crore through the fund while it got over-subscribed to the tune of Rs. 4,300 crores.

This scheme is conceived by the GoI as a means to *disinvest* a part of its holding in Public Sector Units (PSUs) and would be managed by ***Goldman Sachs Asset Management (India) Pvt. Ltd.***, a *mutual fund company* that specialises in managing exchange traded funds.

ETF is a security that tracks an index, a commodity or a basket of assets such as an index fund, but trades like a stock on an exchange – the CPSE ETF tracks the CPSE Index (of 10 PSUs included in the ETF). CPSE Index has been constructed by including companies that meet the following criteria:

(i) Owned 55 per cent or more by the GoI and listed on the NSE;

(ii) Large PSUs (those having more than Rs.1,000 crores as average free float market capitalisation for six months period ending June 2013); and

(iii) With a consistent dividend payment record (at least 4 per cent for 7 years immediately prior to or 7 out of 8/9 years immediately prior to June 2013).

The ten blue-chip PSUs which meet the above criteria and their weightages are: ONGC (26.72 per cent); GAIL (India) (18.48 per cent); Coal India (17.75 per cent); REC (7.16 per cent); Oil India (7.04 per cent); IOC (6.82 per cent); Power Finance Corp. (6.49 per cent); Container Corp. (6.40 per cent); Bharat Electronics (2 per cent) and Engineers India Ltd. (1.13 per cent).

CPSE ETF will invest the corpus in the above-given companies as per the given weightage. Hence, subject to the tracking error and expenses, CPSE ETF's returns will closely correspond to the CPSE Index returns.

ETFs were introduced in India in 2001. At present (by **May 2014**), there are about 33 ETFs with assets under management of close to Rs. 11,500 crore held by 6.20 lakh investors. *Gold ETFs* dominate the market in India.

PENSION SECTOR REFORMS

Pension has been the integral part of government jobs in India. Pension serves two important socio-economic objectives—

(i) It facilitates the flow of long-term savings for development, i.e., *nation-building*; and

(ii) Also helps establish a credible and sustainable *social security system* in the country.

The New Pension System (NPS) was introduced for the new recruits who join government service on or after ***January 1, 2004***. Although the NPS is perhaps one of the cheapest financial products available in the country, in order to make it affordable for the economically disadvantaged, the government in September 2010 introduced a lower cost version, known as ***Swavalamban Scheme***, which enables groups of people to join the NPS at a substantially reduced cost. As per existing scheme under NPS, Swavalamban

could be availed either in 'unorganised sector' or in ***'NPS Lite'***. NPS Lite is a model specifically designed to bring NPS within easy reach of the economically disadvantaged sections of the society —it is extremely affordable and viable due to its optimised functionalities, available at reduced charges. Under the Swavalamban scheme, the government provides subsidy to each NPS account holder and the scheme has been extended until 2016–17.

A customised version of the core NPS model, known as the *NPS Corporate Sector Model* was also introduced from December 2011 to enable 'organised-sector' entities to move their existing and prospective employees to the NPS under its Corporate Model. All pubic sector banks have been asked to provide a link on their website to enable individual subscribers to open online NPS accounts.

As per the ***Economic Survey 2012–13,*** the pension reforms in India have generated widespread interest internationally but before universal inclusion of poorer sections of Indian society into the pension network is a reality, the economy needs to solve the following *major challenges* :

(i) Lower levels of financial literacy, particularly among workers in the unorganised sector;
(ii) Non-availability of even moderate surplus;
(iii) Lukewarm response so far from most of the state/UT governments to a co-contributory Swavalamban Scheme; and
(iv) Lack of awareness, on the supply side, about the NPS and of access points for people to open their accounts individually have been major inhibiting factors.

Financial Stability and Development Council (FSDC)

An apex level Financial Stability and Development Council (FSDC) was set up by the GoI in December 2010, 'in line with the G-20 initiatives' with the following ***objectives***:

(i) To strengthen and institutionalise the mechanism for maintaining financial stability,
(ii) To enhance inter-regulatory coordination, and
(iii) to promote financial-sector development.

The council is *chaired* by the Finance Minister and has *heads* of financial-sector regulatory authorities, the Finance Secretary and/or Secretary of the Department of Economic Affairs, Secretary of the Department of Financial Services, and the Chief Economic Adviser as members. Without prejudice to the autonomy of regulators, the Council ***monitors***—

(i) macro-prudential supervision of the economy, including functioning of large financial conglomerates,
(ii) inter-regulatory coordination and financial-sector development issues, and
(iii) *financial literacy* and *financial inclusion*.

Financial Sector Assessment Programme (FSAP)

The *IMF Board* decided in September 2010, to include 25 *systemically* important economies, including India, under the Financial Stability Assessment Programme (FSAP) for members with systemically important financial sectors. The joint IMF-World Bank Financial Stability Assessment Programme (FSAP) was conducted for India in *January 2013* which assessed Indian financial system in relation to the highest international standards. The **assessment** recognises that the Indian financial system remained *largely stable* on account of a sound regulatory and supervisory

regime. However, the assessment identifies *some gaps* in[18]—

(i) International and domestic supervisory information sharing and co-operation;

(ii) Consolidated supervision of financial conglomerates; and

(iii) Some limits on the *de jure* independence of the regulators (RBI and IRDA).

Despite having reservations on few issues, overall the Indian authorities expect the FSAP exercise to play a *significant role* in shaping India's post-crisis initiatives to strengthen the regulatory and supervisory architecture based on the evolving international consensus as well as careful examination of their relevance in the India-specific context. As a member of the FSB[19], BCBS[20] and IMF[21], India is actively participating in post-crisis reforms of the international regulatory and supervisory framework under the aegis of the **G20**. India remains committed to adoption of international standards and best practices, in a phased manner and calibrated to local conditions, wherever necessary, as it is a country characterised by complex and diverse socio-political and economic conditions.

Financial Stability and Development Council (FSDC)

As a follow-up to the announcement made in the Budget 2010–11, with the ***objective*** to strengthening and institutionalising the mechanism for maintaining financial stability and enhancing inter-regulatory coordination, an apex-level Financial Stability and Development Council under the Chairmanship of the Finance Minister has been set up.

A sub-committee of the FSDC has also been set up under the chairmanship of the Governor RBI. Under the aegis of the FSDC, two empowered Technical Groups (i.e., Technical Group on Financial Literacy and Financial Inclusion and Inter-Regulatory Technical Group) have been formed.

18. RBI, 16th January, 2013

19. The **FSB** was established in April 2009 as the successor to the Financial Stability Forum (FSF). The FSF was founded in 1999 by the G–7 for enhancing cooperation among the various national and international supervisory bodies and international financial institutions so as to promote stability in the international financial system. In November 2008, the leaders of the G–20 countries called for a larger membership of the FSF. As announced in the G–20 Leaders Summit of *April 2009*, the expanded FSF was re-established as the *Financial Stability Board (FSB)* with a broadened mandate to promote financial stability. The FSB is chaired by *Mark Carney*, Governor of the Bank of Canada. Its secretariat is located in Basel, Switzerland, and hosted by the Bank for International Settlements.

    Its ***objective*** is to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies. [*Source*: Financial Stability Board Secretariat, Bank for International Settlements, Basel , Switzerland].

20. The **BCBS** (Basel Committee on Banking Supervision) provides a forum for regular cooperation on banking supervisory matters. The Committee's members, today, come from 27 nations including India. The present Chairman of the Committee is *Stefan Ingves*, Governor of Sveriges Riksbank. It is located at the Bank for International Settlements (BIS) in Basel, Switzerland.

    Its ***objective*** is to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide. It seeks to do so by exchanging information on national supervisory issues, approaches and techniques, with a view to promoting common understanding. At times, the Committee uses this common understanding to develop guidelines and supervisory standards in areas where they are considered desirable. In this regard, the Committee is ***best known*** for its international standards on ***Capital Adequacy*** *(i.e Basel I, Basel II and Basel III, by now)*; the ***Core Principles for Effective Banking Supervision***; and the ***Concordat*** on cross-border banking supervision.

    The *Committee* encourages contacts and cooperation among its members and other banking supervisory authorities. It circulates to supervisors throughout the world both published and unpublished papers providing guidance on banking supervisory matters. Contacts have been further strengthened by an *International Conference of Banking Supervisors (ICBS)* which takes place every two years. [*Source*: BIS, Basel, Switzerlad].

21. See **Chapter 16** for detailed discussion on the **IMF** (International Monetary Fund).

Financial Sector Legislative Reforms Commission (FSLRC)

Fulfilling the announcement of the Budget of 2010–11, to ***rewrite*** and ***harmonise*** financial sector legislations, rules and regulations the GoI constituted the FSLRC under the chairmanship of Justice (Retd.) B. N. Srikrishna in March 2011 (tenure is 2 years). This had become necessary as the institutional framework governing India's financial sector was built over a century.

There are over 60 Acts and multiple Rules/ Regulations in the sector and many of them are decades old, when the financial landscape was very different from what it is obtaining today. Large number of amendments made in in these Acts over time has increased the *ambiguity* and *complexity* of the system.

The commission would simplify and re-write financial sector legislations, including subordinate legislations, to bring them in line with the requirements of the sector to achieve harmony and synergy among them, making them more coherent and dynamic and help cater to the requirements of a large and fast growing economy in tune with the changing financial landscape in an inter-connected financial world. In the long-term, it would help usher in the *next generation of reforms,* contribute to efficient financial intermediation enhancing the growth potential of the nation. The commission handed over its report end-March 2013 (see *Chapter 11* sub-topic 'Financial Regulators').

Financial Action Task Force (FATF)

The FATF is an inter-governmental policy making body that has a ministerial mandate to establish international standards for combating *money laundering* and *terrorist financing. India joined the FATF as its 34th member in June 2010. At present, the FATF has 36 members comprising 34 countries and two organisations (European Union and Gulf Cooperation Council).*

REAL ESTATE & INFRASTRUCTURE INVESTEMNT TRUSTS

The SEBI firmed up regulations that will govern Real Estate Investment Trusts (REITs), and the Infrastructure Investment Trusts (InvITs).[22] The long-pending proposal of 2008, the trusts have the **objective** of enabling the cash-strapped real estate and infrastruture developers to have easy access to funds. They create a new investment avenue for institutions and high net worth individuals, and eventually ordinary investors.

REITs

Major provisions announced by the SEBI for the REITs are as given below:

(i) To be close-ended real estate investment schemes that will invest in property with the aim of providing returns to unit holders.

(ii) The returns will be derived mainly from rental income or capital gains from real estate.

(iii) Allowed to invest in commercial real estate assets, either directly or through special purpose vehicles (SPVs). In SPVs, a REIT must have a controlling interest of at least 50 per cent of the share capital and will have to hold at least

22. **SEBI Press Release**, September 26, 2014.

80 per cent of their assets directly in properties.

(iv) To raise funds only through an initial offering and units of REITs have to be mandatorily listed on a stock exchange, similar to initial public offering (IPO) and listing for equity shares.

(v) Required to have assets worth at least Rs.500 crore at the time of an initial offer and the minimum issue size has to be Rs.250 crore. The minimum subscription size for units of a REIT on offer will be Rs.2 lakh and at least 25 per cent of the units have to be offered to the public.

(vi) Will be able to raise money through follow-on offers, rights issues or qualified institutional placements and the trading lot for such units will be Rs.1 lakh.

According to the norms, although a REIT may raise funds from any type of investors, resident or foreign, initially only wealthy individuals and institutions will be allowed to subscribe to REIT unit offers. The market regulator said a REIT may have up to three sponsors, with each holding at least 5 per cent and collectively holding at least 25 per cent for a period of at least three years from the date of listing. Subsequently, the sponsors' combined holding has to be at least 15 per cent throughout the life of the REIT.

Similar to the practice in the US, Australia, Singapore and other nations where REITs are common, Sebi has decided to allow these trusts to invest primarily in completed revenue-generating properties. To ensure that REITs generate continuous returns, Sebi said at least 80 per cent of the REIT's assets has to be invested in completed and revenue generating properties. And only up to 20 per cent of assets can be invested in properties that are being developed, mortgage-backed securities, debt of companies in the real estate sector, equity shares of listed companies that derive at least 75 per cent of their income from real estate, government securities, or money market instruments. No REIT can invest more than 10 per cent in properties that are under construction.

INVITS

The SEBI also announced the launch of **InvITs** which are *somewhat similar* to REITs. However, an initial offer will not be mandatory for InvITs though listing will be mandatory for both publicly and privately placed InvITs. *Major provisions* are as given below:

(i) It can invest in infrastructure projects, either directly or through an SPV (Specila Purpose vehicle). In case of public-private-partnership (PPP) projects, such investments will be only through an SPV.

(ii) While listing, the collective holding of sponsors of an InvIT has to be at least 25 per cent for at least three years.

(iii) Required to have a holding worth at least Rs.500 crore in the underlying assets, and the initial offer size of the InvIT has to be at least Rs.250 crore.

(iv) Any InvIT, which looks to invest at least 80 per cent of its assets in completed and revenue generating infrastructure assets, has to raise funds only through a public issue of units, with a minimum 25 per cent public float and at least 20 investors.

(v) The minimum subscription size and trading lot of such a listed InvIT has to be Rs.10 lakh and Rs.5 lakh, respectively. A publicly offered InvIT may invest the remaining 20 per cent in under-construction infrastructure projects and other permissible investments.

An InvIT that proposes to invest more than 10 per cent of its assets in under-construction infrastructure projects can raise funds only through private placement from qualified institutional buyers with a minimum investment and trading lot of Rs.1 crore and from at least five investors, where single holding cannot be more than 25 per cent.

The *Union Budget 2014–15* promised a friendlier tax norms for the *REITs* and *InvTs*. These are yet to be announced by the government.

CHAPTER

15

EXTERNAL SECTOR OF INDIA

- Definition
- Forex Reserves
- External Debt
- Fixed Currency Regime
- Floating Currency Regime
- Managed Exchange Rates
- Foreign Exchange Market
- Exchange Rate in India
- Trade Balance
- Trade Policy
- Depreciation
- Devaluation
- Revaluation
- Appreciation
- Current Account

*No country in today's globalised world can be fully insulated from what happens in the global economy and India is no exception to the rule. As the country is increasingly integrated into the world, it cannot remain impervious to developments abroad. The unfolding of the Euro zone crisis and uncertainty surrounding the global economy have impacted the Indian economy causing drop in growth, higher current account deficit and declining capital inflows.**

* As writes the MoF, **Economic Survey 2012–13**, GoI, N. Delhi, p. 131.

- ⇨ Capital Account
- ⇨ Balance of Payment (BoP)
- ⇨ Convertibility
- ⇨ LERMS
- ⇨ NEER
- ⇨ REER
- ⇨ EFF
- ⇨ IMF Conditions on India
- ⇨ Hard Currency
- ⇨ Soft Currency
- ⇨ Hot Currency
- ⇨ Heated Currency
- ⇨ Cheap Currency
- ⇨ Dear Currency
- ⇨ Special Economic Zone
- ⇨ GAAR
- ⇨ Risks in Foreign Currency Borrowings
- ⇨ Recent RTAs by India
- ⇨ Crude Oil Price Movements
- ⇨ Composition of Trade
- ⇨ Direction of Trade
- ⇨ Recent Steps to Promote Trade
- ⇨ New Foreign Trade Policy

DEFINITION

All economic activities of an economy which take place in foreign currency fall in sectors such as export, import, foreign investment, external debt, current account, capital account, balance of payment, etc., to name a few (***definition***).[1]

FOREX RESERVES

The total foreign currencies (of different countries) an economy possesses at a point of time is its 'foreign currency assets/reserves'.[2] The Forex Reserves (short for '**for**eign **ex**change reserves') of an economy is its 'foreign currency assets' added with its *gold reserves, SDRs* (Special Drawing Rights) and *Reserve Tranche* in the IMF.[3] In a sense, the Forex reserves is the upper limit upto which an economy can manage foreign currency in normal times if need be.

As per a RBI release on April 3, 2015, India's forex reserves was at US$ 341.37 (composed of Gold Reserves of US$ 19,83 buillion; SDR of US$ 4 billion and Reserve Tranche Position with the IMF at US$ 1.29 billion). As per the *Annual Report* of the IMF (released on March 11, 2015), India's forex reserves stood at 148 per cent of IMF's reserve adequacy.

OPTIMUM FOREX – THE RIDDLE

In recent times, there has been a debate over India's optimum level of the forex reserves. The RBI is aware of the downside risks to the exchange rate, as is reflected by its action of buying the US dollar. Officially, the RBI *targets neither* a particular exchange rate nor foreign exchange reserves, and maintains such interventions by it to just *reduce volatility* in the forex market. But in the process of supporting weakening rupee, RBI needs to buy dollar, ultimately, leading to higher forex buid-ups. The Chief Economic Advisor of the Finance ministry, however, clearly stated the kind of reserve accretion the government is looking at. Citing the example of China, the *Economic Survey 2014–15* said India could target foreign exchange reserves of US$750 billion to $1 trillion.

Today, China has *de facto* become one of the lenders of last resort to governments experiencing financial troubles. China, in its own heterodox and multiple ways, is assuming the roles of both an IMF and World Bank as a result of its reserves. The question for India, as a rising economic and political power, is whether it, too, should consider a substantial addition to its reserves.

While forex reserves act as insurance when the rupee tends to be volatile against the dollar, there are costs attached to it. When RBI purchases dollars in the spot, it leads to infusion of rupee into the system which leaves *inflationary* effect on the economy. Since the RBI does not want such actions to create inflationary pressure, so, it converts spot purchases into forwards. This way, it is a direct cost because of the forward premiums. If RBI opts for open market operations (OMOs) to mop up excess liquidity, that also involves costs.

RBI invests these dollars in instruments such as US treasuries, which offer *negligible* returns, owing to lower yields. But experts say these are unavoidable costs. The returns from rupee assets are much lower compared to returns from dollar assets. But RBI is not into investment management, it is there to maintain stability in the system.

In August 2014, RBI chief Raghuram Rajan agreed foreign exchange reserves came at a cost. India earns next to nothing for the foreign reserves it holds—actually, this way India finances another

1. Based on Stiglitz and Walsh, ***Economics***, op. cit., pp. 757–58.
2. Based on Samuelson and Nordhaus, ***Economics,*** op. cit., p. 604.
3. Ibid., pp. 605–07.

country when it has a significant financing needs. It is very difficult to state the level of reserves considered adequate by RBI. Though there are costs involved, the costs to benefit cannot be quantified by any model. Globally, there has been no study on the adequacy of reserves. In such an environment, RBI will have to go by experiences.

EXTERNAL DEBT

After the BoP crisis of 1991, India's prudent external debt policies and management with a focus on sustainability, solvency, and liquidity have helped contain the increase in size of external debt to a moderate level and it is compositionally better with a longer term maturity profile. India's total external debt stock stood at US$ **455.9** billion by September 2014 (3 per cent higher over March 2014), as per the latest data *(Economic Survey 2014–15)*. The rise in total external debt during the period was due to long-term debt, particularly NRI deposits.

The ***maturity profile*** of India's external debt indicates the dominance of long-term borrowings (by September 2014):

- Long-term debt accounted for 81.1 per cent of the total external debt.
- Short-term debt in total external debt was 18.9 per cent. at end-September 2014.
- Government debt share was 19.4 per cent while the non-government debt share was 80.6 per cent.
- Currency composition: US dollar-denominated debt in external debt stock continued to be the highest at 60.1 per cent, followed by Indian rupee (24.2 per cent), the SDR (6.5 per cent), Japanese yen (4.5 per cent), and euro (3.0 per cent) denominated.

The currency composition of government (sovereign) debt indicates predominance of SDR- denominated debt (33.5 per cent), which is attributable to borrowing from the International Development Association (IDA), i.e. the soft loan window of the World Bank under the multilateral agencies, and SDR allocations by the International Monetary Fund (IMF).

Over the years, India's external debt stock has witnessed ***structural change*** in terms of composition (by September 2014):

- The proportion of concessional debt declined from 42.9 per cent during the period 1991–2000 to 28.1 per cent in 2001–10 and further to 9.8 per cent at end-September 2014.
- The dominance of non-government debt in total external debt is evident from the fact that such debt accounted for 65.6 per cent of total debt during the 2000s decade, against 45.3 per cent in the 1990s. Non-government debt accounted for over 70 per cent of total debt in the last five years and stood at 80.6 per cent at end-September 2014.
- India's foreign exchange reserves provided a cover of 68.8 per cent at end-March 2014.
- India's external debt has remained within manageable limits as indicated by the external debt to GDP ratio of **23.5** per cent and debt service ratio of **5.9** per cent in 2013–14.

The prudent external debt management policy of the GoI has helped in containing rise in external debt and maintaining a comfortable external debt position. The policy continues to focus on—

(i) Monitoring long- and short-term debt.

(ii) Raising sovereign loans on concessional terms with longer maturities.

(iii) Regulating external commercial borrowings through enduse, all-in-cost, and maturity restrictions.

(iv) Rationalizing interest rates on NRI deposits.

Cross-country comparison of external debt based on the *World Bank's International Debt Statistics 2015,* which contains the external debt data for the year 2013, indicates that India continues to be among the less vulnerable countries. India's key debt indicators compare well with other indebted developing countries. The ratio of India's external debt stock to gross national income at 23.0 per cent was the sixth lowest. In terms of the cover provided by foreign exchange reserves to external debt, India's position was sixth highest at 64.7 per cent

FIXED CURRENCY REGIME[4]

A method of regulating exchange rates of world currencies brought by the IMF. In this system exchange rate of a particular currency was fixed by the IMF keeping the currency in front of a basket of important world currencies (they were UK£, US $, Japanese ¥, German Mark DM and the French Franc FFr). Different economies were supposed to maintain that particular exchange rate in future. Exchange rates of currencies were modified by the IMF from time to time.

FLOATING CURRENCY REGIME[5]

A method of regulating exchange rates of world currencies based on the market mechanism (i.e., demand and supply). In the follow up to the fixed currency system of exchange rate determination, it was the UK which blamed the system for its payment crisis of late 1960s. Looking at the major loopholes in this system, the UK government decided to switch over to the floating currency regime in 1973—the same year the IMF allowed an option to its member countries to go for either of the currency systems.

In the floating exchange rate system, a domestic currency is left free to float against a number of foreign currencies in its foreign exchange market and determine its own value. Such exchange rates, are also called as *market driven* or *based* exchange rates, which are regulated by factors such as the demand and supply of the domestic and the foreign currencies in the concerned economy.

MANAGED EXCHANGE RATES

A managed-exchange-rate system is a hybrid or mixture of the fixed and flexible exchange rate systems in which the government of the economy attempts to affect the exchange rate ***directly*** by buying or selling foreign currencies or ***indirectly***, through monetary policy[6] (i.e., by lowering or raising interest rates on foreign currency bank accounts, affecting foreign investment, etc.).

Today, most of the economies have shifted to this system of exchange rate determination. Almost all countries tend to intervene when the markets become ***disorderly*** or the ***fundamentals*** of economics are challenged by the exchange rate of the time. Some of the major examples of the managed exchange-rate system have been given below:[7]

(i) Some countries allow to ***free float*** their currencies and allow the market forces to determine their exchange rate with rare government intervention. This is the idea

4. Ibid., pp. 610–11.
5. Ibid., pp. 611–15.
6. Ibid., p. 615.
7. The discussion is based primarily on Samuelson and Nordhaus, ***Economics,*** op. cit., pp. 613–15 and D. Salvatore, ***International Economics,*** John Wiley & Sons, New Jersey, USA, 2004, pp. 717–22.

from which the ***floating currency regime*** basically emerged. The USA and the EU are the major examples in this category.

(ii) Some economies have ***managed but flexible*** exchange rates, under which the governments buy or sell its currency to reduce day-to-day volatility of currency fluctuations and sometimes go for systematic intervention for desired objectives. Canada and Japan fall in this category, besides many developing countries. India too falls under this category which follows the ***dual currency regime*** since 1992–93 financial year.[8]

(iii) Some economies, particularly small ones, peg their currencies to a major currency or to a ***basket*** of currency in a fixed exchange rate—known as the ***pegging of currencies.*** At times, the peg is allowed to glide smoothly upward or downward—a system which is known as ***gliding*** or ***crawling peg.*** Some economies have a ***hard fix*** of a ***currency board.*** A ***currency board*** is working well in Hong Kong while the same failed in Argentina in 2002.

FOREIGN EXCHANGE MARKET

The market where different currencies can be bought and sold is called the foreign exchange market.[9] Out of the trades in different currencies, the exchange rate of the currency is determined by the economy.[10] This is an institutional framework for the exchange of one national currency for another.[11] This is particularly correct either in the case of a free float exchange (i.e., floating currency) regime or is a managed or hybrid exchange rate system. It is altogether not allowed either in a ***fixed currency system*** or a ***hard fix*** (in a hard fix this happens once the currency to which the hard fix has been done itself starts fluctuating).

EXCHANGE RATE IN INDIA

Indian currency, the 'rupee', was historically linked with the British Pound Sterling till 1948 which was fixed as far back as 1928. Once the IMF came up, India shifted to the fixed currency system committed to maintain rupee's external value (i.e., exchange rate) in terms of gold or the US ($ Dollar). In 1948, Rs. 3.30 was fixed equivalent to US $ 1.

In September 1975, India delinked rupee from the British Pound and the RBI started determining rupee's exchange rate with respect to the exchange rate movements of the basket of world currencies (£, $, ¥, DM, Fr.). This was an arrangement between the fixed and the floating currency regimes.

In 1992–93 financial year, India moved to the floating currency regime with its own method which is known as the 'dual exchange rate'.[12] There are two exchange rates for rupee, one is the 'official rate' and the other is the 'market rate'. Here the point should be noted that it is the everyday's changing market-based exchange rate of rupee which affects the official exchange rate and not the other way round. But the RBI may intervene in the forex market via the demand and supply of rupee or the foreign currencies. Another point which should be kept in mind is that none of the economies have till date followed an ideal free-floating exchange rate. They require some

8. ***LERMS, Union Budget 1992–93,*** MoF, GoI, N. Delhi.
9. Stiglitz and Walsh, op. cit., p. 757.
10. Samuelson and Nordhaus, op. cit., p. 604
11. D. Salvatore, 2004, op. cit., p.7.
12. ***LERMS,*** op. cit.

mechanism to intervene in the foreign exchange market because this is a highly speculative market.

TRADE BALANCE

The monetary difference of the total export and import of an economy in one financial year is called trade balance. It might be positive or negative, known to be either favourable or unfavourable, respectively to the economy.

TRADE POLICY

Broadly speaking, the economic policy which regulates the export-import activities of any economy is known as the trade policy. It is also called the foreign trade policy or the Exim Policy. This policy needs regular modifications depending upon the economic policies of the economies of the world or the trading partners.[13]

DEPRECIATION

This term is used to mean two different things. In foreign exchange market, it is a situation when domestic currency loses its value in front of a foreign currency if it is market-driven. It means depreciation in a currency can only take place if the economy follows the floating exchange rate system.

In domestic economy, depreciation means an asset losing its value due to either its use, wear and tear or due to other economic reasons. Depreciation here means *wear and tear*. This is also known as ***capital consumption.*** Every economy has an official annual rates for different assets at which fixed assets are considered depreciating.

DEVALUATION

In the foreign exchange market when exchange rate of a domestic currency is cut down by its government against any foreign currency, it is called devaluation. It means official depreciation is devaluation.

REVALUATION

A term used in foreign exchange market which means a government increasing the exchange rate of its currency against any foreign currency. It is official appreciation.

APPRECIATION

In foreign exchange market, if a free floating domestic currency increases its value against the value of a foreign currency, it is appreciation. In domestic economy, if a fixed asset has seen increase in its value it is also known as appreciation. Appreciation rates for different assets are not fixed by any government as they depend upon many factors which are unseen.

CURRENT ACCOUNT

It has two meanings—one is related to the banking sector and the other to the external sector:

(i) In the banking industry, a business firms bank account is known as current account. The account is in the name of a firm run by authorised person or persons in which no interest is paid by the bank on the deposits. Every withdrawal from the account takes place by cheques with limitations on the number of deposits and withdrawals in a single day. The *overdraft* facility or the *cash-cum-credit* (c/c Account) facility to business firms is offered by the banks on this account only.

(ii) In the external sector, it refers to the account maintained by every government of the world in which every kind of

13. D. Salvatore, 2004, op.cit., pp. 235–36.

current transactions is shown—basically this account is maintained by the central banking body of the economy on behalf of the government. Current transactions of an economy in foreign currency all over the world are—export, import, interest payments, private remittances and transfers.

All transactions are shown as either inflow or outflow (credit or debit). At the end of the year, the current account might be positive or negative. The positive one is known as a surplus current account, and the negative one is known as a deficit current account. India had surplus current accounts for three consecutive years (2000–03)—the only such period in Indian economic history.

Current account deficit is shown either numerically by showing the total monetary amount of the deficit, or in percentage of the GDP of the economy for the concerned year. Both the data are used in analysis as per the specific requirement. As per a RBI release of April 2014, presently the sustainable level of current account deficit for India is 2.5 per cent of the GDP.

CAPITAL ACCOUNT

Every government of the world maintains a capital account, which shows the capital kind of transactions of the economy with outside economies. Every transaction in foreign currency (inflow or outflow) considered as capital is shown in this account—external lending and borrowing, foreign currency deposits of banks, external bonds issued by the Government of India, FDI, PIS and security market investment of the QFIs (Rupee is fully convertible in this case).

There is no deficit or surplus in this account like the current account .

BALANCE OF PAYMENT (BoP)

The outcome of the total transactions of an economy with the outside world in one year is known as the balance of payment (BoP) of the economy.[14] Basically, it is the net outcome of the current and capital accounts of an economy. It might be favourable or unfavourable for the economy. However, negativity of the BoP does not mean it is unfavourable. A negative BoP is unfavourable for an economy if only the economy lacks the means to fill the gap of negativity.

The BoP of an economy is calculated on the principles of accountancy (***double-entry book-keeping***)[15] and looks like the balance sheet of a company—every entry shown either as credit (inflow) or debit (outflow). If there is a positive outcome at the end of the year, the money is automatically transferred to the foreign exchange reserves of the economy. And if there is any negative outcome, the same foreign exchange is drawn from the country's forex reserves. If the forex reserves are not capable of fulfilling the negativity created by the BoP, it is known as a BoP crisis and the economy tries different means to solve the crisis in which going for forex help from the IMF is the last resort.

CONVERTIBILITY

An economy might allow its currency full or partial convertibility in the current and the capital accounts. If domestic currency is allowed to convert into foreign currency for all current account purposes, it is a case of full current account convertibility. Similarly, in cases of capital outflow, if the domestic currency is allowed to

14. Samuelson and Nordhaus, op. cit., p. 601.
15. It means that each external transaction is recorded/entered twice—once as a credit and once as a debit of an equal amount. This is because every transaction has two sides—we sell something and we receive payment for it, similarly we buy something and we have to pay for it (See ***Salvatore,*** op. cit., p. 432).

convert into foreign currency, it is a case of full capital account convertibility. If the situation is of partial convertibility, then the portion allowed by the government can be converted into foreign currency for current and capital purposes. It should always be kept in mind that the issue of currency convertibility is concerned with foreign currency *outflow* only.

CONVERTIBILITY IN INDIA

India's foreign exchange earning capacity was always poor and hence it had all possible provisions to check the foreign exchange outflow, be it for current purposes or capital purposes (remember the draconian FERA). But the process of economic reforms has changed the situation to unidentifiable levels.

CURRENT ACCOUNT

Current account is today fully convertible (operationalised on August 19, 1994). It means that the full amount of the foreign exchange required by someone for current purposes will be made available to him at official exchange rate and there could be an unprohibited outflow of foreign exchange (earlier it was partially convertible). India was obliged to do so as per Article VIII of the IMF which prohibits any exchange restrictions on current international transactions (keep in mind that India was under pre-conditions of the IMF since 1991).

CAPITAL ACCOUNT

After the recomendations of the S.S. Tarapore Committee (1997) on Capital Account Convertibility, India has been moving in the direction of allowing full convertibility in this account, but with required precautions. India is still a country of partial convertibility (40:60) in the capital account, but inside this overall policy, enough reforms have been made and to certain levels of foreign exchange requirements, it is an economy allowing full capital account convertibility—

(i) Indian corporate are allowed full convertibility in the automatic route upto $ 500 million overseas ventures (investment by Ltd. companies in foreign countries allowed).

(ii) Indian corporate are allowed to prepay their external commercial borrowings (ECBs) via automatic route if the loan is above $ 500 million.

(iii) Individuals are allowed to invest in foreign assets, shares, etc., upto the level of $ 2,50,000 per annum.

(iv) Unlimited amount of gold is allowed to be imported (this is equal to allowing full convertibility in capital account via current account route, but not feasible for everybody) which is not allowed now.

The Second Committee on the Capital Account Convertibility (CAC)—again chaired by S.S. Tarapore—handed over its report in September 2006 on which the RBI/the government is having consultations.

LERMS

India announced the Liberalised Exchange Rate Mechanism System (LERMS) in the Union Budget 1992–93 and in March 1993 it was operationalised. India delinked its currency from the fixed currency system and moved into the era of floating exchange-rate system under it.

Indian form of exchange rate is known as the 'dual exchange rate', one exchange rate of rupee is official and the other is market-driven.[16] The market-driven exchange rate shows the actual tendencies of the foreign currency demand and

16. **LERMS**, op. cit.

supply in the economy vis-a-vis the domestic currency. It is the market-driven exchange rate which affects the official rate and not the other way round.

NEER

The Nominal Effective Exchange Rate (NEER) of the rupee is a weighted average of exchange rates before the currencies of India's major trading partners.

REER

When the weight of inflation is adjusted with the NEER, we get the Real Effective Exchange Rate (REER) of the rupee. Since inflation has been on the higher side in recent months, the REER of the rupee has been more against it than the NEER.

EFF

The Extended fund Facility (EFF) is a service provided by the IMF to its member countries which authorises them to raise any amount of foreign exchange from it to fulfil their BoP crisis, but on the conditions of structural reforms in the economy put by the body. It is the first agreement of its kind. India had signed this agreement with the IMF in the financial year 1981–82.

IMF CONDITIONS ON INDIA

The BoP crisis of the early 1990s made India borrow from the IMF which came on some conditions. The medium term loan to India was given for the restructuring of the economy on the following conditions:

(i) Devaluation of rupee by 22 per cent (done in two consecutive fortnights—rupee fell from '21 to '27 against every US Dollar).

(ii) Drastic custom cut to a peak duty of 30 per cent from the erstwhile level of 130 per cent for all goods.

(iii) Excise duty to be increased by 20 per cent to neutralise the loss of revenue due to custom cut.

(iv) Government expenditure to be cut by 10 per cent per annum (the burden of salaries, pensions, subsidies, etc.).

The above-given conditions to which India was obliged were vehemently opposed by the Indian corporate sector, opposition in the Parliament and majority of Indians. But by the end of 1999–2000, when India saw every logic in strengthening its BoP position there was no ideological opposition to the idea. It should always be kept in mind that the nature of structural reforms India went through were guided and decided by these pre-conditions of the IMF.

This is how the direction of structural reforms of an economy are regulated by the IMF in the process of strengthening the BoP position of the crisis-driven economy. The purpose has been served in the Indian case. India has not only fulfilled these conditions but it has also moved ahead.

HARD CURRENCY

It is the international currency in which the highest faith is shown and is needed by every economy. The strongest currency of the world is one which has a high level of liquidity. Basically, the economy with the highest as well as highly diversified exports that are compulsive imports for other countries (as of high-level technology, defence products, life saving medicines and petroleum products) will also create high demand for its currency in the world and become the hard currency. It is always scarce.

Upto the second world war, the best hard currency was the Pound Sterling (£) of the UK, but soon it was replaced by the US Dollar—at present some experts believe that the Euroland's currency (€) might replace it, too. Some of the

best hard currencies of the world today are the US Dollar, the Euro(€), Japanese Yen (¥) and the UK Sterling Pound (£).

SOFT CURRENCY

A term used in the foreign exchange market which denotes the currency that is easily available in any economy in its forex market. For example, rupee is a soft currency in the Indian forex market. It is basically the opposite term for the hard currency.

HOT CURRENCY

Hot currency is a term of the forex market and is a temporary name for any hard currency. Due to certain reasons, if a hard currency is exiting an economy at a fast pace for the time, the *hard* currency is known to be *hot*. As in the case of the SE Asian crisis, the US dollar had become hot.

HEATED CURRENCY

A term used in the forex market to denote the domestic currency which is under enough pressure (heat) of depreciation due to a hard currency's high tendency of exiting the economy (since it has become hot). It is also known as *currency under heat* or *under hammering*.

CHEAP CURRENCY

A term first used by the economist J. M. Keynes (1930s). If a government starts re-purchasing its bonds before their maturities (at full-maturity prices) the money which flows into the economy is known as the cheap currency, also called cheap money.

In the banking industry, it means a period of comparatively lower/softer interest rates regime.

DEAR CURRENCY

This term was popularised by economists in early 1930s to show the opposite of the cheap currency. when a goverment issues bonds, the money which flows from the public to the government or the money in the economy in general is called dear currency, also called as *dear money*.

In the banking industry, it means a period of comparatively higher/costlier interest rates regime.

SPECIAL ECONOMIC ZONE[17]

How does a country of over a billion people take on the challenge of providing a better life to its citizens? The question would naturally elicit a million different responses having their roots in several social, economic and political measures. No one today, however, doubts the efficacy of faster and broad-based economic development as a primary tool for providing the average Indian a better deal. The country needs massive investments in manufacturing, infrastructure development and in its productive capacities. We also need to aggressively promote exports of goods and services in an ever so highly competitive global market place. This alone would lead to a strong edifice for sustained growth and creation of productive employment. These were the very aims for which the Government of India mooted the Special Economic Zone (SEZ) Policy in April 2000 which was further concretised through the SEZ Act 2005 and the SEZ Rules 2006 policy.

The concept of SEZ is not a new one and it is an improvement to the concept of Export Processing Zones. India was *one of the first* in Asia to recognise the effectiveness of the Export Processing Zone (EPZ) model in promoting exports, with ***Asia's first*** EPZ set up in Kandla in 1965—seven more

17. Based on the updated informations available with the **Ministry of Commerce & Industry,** GoI, N. Delhi, May 11 , 2012.

EPZs were set up thereafter. However, the EPZs were not able to emerge as effective instruments for export promotion on account of multiplicity of controls and clearances, absence of world-class infrastructure, and an unstable fiscal regime. In order to overcome these shortcomings and attract larger foreign investments in India, the SEZ Policy was announced in April 2000. This policy was intended to make *SEZs an engine for economic growth* supported by quality infrastructure complemented by an attractive fiscal package, both at the Centre and the state levels, with the minimum possible regulations.

What is SEZ?

SEZ, or Special Economic Zone, is essentially an industrial cluster meant largely for exports. An SEZ is governed by a special set of rules aimed at attracting direct investment for export-oriented production. SEZs, earlier known as Export Processing Zones or Free Trade Zones, are *duty free enclaves* which are treated as *foreign territory* only for trade operations, duties, tariffs and typically marked by the best infrastructure and least red tape. Other salient features of SEZs are:

(i) manufacturing or service activities are allowed;
(ii) full freedom for sub-contracting;
(iii) no routine examination by customs authorities of export/import cargo;
(iv) units in SEZs have to become net foreign exchange earners within three years; and
(v) domestic sales from them are subject to full customs duty and the import policy in force.

The SEZ concept recognises the issues related to economic development and provides for developing self-sustaining industrial townships so that the increased economic activity does not create pressure on the existing infrastructure. This issue is addressed in the SEZ policy by specifying a non-processing area for creation of support infrastructure. Every SEZ is divided into a processing area where alone the SEZ units would come up and the non-processing area where the supporting infrastructure is to be created. The SEZ developer would be responsible for all civic amenities and infrastructure including roads, sewerage, open spaces, green spaces, education facilities, power, water supply and housing etc.

Land Acquisition Issue & SEZ

While the benefits of SEZs are visible and evident, one major issue that has often been raised pertains to the acquisition of agricultural land for setting up SEZs. Acquisition of land is a matter that comes under the purview of the state governments since land/land usage is a state subject. While there is a *Central Land Acquisition Act* of 1894 extensively amended in 1971, the states have made modifications to the same and have their own compensation and relief & rehabilitation measures depending upon their requirements and necessities.

The need of the hour is to formulate a working land reforms and land acquisition law which could address the emerging new realities (like agitations by farmers after the land has already been acquired and compensation paid to them) related to the issue of land acquisition. The second thing is an active and willing co-operation/participation coming from the state governments. Involving the PRIs will provide a more durable and effective way out to this issue.

Meanwhile, on the proposed and revised **Land Acquisition Bill, 2013**, a political concensus has been reached *(on April 18, 2013)*—which paved the way for the Bill to get introduced in the current Session of the Parliament—it will replace India's existing *Land Acquisition Act, 1894*. The Bill is more careful, realistic and futuristic about the contemporary and emerging challenges of land acquisition in the country. The major highlights of the Bill are as follows:

(i) For the first time, resettlement and rehabilitation both have been emphasised on the same footing;

(ii) Scrutiny of all private purchase of land between 2011 and 2013 (there has been a concern among many that the land mafias have grabbed cheap land from the farmers before the proposed Bill has been passed by the government);

(iii) A provision to enable state legislation on leasing in place of acquisition of land;

(iv) Instead of acquisition, land to be leased to developers, so that the ownership remains with farmers and provides them a regular income. The government to amend the *Land Acquisition, Rehabilitation and Resettlement Bill, 2011*, to provide for an enabling provision to states for enacting laws in this regard (leasing of land is a state subject under the Constitution).

The new government at the centre has, meanswhile, proposed a new *Land Acquisition Bill, 2015*. The bill is faced with stiff opposition from the political parties in opposition farmers alike and is still to be passed by the parliament.

GAAR

The GAAR (General Anti-Avoidance Rules), originally proposed in the *Direct Taxes Code 2010*, are targeted at arrangements or transactions made specifically to avoid taxes. The government had decided to advance the introduction of GAAR and implement it from the financial year 2013–14 itself. More than 30 countries have introduced GAAR provisions in their respective tax codes to check such tax evasion.

The ***objective*** of the GAAR provisions is to codify the doctrine of *'substance over form'* where the real intention of the parties and purpose of an arrangement is taken into account for determining the tax consequences, irrespective of the legal structure of the concerned transaction or arrangement. It essentially comes into effect where an arrangement is entered into with the main purpose or one of the main purposes of obtaining a *tax benefit* and which also satisfies at least one of the following *four tests*:

(i) The arrangement creates rights and obligations that are not at arm's length,

(ii) it results in misuse or abuse of provisions of tax laws,

(iii) lacks commercial substance or is deemed to lack commercial substance, or

(iv) it is not carried out in a bona fide manner.

Thus, if the tax officer believes that the main purpose or one of the main purposes of an arrangement is to obtain a tax benefit and even if one of the above *four tests* are satisfied, the tax officer has powers to declare it as an impermissible avoidance arrangement and re-characterise the entire transaction in a manner that is more conducive to maximising tax revenues. There are many troubling aspects of this provision that will make doing business in India even more ***challenging***, than what it already is from a tax perspective—

(i) It is presumed that obtaining tax benefit is the main purpose of the arrangement unless otherwise proved by the taxpayer. This is an onerous burden that under a fair rule of law should be discharged by the revenue collector and not the taxpayer. In fact, the *Parliamentary Standing Committee on DTC* has specifically recommended that the onus of proving the existence of a tax-avoidance motive and a transaction lacking commercial substance, should rest with the revenue invoking GAAR and not shifted to the taxpayer. This is essentially to ensure that the revenue authorities exercise proper discretion, proper application of mind

and gather enough credible data and evidence before attempting to invoke far-reaching provisions such as GAAR.

(ii) An arrangement will be deemed to lack commercial substance under GAAR if it involves the location of an asset or of a transaction or of the place of residence of any party that would not have been so located for any substantial commercial purpose other than obtaining tax benefit. This again is an amazingly wide provision that provides a great weapon in the armoury of the tax authorities to challenge almost every inbound or outbound transaction with respect to India, made through any of the favourable tax treaties that India has entered into. The governments intention becomes clear visibly by one of the finance ministry replies to the *Standing Committee on DTC*, where it has made it clear that the GAAR provisions will check *treaty shopping* by the taxpayer for avoidance of payment of tax in India.

(iii) GAAR allows tax authorities to call a business arrangement or a transaction 'impermissible avoidance arrangement' if they feel it has been primarily entered into to avoid taxes. Once an arrangement is ruled 'impermissible' then the tax authorities can deny tax benefits. Most aggressive tax avoidance arrangements would be under the risk of being termed impermissible. It has a provision according to which the onus to prove that an arrangement is 'impermissible' will lie with the tax department. The GAAR panel, the final body that will decide on the applicability of the law, will include an independent member. The rule can apply on domestic as well as overseas transactions.

(iv) GAAR is a very broadbased provision and can easily be applied to most tax-saving arrangements. Many experts feel that the provision would give unbridled powers to tax officers, allowing them to question any taxsaving deal. Foreign institutional investors are worried that their investments routed through Mauritius could be denied tax benefits enjoyed by them under the Indo-Mauritius Tax Treaty. The proposal *(announced on May 8, 2012)* had spooked stock market as FII inflows dropped on concerns, and the rupee hit a low of Rs. 53.47 to the Dollar.

Meanwhile, the government has postponed GAAR to the next financial year (i.e., 2016–17). This will give a breather to tax payers and also allow the government time to frame clear rules after consultations with stakeholders.

RISKS IN FOREIGN CURRENCY BORROWINGS

Corporate borrowers in India and other emerging economies are keen to borrow in foreign currency to benefit from lower interest and longer terms of credit. Such borrowings however, are not always helpful, especially in times of high currency volatility. During good times, domestic borrowers could enjoy triple benefits of

(i) lower interest rates,
(ii) longer maturity, and
(iii) capital gains

due to domestic currency appreciation. This would happen when the local currency is appreciating due to surge in capital flows and the debt service liability is falling in domestic currency terms. The opposite would happen when the domestic currency is depreciating due to reversal of capital flows during crisis situations, *as happened during the 2008 global crisis.*

A sharp depreciation in local currency would mean corresponding *increase in debt service liability*, as more domestic currency would be required to buy the same amount of foreign exchange for debt service payments. This would lead to ***erosion in profit*** margin and have 'mark-to-market' implications for the corporate. There would also be 'debt overhang' problem, as the volume of debt would rise in local currency terms. Together, these factors could create corporate distress, especially because the rupee tends to depreciate precisely when the Indian economy is also under stress, and corporate revenues and margins are under pressure.

In this context, it is felt that one of the factors contributing to faster recovery of the Indian economy after the 2008 global crisis was the low level of corporate external debt. As a result, the significant decline in the value of rupee did not have a major fallout for the corporate balance-sheets. Foreign currency borrowings, therefore, have to be contracted carefully, especially when no 'natural hedge' is available. Such natural hedge would happen when a foreign currency borrower also has an export market for its products. As a result, export receivables would offset, at least to some extent, the currency risk inherent in debt service payments. This happens because fall in the value of the rupee that leads to higher debt service payments is partly compensated by the increase in the value of rupee receivables through exports.

When export receivables and the currency of borrowings is different, the *prudent approach* is for corporations to enter *currency swaps* to re-denominate asset and liability in the same currency to create natural hedge. Unfortunately, too many Indian corporations with little foreign currency earnings leave foreign currency borrowings unhedged, so as to profit from low international interest rates. This is a dangerous gamble for reasons described above and should be avoided.

RECENT RTAs BY INDIA

Since India became one of the founding members of the WTO, its attention has grown towards the regional trade groupings. These groupings give regional competitveness to the economy and strengthens it to compete at the global level in a more organised way. Recent developments with regard to India's regional trade agreements (RTAs) have been given below: [18]

SAFTA

The SAFTA (South Asia Free Trade Area) Agreement came into force on January 1, 2006. Under it, India has granted *zero basic custom* duty to all LDCs, viz., Afghanistan, Bangladesh, Bhutan, and Maldives, on all items except 25 items relating to alcohol and tobacco. Under the SAFTA Agreement, India has reduced the SAFTA Sensitive List for non-LDCs from 878 to 614 by reduction of 264 tariff lines from September 6, 2012. As per the schedule of Tariff Liberalisation Programme (TLP) under SAFTA, India has brought down its peak tariff rates to ***5 the per cent from January 1, 2013***.

EHS

India-Thailand FTA, *Early Harvest Scheme* (EHS) under the Framework Agreement for establishing India-Thailand FTA was signed on October 9, 2003, which includes trade in goods trade in services, investment, and other areas of economic cooperation, to be concluded as a single undertaking. Under EHS, tariff has gradually been eliminated on a list of 82 common items

18. Department of Commerce, Ministry of Commerce and Industry, GoI, N Delhi, April 24, 2013.

simultaneously by both sides between September 1, 2004 and August 31, 2006. Under the India-Thailand FTA, it is proposed to provide ASEAN plus tariff concessions. So far 26 rounds of the India-Thailand Trade Negotiation Committee (ITTNC) meetings have been held. The last round was held on November 26–27, 2012 in New Delhi.

CECA

India-ASEAN Comprehensive Economic Cooperation Agreement (CECA) Services and Investment Agreements was signed on August 13, 2009 under the broader framework of the CECA between India and ASEAN which has already come into force. Conclusions of negotiations for the Services Agreement and Investment Agreement have been announced during the ASEAN-India Commemorative Summit held on *December 20, 2012* in New Delhi—legal scrubbing for these agreements were finalised in February 2013. The agreement will be signed during ASEAN Economic Ministers (AEM)-India Consultations in *August 2013*.

RCEP

During the 20th ASEAN Summit held in Cambodia in April 2012, ASEAN States agreed to move towards establishing an RCEP (Regional Comprehensive Economic Partnership) Agreement among *ASEAN + 6* (Australia, China, India, Japan, Korea, and New Zealand involving ASEAN and its FTA partners. The *objective* of launching RCEP negotiations is to achieve a modern, comprehensive, high-quality, and mutually beneficial economic partnership agreement among the ASEAN member States and ASEAN's FTA partners. The RCEP will *cover* trade in goods and services, investment, economic and technical cooperation, intellectual property, competition, dispute settlement, and other issues.

BITA

Fifteen rounds of negotiations and a number of inter-sessional and Chief Negotiator level meetings of BITA (India - EU Broad Based Trade and Investment Agreement) have been held till date. The 15th round was held in December 4–7, 2012 in New Delhi. Chief negotiator level meeting was held on *January 29–30, 2013* in New Delhi.

GSTP

The agreement establishing the GSTP (Global System of Trade Preferences) among developing countries was signed on April 13, 1988 at Belgrade following the conclusion of the First Round of Negotiations. Forty-three countries have ratified the agreement and become participants. India has offered tariff concessions on 70.08 per cent of dutiable tariff lines with an across-the-board *margin of preference* (MoP) of 20 per cent on the applied tariffs prevailing on the date of import. India has also unilaterally offered special concessions to LDC participants by granting an MoP of 25 per cent on 77 per cent of all its dutiable tariff lines. The Cabinet Committee on Economic Affairs (CCEA), in its meeting on August 23, 2012, has granted approval for implementing India's schedule of concessions. The tariff concessions are to be implemented in 30 days after a minimum of four participants ratify their schedules of concessions. So far India and Malaysia have ratified their schedules.

CRUDE OIL PRICE MOVEMENTS

Any major change in global commodity prices, particularly crude oil prices, has implication for the external sector as India is increasingly integrated with the rest of the world. India's rising two-way external-sector transactions have more than doubled as a proportion of GDP over the last ten years. Trade openness provides opportunities for

higher growth through higher exports and makes available better quality products domestically at globally competitive prices.

India's large oil import dependence and the sharp rise in global crude oil prices, the widening of the CAD in 2011–12 and 2012–13 may be an atypical outcome. Changes in crude oil prices have direct bearing on India's CAD.

Historically, crude oil imports accounted for a substantial portion of the country's total imports. Petroleum, oil, and lubricants (POL) imports accounted for more than ***one-third*** of India's total imports in recent years. In 2013–14, POL imports accounted for 36.6 per cent of total imports and was estimated to be over 33 per cent in 2014–15. The changes in trade deficit and by implication CAD in recent years are largely explained by the changes in crude oil prices.

COMPOSITION OF TRADE

The commodity composition of India's trade has undergone many changes since liberalization and has been driven by trade policy, movements in international prices, and the changing pattern of domestic demand. Main features of India's composition of trade, as per the *Economic Survey 2014–15,* are as given below:

Export Composition

- *Manufactured goods* constitute the bulk of exports—over 63 per cent in recent years, followed by crude and petroleum products (including coal) with a 20 per cent share, and agriculture and allied products with a share of 13.7 per cent share.
- The *top seven* product groups accounting for nearly 80.9 per cent of India's total exports in were shared as: petroleum products (19.4 per cent); gems and jewellery (13.0 per cent); agriculture and allied products (12.0 per cent); textiles and allied products (11.6 per cent); chemicals and related products (10.1 per cent); transport equipment (8.5 per cent) and machinery (6.3 per cent).

Import Composition

- One of the major items in India's import basket is the POL group, which accounted for 36.6 per cent of India's total imports. POL imports surged with a growth of 46.2 per cent in 2011–12, mainly on account of significant increase in global crude oil prices.
- Capital goods imports are another major group which declined continuously from 2011–12 onwards. Within capital goods, imports of machinery registered positive growth in 2014–15.
- Gold and silver imports accounted for 11.4 per cent of India's total imports in 2012–13 and 7.4 per cent in 2013–14.

DIRECTION OF TRADE

There has been significant *market diversification* in India's trade in recent years—a process that has helped in coping with the sluggish global demand, which owes to a great extent to the weakness in the euro zone. Main features of India's direction of trade, as per the *Economic Survey 2014–15,* is given below:

India's Exports

- Region-wise, India's export shares to Europe and America have declined over the years—from 23.6 per cent and 20.1 per cent, respectively in 2004–05 to 18.6 per cent and 17.2 per cent, respectively.
- India's exports to Asia and Africa have increased from 47.9 per cent and 6.7 per cent, respectively in 2004–05 to 49.4

per cent and 9.9 per cent respectively in 2013–14.

- The change in direction immediately prior to the global financial crisis and since 2010–11 indicates the process of diversification underway.
- Countrywise, India's exports to the USA and UAE—major destinations with a share in India's total exports of 12.5 per cent and 9.7 per cent, respectively. However, India's exports to China (4.7 per cent share) and Belgium (2.0 per cent share) declined by 14.7 per cent and 10.7 per cent during the same period.

India's Imports

- The share of Europe in India's imports also declined from 23.0 per cent in 2004-05 to 15.8 per cent while the shares of Asia and Africa increased substantially from 35.6 per cent and 3.6 per cent in 2004–05 to 60.7 per cent and 8.1 per cent, respectively.
- The share of America in India's imports has also increased from 8.8 per cent to 12.8 per cent.
- China is the major source of India's imports, accounting for 11.3 per cent of India's total imports, followed by Saudi Arabia (8.1 per cent share), the UAE (6.5 per cent share), and the USA (5.0 per cent share).

RECENT STEPS TO PROMOTE TRADE

The government has taken sveral new initiatives to promote trade conditions of India in recent times. Major ones, as per the *Economic Survey 2014–15*, are as given below:

(i) To promote domestic manufacturing capabilities, scrips issued under different schemes, namely FPS (Focus Product Scheme), FMS (Focus Market Scheme), VKGUY (Vishesh Krishi & Gram Udyog Yojana), SFIS (Served From India Scheme), AIIS (Agri Infrastructure Incentive Scheme), for import of goods can be utilized for payment of *excise duty* for domestic procurement. This is an important measure for ***import substitution*** and will help save foreign exchange as well as create additional employment.

(ii) Scrips issued under the FPS, FMS, VKGUY can be utilized for payment of service tax.

(iii) To support export of products from the North Eastern Region (NER), exporters are entitled to additional incentives of 1 per cent of FOB[19] value of exports in addition to other benefits under the FTP if exports are made from land customs station located in the NER.

(iv) To diversify India's exports, *7 new markets* (Algeria, Aruba, Austria, Cambodia, Myanmar, Netherlands Antilles, and Ukraine) have been added to the FMS, 7 new markets (Belize, Chile, EI Salvador, Guatemala, Honduras, Morocco, and Uruguay) to the Special FMS.

(v) To boost export of *services,* the government has organised two editions of a 'Services Conclave' in identified service sectors which are crucial to India.

19. **FOB** (Free On Board) is a transportation term related to the shipping of goods. Normally, the term FOB along with some point represents the sellers responsibility to the mentioned point, henceforth all freight, carriage and insurance costs to be borne by the buyer. The term is used by a seller 'FOB Chennai' means that the seller will pay all the expenses upto the port of Chennai (which includes cost of loading, Customs clearance, origin documentation charges, and other charges). Beyond this point, it will be the responsibility of the buyer to pay all the charges.

In the Conclave, barriers, if any, in the specific service sectors are identified and issues relating to the reforms needed, India's potential for enhancing exports in those sectors, and new markets for exporting services are discussed.

Global Services Exhibition was organized in April 2015 in New Delhi—as a platform for enhancing strategic cooperation and developing synergies between competitive players of the services sector and their global counterparts.

(vi) *Indian Trade Portal* was launched in December 2014. This portal provides vital information to Indian industry on forty-two export markets and also a mechanism to take advantage of the increased market access provided through various regional and bilateral free trade agreements (FTA) and comprehensive economic cooperation/partnership agreements (CECA/CEPA).

The information is provided in a user-friendly manner in four easy steps for exporters and importers to access the portal, which will contribute to ease of doing usiness for trade and industry. This portal makes available important data like:

(a) Most favoured nation (MFN) tariff,

(b) Preferential tariff,

(c) Rules of Origin (RoO), and

(d) Non-tariff measures.

(vii) In order to mainstream the *states* so that they focus expressly on boosting exports, the key steps required to be initiated by them have been distilled and listed. A *fifteen-point matrix* has been developed and sent to all states/union territories (UTs) to incorporate the following:

(a) Development of export strategy by the state government,

(b) Appointment of an Export Commissioner for coordination of all export-related activities by the state government, and

(c) Instituting export awards to motivate the leading exporters from the state and encourage them to bring in greater export revenues.

NEW FOREIGN TRADE POLICY

The GoI announced the new Foreign Trade Policy 2015–20 on April 1, 2015. The new five year Foreign Trade Policy, 2015–20 provides a framework for increasing exports of goods and services as well as generation of employment and increasing value addition in the country, in keeping with the Make in India. The focus of the new policy is to support both the manufacturing and services sectors, with a special emphasis on improving the 'ease of doing business'. The special features of the FTP 2015–20 are as follows:

1. Two new schemes have been intorduced, namely—

   (i) Merchandise Exports from India Scheme (MEIS) for export of specified goods to
   specified markets.

   (ii) Services Exports from India Scheme (SEIS) for increasing exports of notified services, in place of a plethora of schemes earlier, with different conditions for eligibility and usage.

   There would be no conditionality attached to any scrips issued under these schemes. Duty credit scrips issued under MEIS and SEIS and the goods imported against these scrips are fully transferable. For grant of rewards under MEIS, the

countries have been categorized into 3 Groups, whereas the rates of rewards under MEIS range from 2 per cent to 5 per cent. Under SEIS the selected Services would be rewarded at the rates of 3 per cent and 5 per cent.

2. Measures have been adopted to nudge procurement of capital goods from indigenous manufacturers under the EPCG scheme by reducing specific export obligation to 75 per cent of the normal export obligation. This will promote the domestic capital goods manufacturing industry. Such flexibilities will help exporters to develop their productive capacities for both local and global consumption.
3. Measures have been taken to give a boost to exports of defense and hi-tech items. At the same time *e-Commerce* exports of handloom products, books/periodicals, leather footwear, toys and customized fashion garments through courier or foreign post office would also be able to get benefit of MEIS (for values upto INR 25,000). These measures would not only capitalize on India's strength in these areas and increase exports but also provide employment.
4. In order to give a boost to exports from SEZs, government has now decided to extend benefits of both the reward schemes (MEIS and SEIS) to units located in SEZs. It is hoped that this measure will give a new impetus to development and growth of SEZs in the country.
5. Trade facilitation and enhancing the *ease of doing business* are the other major focus areas—
   (a) One of the major objective of new FTP is to move towards paperless working in 24×7 environment.
   (b) The government has reduced the number of mandatory documents required for exports and imports to three, which is comparable with international benchmarks.
   (c) A facility has been created to upload documents in exporter/importer profile and the exporters will not be required to submit documents repeatedly.
   (d) Attention has also been paid to simplify various *Aayat Niryat Forms*, bringing in clarity in different provisions, removing ambiguities and enhancing electronic governance.
   (e) Approved Exporter System (AES) has been launched to enable manufacturers to self-certify their manufactured goods originating from India with a view to qualifying for preferential treatment under various forms of bilateral and regional trade agreements. This will help these manufacturer exporters considerably in getting fast access to international markets.
6. A number of steps have been taken for encouraging manufacturing and exports under 100 per cent schemes. The steps include a fast track clearance facility for these units, permitting them to share infrastructure facilities, permitting inter unit transfer of goods and services, permitting them to set up warehouses near the port of export and to use duty free equipment for training purposes.
7. Considering the strategic significance of *small and medium scale enterprise* in the manufacturing sector and in employment generation, *MSME Clusters-108* have been identified for focused interventions

to boost exports. Outreach activities will be organized in a structured way at these clusters with the help of EPCs and other willing *Industry Partners* and *Knowledge Partners*.

8. *Niryat Bandhu Scheme* has been galvanized and repositioned to achieve the objectives of Skill India.

The FTP Statement describes the market and product strategy and measures required for trade promotion, infrastructure development and overall enhancement of the trade ecosystem. It seeks to enable India to respond to the challenges of the external environment, keeping in step with a rapidly evolving international trading architecture and make trade a major contributor to the country's economic growth and development. The GoI promised to have regular interactions with all stakeholders, including State Governments to achieve the national objectives.

CHAPTER

16

INTERNATIONAL ECONOMIC ORGANISATIONS & INDIA

- International Monetary System
- Bretton Woods Development
- International Monetary Fund
- World Bank
- Asian Development Bank
- OECD
- World Trade Organisation (WTO)
- WTO Ministerial Conferences
- India's Negotiations With WTO at Bali
- Bilateral and Regional Cooperation
- BRICS Bank
- Asian Infrastructure Inevstment Bank

*'Oh, East is East and West is West, and never the twain shall meet'. Thus, in the year 1889, wrote Kipling in his famous Ballad of East and West. Little did he know that globalisation was only less than a hundred years away.**

** As the Union Finance Minister, P. Chidambram quotes Rudyard Kipling to substantiate the opposite situation in the post-globalisation world in his inaugural Speech on 'The Rise of the East: Implications for the Global Economy' Delivered at the Harvard University (April 17, 2013), MoF, GoI, N Delhi.*

INTERNATIONAL MONETARY SYSTEM

The international monetary system (IMS) refers to the customs, rules, instruments, facilities, and organisations facilitating international (external) payments. Sometimes the IMS is also referred to as an international monetary ***order*** or ***regime.***[1] IMS can be classified according to the way in which exchange rates are determined (i.e., fixed currency regime, floating currency regime or managed exchange regime) and the form foreign reserves take (i.e., gold standard, a pure judiciary standard or a gold-exchange standard).

An IMS is considred good if it fulfils the following ***two objectives***[2] in an impartial manner:

(i) maximises the flow of foreign trade and foreign investments, and
(ii) leads to an ***equitable*** distribution of the gains from trade among the nations of the world.

The evaluation of an IMS is done in terms of ***adjustment, liquidity*** and ***confidence*** which it manages to weild.

ADJUSTMENT

It refers to the process by which the balance-of-payment (BoP) crises of the nations of the world (or the member nations) are corrected. A good IMS tries to minimise the cost of BoP and time for adjustment for the nations.

LIQUIDITY

It refers to the amount of foreign currency reserves available to settle the BoP crises of the nations. A good IMS maintains as much foreign reserves to mitigate such crises of the nations without any inflationary pressures on the nations.

CONFIDENCE

It refers to the faith the nations of the world should show that the adjustment mechanism of the IMS is working adequately and that foreign reserves will retain their absolute and relative values. This confidence is based on the transparent knowledge information about the IMS.

BRETTON WOODS DEVELOPMENT

As the powerful nations of the world were hopeful of a new and more stable world order with the emergence of the UNO, on the contrary, they were also anxious for a more homogenous world financial order, after the Second World War. The representatives of the USA, the UK and 42 other (total 44 countries) nations met at Bretton Woods, New Hampshire, USA in July 1944 to decide a new international monetary system. The International Monetary Fund (IMF) and the World Bank (with its first group-institution IBRD) were set up together—popularly called as the ***Bretton Woods' twins***[3]—both having their headquarters in Washington, DC, USA.

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1. D. Salvatore, ***International Economics,*** John Wiley & Sons, New Jersey, USA, 2005, pp. 737–38; Samuelson and Nordhaus, ***Economics,*** Tata McGraw-Hill, N. Delhi, 2005, pp. 609–12.
2. D. Salvatore, op. cit., p. 738.
3. For the new international monetary system, basically two plans were presented in the meeting—one by the US delegation led by ***Harry D. White*** (of the US Treasury) and the British delegation led by ***John Meynard Keynes.*** It was the US plan which was ultimately agreed upon.

   J.M. Keynes had proposed a more impartial, practical and over-arching idea via his plan at Bretton Woods. His suggestions basically included three things:

   (i) Proposal to set up an International Clearing Union (ICU), a central bank of all central banks, with its own currency (Keynes named this currency ***'bancor'***)—to mitigate the balance of payment crises of member nations.

   This bank was supposed to penalise (***no such provision in the IMF***) the countries holding trade surpluses (with a global tax of one per cent per month) on the ground that such countries were keeping world demand low by under-purchasing the products produced by other countries. The corpus collected via this tax was to be used to

INTERNATIONAL MONETARY FUND

The International Monetary Fund (IMF) came up in 1944 whose Articles came into force on the December 27, 1945 with the main functions as exchange rate regulation, purchasing short-term foreign currency liabilities of the member nations from around the world, allotting special drawing rights (SDRs) to the member nations and the most important one as the bailor to the member economies in the situation of any BoP crisis.

The ***main functions***[4] of the IMF are as given below:

(i) to facilitate international monetary cooperation;

(ii) to promote exchange rate stability and orderly exchange arrangements;

(iii) to assist in the establishment of a multilateral system of payments and the elimination of foreign exchange restrictions; and

(iv) to assist member countries by temporarily providing financial resources to correct mal-adjustment in their balance of payments (BoPs).

The Board of Governors of the IMF consists of one Governor and one Alternate Governor from each member country. For India, Finance Minister is the Ex-officio Governor while the RBI Governor is the Alternate Governor on the Board.

The day-to-day management of the IMF is carried out by the Managing Director who is Chairman *(currently, Ms Christine Lagarde)* of the Board of Executive Directors. Board of Executive Directors consists of 24 directors appointed/elected by member countries/group of countries —is the executive body of the IMF. India is represented at the IMF by an Executive Director (*currently Arvind Virmani*), who also represents three other countries in India's constituency, viz., Bangladesh, Sri Lanka and Bhutan.

INDIA'S QUOTA & RANKING

IMF reviews members' quotas once in every five years—last done in December 2010—here, India consented for its quota increase. After this India's quota (together with its 3 constituency countries) has increased to **2.75** per cent (from 2.44 per cent) and it has become the **8th** (from 11th) largest quota holding country among the **24** constituencies. In absolute terms, India's quota has increased to SDR 13,114.4 million (from SDR 5,821.5 million) which is an increase of approximately US $ 11.5 billion or Rs. 56,000 crore). While 25 per cent of the quota is to be paid

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maintain an international buffer stock of primary goods (i.e., food articles)—to be used in the periods of food shortages among the member nations. (***In place, under the IMF provisions trade deficit countries are penalised***.)

(ii) For the reconstruction of war-devastated Europe, a ***fund*** was to be set up, on the basis of this plan for Relief and Reconstruction (in place of it the US-sponsored ***Marshall Plan*** took care of the needs of Europe).

(iii) There was a proposal of creating Commodity Buffer Stock to be operated by an International Trade Organisation (ITO). This stock of primary goods was to be used to stabilise their prices in the international market.

The operation of this ITO making purchases when the world prices were low and selling when the prices became high. The buffer stock operations, however, were to be helpful to the poor countries, Keynes was primarily interested in stabilising the input prices of the rich countries. (***Though the charter of the ITO was drawn up and other formalities completed, it was never born because of US opposition***.) ***For further readings see*** D. Salvatore, ***International Economics,*** op. cit., pp. 742–43; B. Dasgupta, ***Globalisation : India's Adjustment Experience,*** Sage, N. Delhi, 2005, p. 48.

4. ***Basic Facts About the United Nations,*** UN, New York, 2000, pp. 55 & 137.

in ***cash*** (i.e., in 'Reserve' currency), the balance 75 per cent can be paid in ***securities***.[5]

Once a member nation has signed the ***EFF*** (Extended Fund Facility) agreement with the IMF, borrowing[6] can be done by the member nation—India signed this agreement in the fiscal 1981–82. ***India has been borrowing*** from the IMF due to critical balance of payment (BoP) situations—once between 1981–84 (SDR 3.9 billion) and next during 1991 (SDR 3.56 billion). All the loans taken from the IMF have been repaid. India is now a *contributor* to the IMF as it participates in the Financial Transactions Plan (FTP)[7] of the IMF since September 2002—at this time India was in strong balance of payment situation and in a comfortable forex reserves position.

CURRENT US/EU FINANCIAL CRISES: CHALLENGES REGARDING INTERNATIONAL PAYMENTS

The recent financial crises of the US and the EU nations have raised the questions of the challenges of international payments once again. At this crucial juncture, the world seems tossing the idea of a reserved currency for all international payments—as if the famous Keynesian idea of such a currency (Bancor) is going for a kind of revival. The **Bancor** was a supranational currency that John Maynard Keynes and E. F. Schumacher[8] conceptualised in the years 1940–42 which the United Kingdom proposed to introduce after the Second World War. The proposed currency was, viz., be used in international trade as a unit of account within a multilateral barter clearing system, the *International Clearing Union*, which would also have to be founded. The Bancor was to be backed by barter and its value expressed in weight of gold. However, this British proposal could not prevail against the interests of the United States, which at the Bretton Woods conference established the US Dollar as the world key currency. Milton Friedman[9], the famous US economist insisted that Keynes' theories were incorrect who believed that, 'inflation was highly destructive and that only monetary policy could control it and that monetary policy is a heavyweight instrument and cannot be used for short-term economic management.'

Since the outbreak of the financial crisis in 2008 ***Keynes's proposal*** has been revived—in a speech delivered in March 2009 entitled *Reform the International Monetary System,* Zhou Xiaochuan, the Governor of the People's Bank of China called Keynes's bancor approach **farsighted** and proposed the adoption of International Monetary Fund (IMF) special drawing rights (SDRs) as a global reserve currency as a response to the financial crisis of 2007–2010. He argued that a national currency was unsuitable as a global reserve currency because of the *Triffin dilemma*[10] —the difficulty faced by reserve currency issuers

5. These securities are non-interest bearing note purchase agreements issued by the RBI which can be encashed by the IMF anytime as per its requirement. They do not entail any cash outgo unless the IMF calls upon India to encash a portion of these notes. The 'Reserve' (paid in 'cash') asset portion of the quots is counted as a part of country's 'Reserves'.
6. Such facility from it is available once the member country has signed the agreement with the IMF called as the Extended Fund Facility (EFF). Popularly, this is known as the ***'Conditionalities of the IMF'*** under which India started its Economic Reform Programme in 1991-92 once it borrowed from the IMF in the wake of the BoP crisis of 1990–91.
7. FTP is the mechanism of the IMF through which it finances/repays its operations – member nations contribute money into it from their 'quota resources' on which they get 'interest'.
8. ***E. F. Schumacher,*** *Multilateral Clearing Economica,* New Series, Vol. 10, No. 38 (May, 1943), pp. 150-165.
9. ***M. Friedman.,*** (1968) *The American Economic Review,* Vol. 58, No. 1, 1-17.
10. ***Zhou Xiaochuan,*** (2009). 'Reform the International Monetary System', ***BIS Review***, Bank of International Settlements, Basel, Switzerland, 28th Nov. 2011.

in trying to simultaneously achieve their domestic monetary policy goals and meet other countries' demand for reserve currency.[11] A similar analysis was articulated in the Report of the United Nation's *Experts on Reforms of the International Monetary and Financial System*[12] as well as in a recent IMF's study.[13]

WORLD BANK

The World Bank (WB) Group today consists of ***five*** closely associated institutions propitiating the role of development in the member nations in different areas. A brief account is as follows:[14]

1. IBRD

The International Bank for Reconstruction and Development is the oldest of the WB institutions which started functioning (1945) in the area of reconstruction of the war-ravaged regions (World War II) and later for the development of the middle-income and credit-worthy poorer economies of the world. Human development was the main focus of the developmental lending with a very low interest rate (1.55 per cent per annum)—the areas of focus being agriculture, irrigation, urban development, healthcare, family welfare, dairy development, etc. It commenced lending for India in 1949.

After the process of reforms started in the World Bank in 2010, India was alloted additional shares in IBRD (now holds 56,739 shares accounting to US $ 6,844.7 million). With this India emerged as the 7th largest shareholder (up from the 11th position) in IBRD with voting power of 2.91 per cent (up from 2.77 per cent).[15]

2. IDA

The International Development Agency (IDA) which is also known as the *soft window* of the WB was set up in 1960 with the basic aim of developing infrastructural support among the member nations, long-term lending for the development of economic services. Its loans, known as ***credits*** are extended mainly to economies with less than $895 per capita income. The credits are for a period of 35–40 years, ***interest***-free, except for a small charge to cover administrative costs. Repayment begins after a 10-year grace period. There was no human angle to its lending. But now there remain no hard and fast differences between the purposes for the IBRD and IDA lending.

Every year developing nations make enough diplomatic attempts to carve out maximum loan disbursal for themselves. India had been the ***biggest beneficiary*** of the IDA support. The total support (IBRD + IDA) for India had been $ 91.81 billion till date.[16]

3. IFC

The International Finance Corporation (IFC) was set up in 1956 which is also known as the *private arm* of the WB. It lends money to private sector companies of its member nations. The interest rate charged is commercial but comparatively low. There are many attractive features of IFC's lending. It finances and provides advice for private-public ventures and projects in partnership with private investors and, through its advisory work, helps governments of the member nations to create

11. ***Zhou Xiaochuan,*** *Financial Times, 12th Dec. 2011.*
12. Recommendations by the Commission of Experts of the President of the General Assembly on reforms of the international monetary and financial system, UNO, 20th March, 2009.
13. ***Reserve Accumulation and International Monetary Stability,*** *IMF,* Washington DC, 13th April, 2010.
14. Based on ***Basic Facts About the United Nations,*** op. cit., pp. 52–55; ***India 2004–2013,*** Pub. Div., GoI, N. Delhi.
15. ***India 2014***, Pub. Div, GoI, N Delhi, p. 322.
16. ***India 2013,*** Pub. Div., GoI, N. Delhi, p. 415

conditions that stimulate the flow of both domestic and foreign private savings and investment.

It focuses on promoting economic development by encouraging the growth of productive enterprises and efficient capital markets in its member countries. It participates in an investment only when it can make a special contribution that complements the role of market investors (as a foreign financial investor (FFI). It also plays a catalytic role, stimulating and mobilising private investment in the developing world by demonstrating that investments there too can be profitable.

We have seen a great upsurge in the IFC investments in India which has undoubtedly strengthened the foreign investors' confidence in the Indian economy.

4. MIGA

The Multilateral Investment Guarantee Agency (MIGA), set up in 1988 encourages foreign investment in developing economies by offering insurance (guarantees) to foreign private investors against loss caused by ***non-commercial (i.e., political) risks,*** such as currency transfer, expropriation, war and civil disturbance. It also provides technical assistance to help countries disseminate information on investment opportunities.

5. ICSID

The International Centre for Settlement of Investment Disputes (ICSID), set up in 1966 is an investment dispute settlement body whose decisions are binding on the parties. It was established under the 1966 ***Convention on the Settlement of Investment Disputes between States and Nationals of Other States.*** Though recourse to the centre is voluntary, but once the parties have agreed to arbitration, they cannot withdraw their consent unilaterally. It settles the investment disputes arising between the investing foreign companies and the host countries where the investments have been done.

India is not its member (that is why the Enron issue was out of its preview). It is believed that being signatory to it encourages the foreign investment flows into an economy, but risks independent sovereign decisions, too.

6. BIPA

As part of the Economic Reforms Programme initiated in 1991, the foreign investment policy of the Government of India was liberalised and negotiations undertaken with a number of countries to enter into *Bilateral Investment Promotion & Protection Agreement (BIPAs)* in order to ***promote and protect on reciprocal basis investment of the investors***. Government of India have, so far, *(as by July 2012)* signed BIPAs with 82 countries out of which 72 BIPAs have already come into force and the remaining agreements are in the process of being enforced.[17] In addition, agreements have also been finalised and/or being negotiated with a number of other countries.

The **objective** of the BIPA is to promote and protect the interests of investors of either country in the territory of other country. Such agreements increase the comfort level of the investors by assuring a minimum standard of treatment in all matters and provides for justifiability of disputes with the host country *(it should be noted here that India is not a member of the World Bank group's body, the ICSID, serving the same purpose. BIPA is India's version. While the former is a multilateral body, the latter is a bilateral one).*

ASIAN DEVELOPMENT BANK

The Asian Development Bank (ADB), with an international partnership of 63 member countries,

17. ***Ministry of Commerce & Industry,*** GoI, N. Delhi, as on April 5, 2015.

was established in 1966 and has headquarters at Manila, the Philippines. India is a founder member of ADB. The Bank is engaged in promoting economic and social progress of its developing member countries in the Asia-Pacific region. Its principal functions are as follows:

(i) To make loans and equity investments for the economic and social advancement of its developing member countries;

(ii) To provide technical assistance for the preparation and execution of development projects and programmes and advisory services;

(iii) to respond to the requests for assistance in coordinating development policies and plans in developing member countries; and

(iv) to respond to the requests for assistance and coordinating development policies and plans of developing member countries.

India's subscription to the Bank's capital stock is 7.190 per cent with a voting power of 6.050 per cent (as per the *ADB Annual Report, 2010*), ***as quoted by India 2013.***

India started borrowing from ADB's Ordinary Capital Resources (OCR) in 1986. The Bank's lending has been mainly in the energy, transport and communications, finance, industry and social infrastructure sectors.

The Bank has extended technical assistance to India in addition to loans from its OCR window. The technical assistance provided include support for institutional strengthening, effective project implementation and policy reforms as well as for project preparation.

India holds the position of Executive Director on the Board of Directors of the Bank—its constituency comprises India, Bangladesh, Bhutan, Lao PDR and Tajikistan. The Finance Minister is India's Governor on the Board of Governors of the Asian Development Bank and Secretary (EA) is the Alternate Governor.

OECD

The roots[18] of the Organisation for Economic Co-operation and Development (OECD), Paris, go back to the rubble of Europe after World War II. Determined to avoid the mistakes of their predecessors in the wake of World War I, European leaders realised that the best way to ensure lasting peace was to encourage co-operation and reconstruction, rather than punish the defeated.

The Organisation for European Economic Cooperation (OEEC) was established in 1947 to run the US-financed **Marshall Plan** for reconstruction of a continent ravaged by war. By making individual governments recognise the interdependence of their economies, it paved the way for a new era of cooperation that was to change the face of Europe. Encouraged by its success and the prospect of carrying its work forward on a global stage, Canada and the US joined OEEC members in signing the new OECD Convention on December 14, 1960. The Organisation for Economic Co-operation and Development (OECD) was officially born on September 30, 1961, when the Convention entered into force.

Other countries joined in, starting with Japan in 1964. Today, **34** OECD member countries worldwide regularly turn to one another to identify problems, discuss and analyse them, and promote policies to solve them. The track record is striking. The US has seen its national wealth almost ***triple*** in the five decades since the OECD was created, calculated in terms of gross domestic product per head of population. Other OECD

18. ***India 2012,*** op. cit., p. 418

countries have seen similar, and in some cases even more spectacular, progress.

There are many countries that a few decades ago were still only minor players on the world stage—China, India and Brazil have emerged as new economic giants. Most of the countries that formed part of the former Soviet bloc have either joined the OECD or adopted its standards and principles to achieve the common goals. Russia is negotiating to become a member of the OECD, and now the organisation has close relations with Brazil, China, India, Indonesia and South Africa through its "enhanced engagement" programme. Together with them, the OECD brings around its table **40** countries that account for **80** per cent of world trade and investment, giving it a pivotal role in addressing the challenges facing the world economy.

Enlargement and Enhanced Engagement

In May 2007, OECD countries agreed to invite Chile, Estonia, Israel, Russia and Slovenia to open discussions for membership of the organisation and offered enhanced engagement to Brazil, China, India, Indonesia and South Africa.

Chile became a member of OECD on May 7, 2010, Slovenia became a member on July 21, 2010 and Israel became a member on September 7, 2010. On December 9, 2010, Estonia became a member, once necessary formalities, including parliamentary approval, were completed.

While enhanced engagement is distinct from **accession** to the OECD, it has the potential in the future to lead to membership. The approval of so-called 'road maps' marked the start of accession talks with Chile, Estonia, Israel, Russia and Slovenia. The accession procedure is complex and can be long, as it involves a series of examinations to assess a country's ability to meet OECD standards in a wide range of policy areas. This makes it difficult to bring on board more than a small number of new members at the same time.

WORLD TRADE ORGANISATION (WTO)

The World Trade Organisation (WTO) came into being as a result of the evolution of the multilateral trading system starting with the establishment of the General Agreement on Tariffs and Trade (GATT) in 1947. The protracted Uruguay Round negotiations spanning the period 1986–1994, which resulted in the establishment of the WTO, substantially extended the reach of multilateral rules and disciplines related to trade in goods, and introduced multilateral rules applicable to trade in agriculture (Agreement on Agriculture), trade in services (General Agreement on Trade in Services—GATS) as well as Trade Related Intellectual Property Rights (TRIPS). A separate understanding on WTO dispute settlement mechanism (DSU) and trade policy review mechanism (TPRM) was also agreed upon.

WTO and India

India is a founder-member of both GATT and WTO. The WTO provides a rule based, transparent and predictable multilateral trading system. The WTO rules envisage non-discrimination in the form of National Treatment and ***Most Favoured Nation (MFN)*** treatment to India's exports in the markets of other WTO Members. National Treatment ensures that India's products once imported into the territory of other WTO Members would not be discriminated vis-à-vis the domestic products in those countries. MFN treatment principle ensures that members do not discriminate among various WTO members. If a member country believes that the due benefits are not accruing to it because of trade measures by another WTO member, which are violative of WTO rules and disciplines, it may file a dispute under the Dispute Settlement Mechanism (DSM)

of the WTO. There are also contingency provisions built into WTO rules, enabling member countries to take care of exigencies like balance of payment problems and situations like a surge in imports. In case of unfair trade practices causing injury to the domestic producers, there are provisions to impose Anti-Dumping or Countervailing duties as provided for in the Anti-Dumping Agreement and the Subsidies and Countervailing Measures Agreement.

WTO Membership

The present strength of WTO membership[19] is 160. Against the backdrop of the challenging world economic climate *four countries* acceded to the WTO at the 8th Ministerial Conference, Geneva in December 2011—The Russian Federation, Samoa, Montenegro and Vanuatu. Russian Federation joined it after an 18-year accession process—these countries applied to join the WTO in 1993 – then they entered a period of 18 years of bilateral negotiations with GATT/ WTO members concerning goods and services and various systemic obligations. Significant divergence of views between Russia and the EU, US and Georgia respectively were the source of repeated setbacks in the accession process.

WTO MINISTERIAL CONFERENCES

The highest decision-making body of the WTO is the Ministerial Conference, which has to meet at least once every two years. It brings together all members of the WTO, all of which are countries or separate customs territories. The Ministerial Conference can take decisions on all matters under any of the multilateral trade agreements. Since the coming into being of the WTO in January 1995, nine Ministerial Conferences have been held, namely, ***Geneva*** (December 15–17, 2011); ***Geneva*** (30 November 30–2, December 2009); ***Hong Kong*** (December 13–18, 2005); ***Cancún*** (September 10–14, 2003); ***Doha*** (November 9–13, 2001); ***Seattle*** (November 30–December 3, 1999); ***Geneva*** (May 18–20, 1998); ***Singapore*** (December 9–13, 1996). The Ninth Ministerial Conference was held in ***Bali*** (December 3–7, 2013).

INDIA'S NEGOTIATIONS WITH WTO AT BALI

In wake of the emerging external environment, India continued to be engaged in WTO negotiations that have an impact on the external sector as well as overall economy. The *Ninth Ministerial Conference* of the WTO took place in **Bali** during 3–7 December 2013. Ministers issued a Declaration and ***ten Decisions*** were adopted on various issues including trade facilitation and issues relating to agricultural trade rules, development, and least developed countries (LDCs). Amongst these decisions, two are of particular significance for India—the Ministerial Decision for an Agreement on Trade Facilitation and the Ministerial Decision on Public Stockholding for Food Security Purposes. ***Main features*** of India's engagements with the WTO at this Conference (as per the *Economic Survey 2014–15*) are summed up below:

1. The Trade Facilitation Agreement (TFA), which was also endorsed by India at the Conference, is basically aimed at—
   (a) Greater transparency and simplification of customs procedures,
   (b) Use of electronic payments and risk management techniques, and
   (c) Faster clearances at ports.

   Trade facilitation was put on the agenda mainly by the developed countries while the issue of rules relating to public stockholding for food security purposes

19. As per the ***WTO*** website, May 2014.

was put on the agenda by G-33 group of 46 developing countries including India.

2. WTO's agricultural trade rules (explained in the 'Agreement on Agriculture') do not bar public procurement and stockholding for food security. However, if food for such programmes is acquired at *administered prices* and not market prices, then this is deemed a support to farmers.

   As per WTO rules negotiated in the *Uruguay Round*, all such support has to be kept within a limit of 10 per cent of the value of production of the product in question. This cap can constrain procurement and food aid programmes in developing countries. The WTO rules, made keeping the interests of the developed countries uppermost, have overlooked the interests of the developing countries. The draft agriculture negotiating text of December 2008 seeks to change this. It contains a *proposal to revise* the rules, however, as the negotiations have not concluded, this remains an unfinished agenda. India, as part of a coalition of developing countries (known as the G-33), proposed an amendment to the WTO's Agreement on Agriculture to change these rules.

3. The G-33 proposals, as well as various alternatives suggested by the Group, met with resistance. Negotiations continued during the Bali Ministerial Conference. The finally agreed text of the Ministerial Decision provides for Members to put in place an interim mechanism and to negotiate on an agreement for a permanent solution for adoption by the *Eleventh Ministerial Conference* of the WTO. Related developments regarding it are as follows—

   (i) In the interim, until a permanent solution is found and subject to certain conditions, Members were to be protected against challenge in the WTO under the Agreement on Agriculture in respect of public stockholding programmes for food security purposes.

   (ii) Post Bali, the focus of the developed countries was only on the implementation of the TFA. Concerned at this uneven progress India took the stand in July 2014 that without a firm commitment to implement the other Bali Decisions, it would be difficult to join the consensus on the Protocol of Amendment to incorporate the TFA into the umbrella WTO Agreement.

   (iii) Despite the general campaign of misinformation that followed about missing the deadline for the TFA and the effect of the impasse on the future of the WTO, India stood firm. Concerted efforts were made to explain the concerns underlying the stand taken and India worked with other WTO members to find a way forward.

   (iv) In November 2014, the General Council of the WTO adopted a Decision on Public Stockholding for Food Security Purposes, a Decision on the TFA and a Decision on Post Bali Work. The General Council Decision on Public Stockholding for Food Security Purposes makes it clear that a mechanism under which WTO members will not challenge the public stockholding programmes of developing country members for food security

purposes, in relation to certain obligations under the WTO Agreement on Agriculture, will remain in place in perpetuity until a permanent solution regarding this issue has been agreed upon and adopted.

(v) The decision also includes a commitment to find a ***permanent solution*** on public stockholding for food security purposes by *December 2015* on a best endeavour basis and has a firm commitment to engage in negotiations for a permanent solution through an intensified programme of work.

The decision addresses India's concerns on the issue of public stockholding for food security purposes. The Tenth Ministerial Conference of the WTO (MC10) will be held in **Nairobi**, Kenya, from 15 to 18 December 2015. Meanwhile, the WTO member nations are engaged in discussion to finalise the work programme to conclude the remaining issues of the Doha Development Agenda.

BILATERAL AND REGIONAL COOPERATION

India has always stood for an open, equitable, predictable, non-discriminatory and rule-based international trading system. Considering that regional and bilateral trade and economic cooperation agreements serve as building blocks towards achieving the multilateral trade liberalisation objective, India is actively engaging in regional and bilateral negotiations with her trading partner countries/blocs to diversify and expand the markets for its exports. Some of the recent developments related to major *Free Trade Agreements (FTAs)* are the following:

(i) India–Japan Comprehensive Economic Partnership Agreement (CEPA)

(ii) India–Malaysia Comprehensive Economic Cooperation Agreement (CECA)

(iii) India–ASEAN Trade in Goods Agreement

(iv) India–EU Trade and Investment Agreement Negotiations

(v) India–European Free Trade Association (EFTA)

(vi) BTIA (Iceland, Norway, Liechtenstein, and Switzerland)

(vii) India–New Zealand FTA/CECA

(viii) India–Australia CECA

BRICS BANK

Together with the process of globalisation world regional forces have also been asserting their power through different short of alignments—the *Fortaleza Declaration* of heads of state (late July 2014) from Brazil, Russia, India, China, and South Africa (the BRICS countries) is another such attempt—creation of a BRICS Bank i.e., New Development Bank (NDB). Major highlight about the bank are as given below:

(i) The bank will have initial subscribed capital of $50 billion—eqaully shared by the five nations.

(ii) The capital base is to be used for funding infrastructure and 'sustainable development' projects in the BRICS countries initially.

(iii) Other low and middle-income countries will be able get funding as time progresses.

(iv) A *Contingent Reserve Arrangement* (CRA) of $100 billion is to be also created to provide additional liquidity protection to member-nations during balance of payments problems.

(v) The CRA is being funded 41 per cent by China, 18 per cent each from Brazil,

India, and Russia, and 5 per cent from South Africa.

(vi) CRA, according to the Declaration, is 'a framework for the provision of *currency swaps* in response to actual or potential short-term balance of payments pressures.'

More than the establishment of the NDB, the Fortaleza Declaration is remarkable for adoption of ***one-nation one-vote*** prescription for the proposed bank. The Bretton Woods institutions (the World Bank and the International Monetary Fund) have structures that are not equitable.

As per the experts, *two factors* have triggered the birth of the NDB:

(a) BRICS have *emerged as a big economic power*, and solidified their ties in terms of commerce with the emerging market economies and developing countries (EMDCs) and they are a force to reckon with in the global economy.

(b) Their *disenchantment* with the Bretton Woods institutions has been growing over the years.

Two statements of the *Fortaleza Declaration* make the situation more clear—

- "We are confronted with persistent political instability and conflict in various global hotspots and non-conventional emerging threats. On the other hand, international governance structures designed within a different power configuration show increasingly evident signs of losing legitimacy and effectiveness, as transitional and ad hoc arrangements become increasingly prevalent, often at the expense of multilateralism."
- "We believe the BRICS are an important force for incremental change and reform of current institutions towards more representative and equitable governance, capable of generating more inclusive global growth and fostering a stable, peaceful and prosperous world."

The BRICS bank development comes at a time when reforms at the Bretton Woods institutions fail to fructify for one reason or the other and with the US and European nations still not reconciled to concede BRICS nations a greater voice in the governance structure of the Bretton-Woods institutions.

Whether the BRICS-sponsored NDB will be a fitting alternative to the Bretton Woods twin depends on a host of factors. Major ones of these factors, among others, are its ability—

(i) to put in place a conflict resolution mechanism,

(ii) to devise a robust credit appraisal mechanism, and

(iii) to put in place an effective supervisory regime.

The BRICS-sponsored development bank is not an isolated and unique initiative. Similar initiatives had sprung up in the past to blunt the might of Bretton-Woods twin. *Development Bank of Latin America* (created by *Andean* nations) in the 1960s, the Chiang Mai Initiative in early 2000s (of 10 ASEAN nations plus China, South Korea and Japan) to establish a network of bilateral *currency swap pacts* in the wake of Asian currency crisis, and the establishment of the *Bank of South* by Latin American countries in 2009 were the result of escalating dissatisfaction with the US-dominated IMF and World Bank.

ASIAN INFRASTRUCTURE INEVSTMENT BANK

The AIIB (Asian Infrastructure Investment Bank) was first proposed by the Chinese President Xi Jinping in October 2013. A year later, at its official launch in Beijing, 21 Asian nations, including China, had signed up to be the foundation members. Currently another 21 nations—

including Australia, the United Kingdom, New Zealand, Germany and France—have expressed a desire to join as well. An interesting applicant is Taiwan—which signed up just before the April 1, 2015 deadline—although issues around its membership name may complicate the deal. Russia also left it to the last minute to fire in its application. Chinese media reported that only 30 of the 42 member applications have been accepted. The Chinese foreign ministry has said that the full list of countries approved as founding members would be released by mid-April 2015.

The AIIB is aimed at providing finance to infrastructure projects in the Asia region, as a multilateral instituion. It is planned to operate broadly in the same manner as existing multilateral development banks (MDBs) such as the World Bank and the Asian Development Bank (ADB). While much of the debate is centred on whether the AIIB will complement or compete with existing organisations, it is intended to be more a commercial bank—with nations as shareholders, than a purely development aid institution. The AIIB will start with an authorised **capital base** of US$ 1 billion to be enhanced to **US $ 100 billion**.

Experts have termed it as a rival for the International Monetary Fund (IMF), the World Bank (WB) and the Asian Development Bank (ADB), which are regarded as dominated by developed countries like the United States.[20] The United Nations has addressed the launch of the AIIB as 'scaling up financing for sustainable development' and for the concern of Global Economic Governance.[21]

As per the experts and analysts, there are **several factors** which are behind such an initiative coming from China. Major ones are as given below:

(i) The Chinese government has been frustrated with what it regards as the slow pace of reforms and governance, and wants greater input in global established institutions like the IMF, World Bank and Asian Development Bank which it claims are dominated by American, European and Japanese interests.

(ii) The ADB, a Manila-based regional development bank designed to facilitate economic development in Asia, estimated in a report that developing Asian countries have an infrastructure demand of about US$ 8 trillion between 2010–2020—$2.5 trillion for roads and railroads, $4.1 trillion for power plants and transmission, $1.1 trillion for telecommunications, and $0.4 trillion for water and sanitation investments.[22]

(iii) Oxford Economics reported that by 2025, the region will constitute 60 per cent of global infrastructure investment, with China's share alone is expected to increase from around 22 per cent to 36 per cent over the next decade.

(iv) Despite the significant economic growth enjoyed by countries such as China, India, and South Korea in recent decades, many countries among the developing Asian region are still mired in poverty, suffering from a profound lack of access to modern-day necessities such as sanitation, a reliable power grid, and adequate transportation and communications networks.

(v) It is believed that the new bank could allow Chinese capital to finance these

20. **The Guardian**, *'Support for China-led development bank grows despite US opposition'*, UK edition, March 13, 2015.
21. **United Nations Financing for Development Office**, 'Global Economic Governance'. New York, March 20, 2015.
22. ***The Economist***, *'An Asian Infrastructure Bank: Only Connect'*, October 4, 2013; Biswa N. Bhattacharyay, ***Estimating Demand for Infrastructure in Energy, Transport, Telecommunications, Water and Sanitation in Asia and the Pacific: 2010-2020***, Asian Development Bank Institute, September 9, 2010.

projects and allow it a greater role to play in the economic development of the region commensurate with its growing economic and political clout.

Stand of the USA and Japan: The United States, Japan and Canada remain firmly on the sidelines despite a number of their closest allies and partners recently breaking ranks. The US has argued that the AIIB doubles up on existing organisations, such as the World Bank and ADB, but doubts it will have adequate transparency and governance standards. However, it appears the US may be softening its stance. Japan has said it would not be bound by a deadline not ruling out the possibility of joining in. Though the US has been openly opposing this move some experts view that the US in place of opposing it should work with it. Experts have suggested that China is promoting a solution to the shortage of infrastructure capital in Asia and there is nothing wrong in supporting it.[23]

Size of the AIIB: The AIIB will be one of the largest development banks, but still a fair bit smaller than the European Development Bank, World Bank and ADB. It will start off about the same size as the *BRICS Development Bank*, which was formed by Chinese initiation with Brazil, Russia, India and South Africa in 2014.

Based on the lending capital ratios of the World Bank and European Development Bank —the AIIB could extend loans for infrastructure spending at around 100 per cent to 175 per cent of its subscribed capital. This would mean having outstanding loans of up to $US175 billion. With Public Private Partnerships and increased subscriptions, considerably larger amounts could leveraged for projects in the future.

An edge to China: The Bank is supposed to give China an edge in the global economy, major ones are—

(a) The AIIB will be a better way for Chuna to deploy its massive foreign exchange reserves which are currently earning next to nothing in US Treasury bonds. China believes that the commercial financing of infrastructure differentiates the AIIB from the likes of the ADB which places a greater emphasis on poverty reduction.

(b) The AIIB also supports China's strategic interests in its hugely ambitious 'Silk Road Economic Belt' policy.

(c) By exporting technology, transferring development know-how, and facilitating industrialisation using Chinese long-term finance to the under-developed economies, China will not only find a bigger market, promote prosperity of all nations along the 'Belt and Road', but also diversify its foreign asset portfolio.

(d) It will make China emerge a much bigger global power player which is supposed to be keen to challenge America's long-established strategy of institutionalising power in a rules-based order. The case of the AIIB shows that China now seeks to define this order for itself, with the battle for influence in Asia increasingly fought through rules and institutions.

(e) The so-called 'rules based order' was set up after the 2nd World War through policies such as the Bretton Woods agreement which established US dominated organisations such as the World Bank and IMF in which China plays a very small role.

Members of multilateral development banks, historically, enjoy benefit such as getting ahead of the queue for loans and enjoying a greater chance of success for national firms competing for project

23. *The Guardian*, October 27, 2014.

work. Put bluntly, without signing up it is highly likely that a large chunk of the billions of dollars worth of work on offer will simply be doled out to Chinese companies. Before conclusive remarks could be drawn, it will better to keep watching the future developments regarding the new bank.

CHAPTER

17

TAX STRUCTURE IN INDIA

- Tax
- Methods of Taxation
- A Good Tax System
- Methods of Expenditure
- Value Added Tax
- Goods and Services Tax
- Additional Excise Duty
- CST Reforms
- Service Tax
- Voluntary Compliance Encouragement Scheme
- Commodities Transaction Tax
- Securities Transaction Tax
- Capital Gains Tax
- Minimum Alteranate Tax
- Investment Allowance
- Collection Rates

*Through taxes, government in reality decides how to draw the required resources from the nation's households and businesses for public purposes–the money raised so is the 'vehicle' by which real resources are transferred from private goods to public goods.**

** See Paul A. Samuelson and William D. Nordhaus, **Economics**, The McGraw-Hill Company, New York, 2005, pp. 327–340. Also see Joseph E. Stiglitz and Carl E. Walsh, **Economics,** W. W. Norton, New Yok, 4th Edition, 2006, pp. 380–86.*

- ⇨ Tax Expenditure
- ⇨ 14th Finance Commission
- ⇨ FFC Recommendations
- ⇨ Concepts Related to FC
- ⇨ Direct Tax Code - 2013

TAX

Modern economics ***defines*** tax as a mode of income redistribution.[1] There might be other ways also to look at it—the usual meaning of tax people think is that a tax is imposed by the government to fulfil its important obligations on the expenditure front.[2] We may take an example to see how taxes redistribute income:

Suppose an economy has a flat rate of income tax 30 per cent. Just see the impact of this tax on the income disparity of two people A and B earning Rs. 50,000 and Rs. 80,000, respectively.

Individual	Nominal Income	Income Disparity before Tax	Income after Paying Tax	Income Disparity after Tax
A	Rs. 50,000	Rs. 30,000	Rs. 35,000	Rs. 21,000
B	Rs. 80,000		Rs. 56,000	

We see here through the above-given Table as how the income disparity between two individuals A and B decreases from Rs. 30,000 to Rs. 21,000 after paying taxes—this is the *first level* when incomes of these individuals have got re-distributed.

Now the money the government has got by tax collection, i.e., Rs. 39,000 (Rs. 15,000 + Rs. 24,000) will be spent on different sectors—infrastructure, education, health etc.—which will provide services to each and everybody alike. Here income is re-distributed at the *secondary* level. Consider a person who pays income tax, but does not take services of government schools for his children's education, nor goes to the government hospitals for medical services and compare him with a person who has no option other than the government schools and the hospitals—the higher tax payer getting no government services and a lower tax payer getting all the services. Here income looks re-distributed from the consumption side.

INCIDENCE OF TAX

The point where tax looks as being imposed is known as the incidence of tax—the event of tax imposition.[3]

IMPACT OF TAX

The point where tax makes its effect felt is known as the impact of tax—the after effect of tax imposition.[4]

DIRECT TAX

The tax which has incidence and impact both at the same point is the direct tax—the person who is hit, the same person bleeds.[5] As for example income tax, interest tax, etc.

INDIRECT TAX

The tax which has incidence and impact at the different points is the indirect tax—the person who is hit does not bleed[6] someone else bleeds. As, for example, excise, sales tax, etc., which are imposed on either the producers or the traders, but it is the general consumers who bear the burden of tax.

METHODS OF TAXATION

There are three methods of taxation prevalent in economies with their individual merits and demerits—

1. Samuelson and Nordhaus, ***Economics,*** op. cit., p. 327.
2. For further references, Stiglitz and Walsh, ***Economics,*** op. cit., pp. 378–79 may be referred.
3. Samuelson and Nordhaus, ***Economics,*** op. cit., pp. 75–77.
4. Ibid., pp. 75–77.
5. Ibid., p. 329.
6. Ibid., p. 329.

PROGRESSIVE TAXATION

This method has increasing rates of tax for increasing value or volume on which the tax is being imposed.[7] Indian income tax is a typical example of it. The idea here is less tax on the people who earn less and higher tax on the people who earn more—classifying income earners into different slabs. This method is believed to discourage more earnings by the individual to support low growth and development unintentionally. Being poor is rewarded while richness is punished. Tax payers also start evading tax by showing lower unreal income. But from different angles this tax is pro-poor and taxes people according to their affordability/sustainability. This is the most popular taxation method in the world and a populist one, too.

REGRESSIVE TAXATION

This is just opposite to the progressive method having decreasing rates of tax for increasing value or volume on which the tax is being imposed.[8] There are not any permanent or specific sectors for such taxes. As a provision of promotion, some sectors might be imposed with regressive taxes. As for example, to promote the growth and development of small scale industries, India at one time had regressive excise duty on their productions—with increasing slabs of volume they produced, the burden of tax used to go on decreasing.

This method while appreciated for rewarding the higher producers or income-earners, is criticised for being more taxing on the poor and low-producers. This is not a popular mode of taxation and not as per the spirit of modern democracies.

PROPORTIONAL TAXATION

In such a taxation method, there is neither progression nor regression from the point of view rate of taxes point of view. Such taxes have fixed rates for every level of income or production, they are neutral from the poor or rich point view or from the point of view of the levels of production.[9] Usually, this is not used by the economies as an independent method of taxation. Generally, this mode is used as a complementary method with either progressive or regressive taxation. If not converted into proportional taxes, every progressive tax will go on increasing and similarly every regressive tax will decrease to zero, becoming completely a futile tax methods. That is why every tax, be it progressive or regressive in nature, must be converted into proportional taxes after a certain level.

A GOOD TAX SYSTEM

What are the characteristics of a good tax system? There has always been a debate among economists and policymakers on the issue of design of the tax system. Taxation in developing economies has been even more debated as the trade-off assessment generates enough controversy. Main debatable issues in the design of a tax system are whether progressive or regressive taxation, direct tax or indirect tax collections should be higher, whether revenue deficit is better, etc. The controversies set apart, there is a broad consensus on five ***principles***[10] of a good tax system, among economists and the policymakers:

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7. Samuelson and Nordhaus ***Economics,*** op. cit., p. 329; Stiglitz and Walsh, ***Economics,*** op. cit., p. 380.
8. Ibid.
9. Samuelson and Nordhaus, ***Economics,*** op. cit., p. 329.
10. Stiglitz and Walsh, ***Economics,*** op. cit., 382. A comprehensive analysis of good tax structure is also given in ***Meade Committe Report,*** Institute for Fiscal Studies (IFS), Washington DC, 1978.

(i) Fairness

Though fairness (i.e., the first criteria of a good tax system) is not always easy to define, economists suggest inclusion of two elements in the tax system to make it fair namely, ***horizontal equity*** and ***vertical equity.*** Individuals in identical or similar situations paying identical or similar taxes is known as ***horizontal equity.*** When 'better off' people pay more taxes it is known as ***vertical equity***.

(ii) Efficiency

Efficiency of a tax system is its potential to affect or interfere the efficiency of the economy. A good tax system raises revenue with the least cost on the taxpayers and least interference on the allocation of resources in the economy. The tax system affects the economic decisions of individuals and groups by either encouraging or discouraging them to save, spend, invest, etc. Taxes can improve efficiency of the economy—taxes on pollution or on smoking give revenue to the government and serves broader social purposes, too. This is known as the ***double dividend*** of a tax.

(iii) Administrative Simplicity

This is the third criterion which includes factors like computation, filing, collection, etc. of the taxes that all should be as simple as possible. Simplicity checks tax evasion too. Tax reform in India has simplification of tax as its major plank—also recommended by the Chelliah Committee.

(iv) Flexibility

A good tax system has the scope of desirable modifications in it if there is any such need.

(v) Transparency

How much tax taxpayers are actually paying and what are they getting against it in the form of the public services should be ascertainable, i.e., the transparency factor.

METHODS OF EXPENDITURE

Similar to the methods of taxation the modes of government expenditure are also of three types—Progressive, Regressive and Proportional.[11]

At first instance it seems that as a country achieves better levels of development, sectoral and the item-wise expenditure of the economy must have decreasing trends. But practical experience shows that the level of expenditure needs enhancement everyday and economy always needs more and more revenues to fulfil the rising expenditures. That is why for economies the best form of government expenditure is the progressive expenditure.

The best way of taxation is progressive and the best way of government expenditure is also progressive and they suit each other beautifully. Most of the economies around the world are having progressive taxation with progressive expenditure.

VALUE ADDED TAX

The value added tax (VAT) is a method of tax collection as well as name of a state level tax (***at present***) in India. A tax collected at every stage of value addition, i.e., either by production or distribution is known as value added tax.[12] The name itself suggests that this tax is collected on the value addition (i.e., production).

11. Based on the discussion on Government Expenditure in Samuelson and Nordhaus, ***Economics,*** op. cit.
12. Ibid., p. 333

Production of goods or services is nothing but stages of value additions where production of goods is done by the industrialists or manufacturers. But these goods require value addition by different service providers/ producers (the agents, the wholesalers and the retailers) before they reach the consumers. From production to the level of sale, there are many points where value is added in all goods. VAT method of tax collection is different from the non-VAT method in the sense that it is imposed and collected at different points of value addition chain, i.e., ***multi-point tax collection***. That is why there is no chance of imposing tax upon tax which takes place in the non-VAT method—***single point tax*** collection. This is why VAT does not have a 'cascading effect' on the prices of goods it does not increase inflation—and is therefore highly suitable for an economy like India where due to high level of poverty large number of people lack the market level purchasing capacity. It is a pro-poor tax system without being anti-rich because rich people do not suffer either.

NEED OF VAT IN INDIA

Over 150 nations in the world have implemented the VAT system of taxation regarding collecting their indirect taxes. There have been valid reasons why India should move towards the VAT method of tax collection. We may see some of the major reasons:[13]

(i) Due to single point tax collection, Indian indirect tax collection system was price-increasing (having *cascading effect* on the price) which was highly detrimental to the poor masses. Implementation of VAT will improve the purchasing capacity and so living standard of the poor people.[14]

(ii) India is having a federal political system where side by side the central government, states have also been given power to impose taxes and collect them. At the central level, there had been uniformity of taxes for the economy. But there was no 'uniformity' at the state level taxes (i.e., state excise, sales tax, entertainment tax, etc.). This was detrimental to the development of a single market for Indian economy as a whole. India basically had many markets, but no Indian market as such. To bring in uniformity at the state-level taxes, VAT was a necessary step in India.

(iii) With the process of economic reforms, India moved towards the market economy. And for this, firstly India needed to have a single market. Without uniformity at the state level taxes (***uniform VAT***) this was not possible.

(iv) Indian federal design has resulted in economically weaker states and stronger centre. As VAT increases the total tax collection (experience of the world suggests so) it was fit to be implemented at the state level.

(v) India has been a country of high level tax evasion. By implementing VAT method of indirect tax collection, it becomes almost impossible to go for large scale tax evasion. To prove one's level of value addition, the purchase invoice/receipt is a must which ultimately makes it cross-check the level of production and sale in the economy.[15]

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13. Derived from the points forwarded by the ***GoI*** and the ***Empowered Group of State Ministers.***
14. Raja C. Chelliah, Pawan K. Aggarwal, Mahesh C. Purohit and R. Kavita Rao, ***Introduction to Value Added Tax*** , in Amaresh Bagchi edited ***Readings in Public Finance,*** Oxford University Press, N. Delhi, 2005, pp. 277–78.
15. Ibid.

(vi) If some of the state level taxes (which are many) are converted into state VAT the complexity of taxation will also be minimised. And at the end, it is possible to merge some of the centre's indirect taxes with it, i.e., arrival of the ***single VAT***.

Keeping all such things in mind, India started tax reform (Chelliah Committee and Kelkar Committee) and a certain level of sucess has been achieved in this area which can boost our motivation.

In the year 1996, the central government started collecting its excise duty on the VAT method and the tax was given a new name—the CENVAT.

The next proposal was to merge the states excise duty (imposed on intoxicants only) and their sales taxes into one tax—the state VAT or VAT. This could not take place due to states' lack of political will. Ultimately only sales taxes of the states were changed to be named VAT and was started to be collected on the basis of the VAT method (some states did not join it and some joined later). The experience has been encouraging.

IMPLEMENTATION EXPERIENCE OF VAT

The implementation experience of VAT in India has been very encouraging—the new tax system has been received well by all the stakeholders, the transition being quite smooth.[16] The revenue performance of VAT—implementing states/UTs (25) has been encouraging the tax revenue registered, an increase of 13.8 per cent over the annual growth rate of the last five years.[17] Only 8 states claimed for VAT compensation from the Centre in 2005–06 which came down to only 5 in the fiscal 2006–07.

GOODS AND SERVICES TAX

The Goods and Services Tax (GST) is a tax proposal[18] in India which will emerge after merging many of the state and central level indirect taxes. Important points of the proposed GST are as follows:

(i) It will be a tax collected on the VAT method—having all the benefits of a VAT kind of tax.

(ii) It will be imposed all over the country with the uniformity of rate and will replace multiple central and state taxes (a *single VAT* it will be known). The taxes to be withdrawn or merged into the GST are:

Central Taxes: CENVAT, service tax, sales tax and stamp duty.

State Taxes: State excise, sales tax, entry tax, lease tax, works contract tax, luxury tax, octroi, turnover tax and cess.

(iii) The proposed tax has a single rate of 20 per cent of which Centre and state will have a share of 12 per cent and 8 per cent, respectively.

The Union Budget 2015–16 repeated its commitment towards implementation of GST. The major challenges in the path of its implementation as per the experts are as follows:

(i) States are collecting VAT with five rates—0 per cent, 1 per cent, 4 per cent and 20 per cent. The fifth rate is 12.5 per cent known as the RNR (revenue neutral rate). Now the challenge is to convince the states to be satisfied with their share of only 8 per cent in the GST at one hand and making it politically happen from the consumers point of view.

16. ***Economic Survey 2006–07***, MoF, GoI, N. Delhi, pp. 46–47.

17. Ibid.

18. Recommended by the Vijay Kelkar *Task Force on FRBM, 2003,* GoI, N. Delhi.

(ii) The next challenge is to decide the things like how and where to integrate central taxes and the state taxes as VAT or as the GST.

(iii) What to do with the custom duty is also a matter of concern as there is a move to integrate it with the GST at present.

Recent Attempts to Implement GST

To operationalise the GST, the Constitution (115th Amendment) Bill[19] has been introduced in the Lok Sabha in March 2011 to enable the Parliament and state legislatures to make laws for levying GST on every transaction of supply of goods or services or both. Some goods, namely crude petroleum, diesel, petrol, aviation turbine fuel, natural gas and alcohol are not to come under the purview of the GST.

The constitutional amendment bill also seeks to empower the President to set up within 60 days of the passage of the legislation, a GST Council with the Union Finance Minister as chairperson and Union Minister of State for Revenue and finance ministers of all the states as members. The GST Council is to work on the basis of consensus and make recommendations on issues like GST rates, exemption lists and threshold limits.

Further, the bill provides for setting up of a GST dispute settlement authority, comprising a chairperson and two members to resolve disputes arising out of deviations from the recommendations of the GST Council either by the central or state governments. The draft bill has since been referred to the Parliamentary Committee on Finance for examination.

Among the other steps that are being taken for the introduction of the GST is the establishment of a strong information technology (IT) infrastructure. For this purpose the government has set up an ***Empowered Group*** headed by Nandan Nilekani, Chairman, Unique Identification Authority of India (UIDAI).

Significant progress has been made in the conceptualisation and design of the GST Network (GSTN), which is a common portal for the Centre and states that will enable electronic processing of key business processes of registration, returns and payments. For this purpose, the structure of these processes is in advanced stages of finalisation. The National Securities Depository Limited (NSDL) has been selected as technology partner for incubating the National Information Utility that will establish and operate the IT backbone for the GST. In this regard the NSDL has set up a pilot project in collaboration with states prior to its roll-out across the country.

Launching a single VAT for the country (proposed as the GST) has been postponed sveral times by now. The postponements were due to lack of concensus between the Centre and the States related to several aspects of the GST. Though, a broad concensus is believed to be emerging in 2014–15 after which the GoI moved the *122nd Constitution Amendment Bill* in the Lok Sabha by mid-December 2014. The *Union Budget 2015–16* proposes to implement the GST from the financial year 2016–17.

ADDITIONAL EXCISE DUTY

There is a tax in India known as the Additional Excise Duty (AED) imposed and collected by the Centre. Basically, this is not a form of excise duty. At the same time, though the Centre collects it the total corpus of collected tax is handed over to the states.

On the request of the states, the central government passed the Goods of Special Importance Act, 1957 which empowered the

19. ***Economic Survey 2011–12,*** op. cit., p. 57

Centre to collect the AED on tobacco, textile and sugar in lieu of the states' sales tax on them so that these regionally produced goods (which are consumed nationally) have uniform and affordable prices across the country.

Once VAT is fully operational in the economy this responsibility will be handed over to the states (as proposed) to be integrated with their VAT with the condition that none of these commodities will be charged VAT exceeding 4 per cent.

CST REFORMS

The Central Sale Tax (CST), being an origin—based non-rebatable tax, it is generally agreed, is inconsistent with the concept of VAT. That is why it needs to be phased out; the CST reforms is a part of the tax reforms in India. The critical issue involved in phasing out of CST is that of compensating the states for revenue losses on account of such a phase out. Since phasing out of CST will entail a revenue loss, states have been insisting on a mechanism to compensate them on a permanent basis. The 4 per cent rate of the CST has to be phased out in stages with 1 per cent phase out in one financial year and the states duly compensated through tax devolution. Because of phasing out, it is now at 2 per cent.

SERVICE TAX

The share of the services sector in the GDP of India has been going upward for the last decade. The introduction of service tax in 1994–95 by the Government of India has started paying the government on its tax revenue front. Introduced to redress the asymmentric and distortionary treatment of goods and services in the tax regime, the service tax has seen gradual expansion in the country.

Introduced on only three serviecs, by now, the applies on more than 100 services. The rate of service tax has been increased by the *Union Budget 2015–16* to 14 per cent inclusive of education cesses (it was 12.36 per cent inclusive of education cesses). The change has been done to facilitate a smooth transition to levy tax on services by both Centre and states, once India switches over to the GST by the next year. Other than imposing a 2 per cent Swachh Bharat Cess, the *Budget* has also put all services provided by the government entities under the service tax net (both to be notified in coming times).

The service tax collection was estimated to increase to Rs. 2,16,000 crore (BE) in 2014–15 (from Rs. 71,000 crore of 2010–11) with a growth rate of 33 per cent over the previous year.[20]

VOLUNTARY COMPLIANCE ENCOURAGEMENT SCHEME

Announced in the *Union Budget 2013–14*, the Service Tax *Voluntary Compliance Encouragement Scheme (VCES)* is a one-time amnesty for those who have collected service tax but not deposited the same with the government. Those service tax providers that have not filed service tax return since October 2007 can disclose true liability and get an interest or penalty waive off.

COMMODITIES TRANSACTION TAX

The *Union Budget 2013–14* has introduced (basically, *reintroduced*) the Commodities Transaction Tax (CTT), however, only for ***non-agricultural*** commodity futures at the rate of **0.01** per cent (which is equivalent to the rate of equity futures on which a *Securities Transaction Tax* is imposed in India). Alongwith this, transactions in commodity derivatives have been declared to be

20. ***Economic Survey 2014–15***, MoF, GoI, N. Delhi, Vol. 2, p. 26.

made *non-speculative*; and hence for traders in the commodity derivative segment, any losses arising from such transactions can be set off against income from any other source (similar provisions are also applicable for the securities market transactions).

Like all financial transaction taxes, CTT ***aims*** at discouraging excessive speculation, which is detrimental to the market and to bring parity between securities market and commodities market such that there is no tax/regulatory arbitrage. *Futures contracts* are financial instruments and provide for price risk management and price discovery of the underlying asset commodity / currency / stocks / interest. It is, therefore, essential that the policy framework governing them is uniform across all the contracts irrespective of the underlying assets to minimise the chances of regulatory arbitrage. The proposal of CTT also appears to have stemmed from the general policy of the government to widen the tax base.

Commodities Transaction Tax (CTT) is a tax similar to Securities Transaction Tax (STT), proposed to be levied in India, on transactions done on the domestic commodity derivatives exchanges. Globally, commodity derivatives are also considered as financial contracts. Hence CTT can also be considered as a type of 'financial transaction tax'.

The concept of CTT was ***first*** introduced in the *Union Budget 2008–09*. The government had then proposed to impose a commodities transaction tax (CTT) of 0.017 per cent (equivalent to the rate of equity futures at that point of time). However, it was withdrawn subsequently as the market was *nascent* then and any imposition of transaction tax might have adversely affected the growth of organised commodities derivatives markets in India. This has helped Indian commodity exchanges to grow to global standards [MCX is the world's ***No. 3*** commodity exchange; globally, MCX is ***No. 1*** in gold and silver, ***No. 2*** in natural gas and ***No. 3*** in crude oil].

SECURITIES TRANSACTION TAX

The Securities Transaction Tax (STT) is a type of 'financial transaction tax' levied in India on transactions done on the domestic stock exchanges. The rates of STT are prescribed by the central government through its budget from time to time. In tax parlance, this is categorised as a ***direct tax***. The tax came into effect from *October 1, 2004*. In India, STT is collected for the Government of India by the stock exchanges. With charging of STT, long-term capital gains tax was made ***zero*** and short-term capital gains tax was reduced to 10 per cent (subsequently, changed to 15 per cent since 2008).

The STT framework was subsequently reviewed by the central government in the year 2005, 2006, 2008, 2012 and ***2013***. The STT rates were revised upwards in the year 2005 and 2006 while it was reduced for certain segments in 2012 and 2013. The STT provisions were altered in the year 2008 such that for professional traders (brokers), STT came to be treated as an *expense* which can be deducted from the income instead of treating the same as an advance tax paid. [The 2004 STT provisions provided that the STT payments of professional traders, whose 'business income' arising from purchase and sale of securities could be set off against their total tax liability.]

As on date, STT is not applicable in case of *preference shares, government securities, bonds, debentures, currency derivatives, units of mutual fund other than equity oriented mutual fund,* and *gold exchange traded funds* and in **such cases**, tax treatment of short-term and long-term gains shall be as per normal provisions of law.

Transactions of the shares of listed companies on the floor of the stock exchange or otherwise, mandated under the regulatory framework of SEBI, such as *takeover, buyback, delisting offers,* etc., also does not come under STT framework. The *off-market* transactions of securities (which entails

changes in ownership records at depositories) also does not attract STT.

CAPITAL GAINS TAX

This is a direct tax and applies on the sales of all 'assets' if a profit (gain) has been made by the owner of the asset—a tax on the 'gains' one gets by selling assets. The tax has been classified into two—

(i) *Short Term Capital Gain* (STCG): It applies 'if the Asset has been sold within 36 months of owning it'. In this case the 'rate' of this tax is similar to the normal income tax slab. But the period becomes '12 months' in cases of shares, mutual funds, units of the UTI and 'zero coupon bond'—in this case the 'rate' of this tax is **15** per cent.

(ii) *Long Term Capital Gain* (LTCG): It applies 'if the asset has been sold after 36 months of owning it'. In this case the 'rate' of this tax is **20** per cent. In cases of shares, mutual funds, units of the UTI and 'zero coupon bond' there is 'exemption' (zero tax) from this tax (provided that such transaction is subject to 'Securities Transaction Tax').

MINIMUM ALTERANATE TAX

The Minimum Alternate Tax (MAT) is a direct tax imposed on the 'zero tax' companies at the rate of 18.5 per cent on their book profit. This was first imposed in 1997–98.

Basically, income tax is paid as per the provisions of the Income Tax Act (IT Act), but companies calculate their profit (through profit and loss account) as per the provisions of the Companies Act. The IT Act allows several kinds of exemptions and other incentives from total income together with deductions on the gross income. Again, the rates of 'depreciation' under the Companies Act is higher than the IT Act. As a result of these exemptions, deductions and other incentives under IT Act together with higher depreciation under the Companies Act, companies show their taxable income either 'nil' or 'negative', and this way, the 'zero tax' companies emerge.

Practically, 'zero tax' companies, might be having high 'book profit' and distributing huge dividends (under the Companies Act) to their shareholders, too, but showing 'nil' or 'negative' taxable income (under the IT Act) they might not pay any income tax! To bring such companies under the income tax, *Section 115JB* was introduced in the IT Act in 1997–98 and MAT was imposed accordingly.

MAT is a way of making companies pay minimum amount of tax. It is applicable on all companies except those engaged in infrastructure and power sectors, free trade zones, charitable activities, venture and angel funds. Foreign companies with income sources in India also come under it. The *Union Budget 2015–16* has rationalised the MAT provisions for the FIIs (Foreign Financial Institutions)—now they do not need to pay MAT on their profits from capital gains on transactions in securities (which are liable lower tax rate).

We may take an example – suppose a company has 'book profit' of Rs. 10 lakh. And, after claiming the deductuions, exemptions and depreciation its 'gross taxable income' comes down to Rs. 6 lakh, its taxable income becoming Rs. 4 lakh. In this case, the applicable income tax would be Rs. 1.2 lakh (if rate of income tax is 30 per cent flat). But the comapny will pay a MAT of Rs. 1.85 lakh (at the rate of 18.5 per cent on its 'book profit' of Rs. 10 lakh). The concerned comapny needs to pay the tax which is higher—here, the tax to be paid will be Rs. 1.85 lakh.

The MAT paid can be carried forward and set-off (adjustment) against regular tax payable during the subsequent five-year period subject to certain conditions. This is known as MAT credit.

INVESTMENT ALLOWANCE

Announced in the *Union Budget 2013–14*, a tax break given to companies for high value investment in plant and machineries, over and above depreciation benefits enjoyed by them. A company investing Rs. 100 crore or more in plant and machinery during the April 2013 to March 2015 will be entitled to deduct an investment allowance of **15** per cent of the investment. This is expected to see enormous spill-over benefits to small and medium enterprises.

The proposed investment allowance scheme should be seen a drain on the government's tax collections. It may be seen as a kind of *tax exemption*.

COLLECTION RATES

Given the large number of exemptions to rate of customs, the increase in value of imports does not necessarily imply similar magnitude in customs revenue. Collection rates are an indicator of overall incidence of customs tariffs including countervailing and special additional duties of imports. These are computed as the ratio of revenue collected from these duties to the aggregate value of imports in a year (or period) and thus represent trade-weighted tariffs. A major reason for the fall in rates has been the lower levels of duties on many items including on petroleum, oil, and lubricants (POL), which has significant import value and of course the impact of the various exemptions. At the overall level, the effective rate of taxes at around 6.1 per cent in 2013–14 as against the level of simple average tariff rates of basic customs duties and the CVD indicates the impact of exemptions.[21]

TAX EXPENDITURE

As per the current *Economic Survey 2014–15*, there is significant divergence in India between the official rates of taxes and the actual or *effective rate of taxation* (which is a simple 'ratio of tax revenue collected to the tax base'). This arises on account of the *exemptions* to the tax rate. As indicated earlier in the section on *collection rates*, the magnitude of **revenue foregone** *(*i.e., *tax expenditure)* is indeed high.

In case of the ***direct taxes***, the situation prevails as given below:

(i) Tax foregone on account of exemptions under *corporate income tax* for 2013–14 was estimated at Rs. 76,116 crore. In this case, ***deduction*** on account of accelerated depreciation, deduction for export profits of export-oriented units located in special economic zones (SEZs) and profits of businesses in the power and telecom sectors were some of the major incentives. Though, the absolute amount of deductions has decreased as a result of phasing out of profit-linked deductions.

(ii) Tax forgone on account of exemptions under *personal income tax* for individual taxpayers was estimated at Rs. 40,414 crore in 2013–14. In this case, the bulk of the revenue foregone was on account of the exemptions given for certain investments and payments under Section 80 C of the Income Tax Act.

In so far as ***indirect taxes*** are concerned, revenue forgone is defined as the difference between duty that would have been payable but for the issue of exemption notification and actual duty paid in terms of the relevant notification. The situation stands as given below:

21. ***Economic Survey 2014–15***, op. cit.

(i) The revenue forgone for the financial year 2013–14 in respect of *excise duties* is estimated at Rs. 1,95,679 crore including Rs. 12,880 crore on account of area-based exemptions.

(ii) Duty forgone for the year 2013–14 on account of all the exemption notifications on *customs* was estimated at Rs. 2,60,714 crore.

There is merit in limiting the exemptions or their *grandfathering*[22] on a case-by-case basis so as to realise fuller tax potential through a wider tax base. The *Direct Tax Code 2010* has enough scope to cut such exemptions. Similarly, the on-going indirect tax reforms such as the GST has such provisions.

14TH FINANCE COMMISSION

The 14th Finance Commission (FFC) was constituted on *January 2, 2013* under the Chairmanship of Dr. Y. V. Reddy, former RBI Governor with Prof. Abhijit Sen, Ms. Sushma Nath, Dr. M. Govinda Rao and Dr. Sudipto Mundle as the other *four* members. The recommendations of the commission will apply on the period ***2015–20*** and its report has to be submitted by October 31, 2014.

The broad *Terms of Reference* and the *matters* to be taken into consideration by the commission are:

(i) *Tax Devolution* & *Grant* related references

(a) the distribution between the union and states of the net *proceeds of taxes* which are to be, or may be, divided between them under *Chapter I, Part XII* of the Constitution and the allocation between the states of the respective shares of such proceeds;

(b) the principles which should govern the *grants-in-aid* of the revenues of the states out of the Consolidated Fund of India and the sums to be paid to the states which are in need of assistance by way of grants-in-aid of their revenues under *Article 275* of the Constitution for the purposes other than those specified in the provisos to *Clause (1)* of that article; and

(c) measures needed to augment the Consolidated Fund of a state to supplement the resources of the *panchayats* and *municipalities* in the state on the basis of the recommendations made by the finance commission of the state.

(ii) To review the state of finances, *deficit*, and *debt* levels of the union and states, and suggest measures for maintaining a stable and sustainable fiscal environment consistent with equitable growth including suggestions to amend the FRBMAs currently in force. The commission has been asked to consider and recommend incentives and disincentives for states for observing the obligations laid down in the FRBMAs.

(iii) In commission is required to consider—

(a) the *resources* of the Central government and the *demands* on the resources of the central government;

(b) the *resources* of the state governments and *demands* on such resources under

22. **Grandfather Clause** – a clause in a new law that exempts certain persons or businesses from abiding by it. For example, suppose a country passes a law stating that it is illegal to own a cat. A grandfather clause would allow persons who already own cats to continue to keep them, but would prevent people who do not own cats from buying them. Grandfather clauses are controversial, but they are common around the world. [*Source:* **Farlex Financial Dictionary**, Farlex Inc., N. York, USA, 2012; **Collins English Dictionary- Complete & Unabridged**, HaperCollins, N. York, USA, 2003.]

different heads, including the impact of debt levels on resource availability in debt-stressed states;

(c) the objective of not only balancing the receipts and expenditure on revenue account of all the states and the union but also generating surpluses for capital investment;

(d) the *taxation efforts* of the central government and each state government and the potential for additional resource mobilisation;

(e) the level of *subsidies* required for sustainable and inclusive growth and equitable sharing of subsidies between the central and state governments;

(f) the *expenditure* on the non-salary component of maintenance and upkeep of capital assets and the non-wage-related maintenance expenditure on Plan schemes to be completed by March 31, 2015 and the norms on the basis of which specific amounts are recommended for the maintenance of capital assets and the manner of monitoring such expenditure;

(g) the need for *insulating the pricing* of public utility services like drinking water, irrigation, power, and public transport from policy fluctuations through statutory provisions;

(h) the need for making public-sector enterprises competitive and market oriented; listing and disinvestment; relinquishing of non-priority enterprises;

(i) the need to balance *management of ecology, environment, and climate change* consistent with sustainable economic development; and

(j) the impact of the proposed *goods and services tax* on the finances of the Centre and states and the mechanism for compensation in case of any revenue loss.

(iv) To review the present *public expenditure management* systems and recommend, including—

(a) budgeting and accounting standards and practices;

(b) the existing system of classification of receipts and expenditure;

(c) linking outlays to outputs and outcomes; and

(d) best practices within the country and internationally.

6. To review the present arrangements of financing of *Disaster Management* with reference to the funds constituted under the Disaster Management Act 2005 and make recommendations.

7. To indicate the basis on which it has arrived at its findings and make available the *state-wise estimates of receipts and expenditure.*

The commission is required to generally take the base of population figures as of 1971 in all cases where population is a factor for determination of devolution of taxes and duties and grants-in-aid. However, the commission may also take into account the demographic changes that have taken place subsequent up to 1971.

FFC RECOMMENDATIONS

The 14th Finance Commission (FFC) submitted its report by early 2015. It has advised for far-reaching changes for sharing of revenues between the Center and the States, on the one hand, and between the States, on the other. The advices apply on the period 2015–20 and are

likely to have major implications for Center-State relations, for budgeting by, and the fiscal situation of, the Center and the states. 'Successful implementation of the advices will advance the cause of cooperative federalism that the new government has enthusiastically embraced', the *Economic Survey 2014–15* concluded. Some of the ***major recommendations*** are as follows:

(i) It has radically enhanced the share of the states in the central 'divisible pool' of taxes from the current **32** per cent to **42** per cent which is the biggest ever increase in vertical tax devolution. The last two Finance Commissions, viz., Twelfth (2005–10) and Thirteenth (2010–15) had recommended a state share of 30.5 per cent (increase of 1 per cent) and 32 per cent (increase of 1.5 per cent), respectively in the central divisible pool.

(ii) It has also proposed a new horizontal formula for the distribution of the divisible pool among the states. There are changes both in the variables included/excluded as well as the weights assigned to them. Relative to the Thirteenth Finance Commission, the FFC has incorporated two new variables—

(a) 2011 population and forest cover; and

(b) Excluded the variable relating to fiscal discipline.

(iii) Implementing these recommendations will move the country toward greater *fiscal federalism*, conferring more fiscal autonomy on the states. For example, based on assumptions about nominal GDP growth and tax buoyancy and the policy measures that are contemplated for 2015–16, it is estimated that the additional revenue for the states could be as much as Rs. 2 lakh crores relative to 2014–15. Of this, a substantial portion represents the difference that is purely due to the change in the States' share in the divisible pool.

(iv) Preliminary estimates suggest that *all States stand to gain* from FFC transfers in absolute terms. However, to assess the distributional effects, the increases should be scaled by population, Net State Domestic Product (NSDP) at current market price, or by States' own tax revenue receipts. This will make the following effects on the ststes' revenue—

(a) The biggest gainers when scaled by any of these indicators tend to be the Special Category States (SCS, mostly those in the North-East) and by orders of magnitude.

(b) The major gainers in per capita terms turn out to be Arunachal Pradesh, Mizoram and Sikkim for the SCS states and Kerala, Chhattisgarh and Madhya Pradesh for other states (GCS or General Category States). Clearly, this increase in taxes to the States is sustainable for the center, only if there is a reduction in the central (Plan) assistance to the states (CAS).

In other words, States will now have greater autonomy both on the revenue and expenditure fronts.

(v) It is also possible to tentatively estimate what the FFC recommendations would do to net spending capacity of the States, where net refers to the difference between the extra FFC transfers and the reduced CAS that will be required by the FFC recommendations. Broadly, the Special Category States will be the biggest gainers. In addition, there are nine States among the GCS which are expected to get more than 25 per cent of their own tax revenue.

(vi) A collateral benefit of moving from CAS to FFC transfers is that overall progressivity will improve; that is, on average, States with lower per capita NSDP will receive more than those with a higher per capita NSDP. This results from the fact that CAS transfers, which tended to be discretionary, were less progressive than Finance Commission transfers.

To be sure, there will be transitional costs entailed by the reduction in CAS transfers. But the scope for dislocation has been minimised because the extra FFC resources will flow broadly to the states that have the largest CAS-financed schemes.

The far-reaching recommendations of the FFC, along with the creation of the *NITI Aayog*, will further the government's vision of *cooperative* and *competitive* federalism. The necessary, indeed vital, encompassing of cities and other local bodies within the embrace of cooperative and competitive federalism is the next policy challenge, which is believed to be strengthened by the body NITI Aayog.

CONCEPTS RELATED TO FC

Tax Devolution: Advising a formula to distribute the Union tax proceeds between Union and the States is the most important task of a FC, as the share of states in the net proceeds of Union taxes is the *predominant channel* of resource transfer from the Centre to states.

Divisible Pool: It is that portion of gross tax revenue which is distributed between the Centre and the States. The divisible pool consists of all taxes, except surcharges and cess levied for specific purpose, net of collection charges.

Before the 80th Constitution Amendment (2000), the sharing of the Union tax revenues with the states was in accordance with the provisions of articles 270 and 272, as they stood then. This amendment altered the pattern of sharing of Union taxes in a fundamental way—dropping the Article 272 and substantially changing the Article 270. The new Article 270 provides for sharing of all the taxes and duties referred to in the Union List putting all in a 'divisible pool'. There are some exceptions to it. The taxes and duties referred in the Articles 268 and 269 of the Constitution, together with surcharges and cesses on taxes and duties (referred in the Article 271) and any cess levied for specific purposes—do not fall under this 'pool'.

The new arrangement of tax devolution came as a follow-up to the recommendations of the 10th FC (1995–2000) which the FC termed as the 'Alternative Method of Tax Devolution' (AMD). A concensus between Union and States was a advised by the FC for such an arragnement to be effected. States were going to get extra 5 per cent share in the Union taxes in the AMD, thus, a serious demand came from them—ultimately, the AMD was accepted by the Centre. To make the AMD irreversible, the GoI went for the 80th Amendment in the Constituion.

Grants-in-aid: Though, tax devolution (from the *Divisible Pool*) is the primary instrument to attend the issue of 'horizontal imbalances' of revenue accruing to the states, the grants-in-aid is a complimentary/secondary instrument regarding the same. As per the Article 275, the FC recommends the *principles* as well as the *quantum* of grants to those states which are in need of assistance – different sums may be fixed for different states (one of the pre-requisites for such grants is the assessment of the needs of the states). The 1st FC had laid down *five broad principles* for determining the eligibility of a state for grants:

(i) The Budget of a state as the starting point for examination of a need.

(ii) The efforts made by states to realize the potential.

(iii) The grants should help in equalizing the standards of basic services across states.

(iv) Any special burden or obligations of national concern, though within the state's sphere, should also be taken into account.

(v) Grants might be given to further any beneficent service of national interest to less advanced states.

The grants recommended by FC are predominantly in the nature of general purpose grants meeting the difference between the assessed expenditure on the *non-plan revenue* account of each state and the *projected revenue* including the share of a state in Central taxes. These are often referred to as 'gap filling grants'.

The scope of grants to states, over the yaer, was extended further to cover special problems. Following the 73rd and 74th Amendments to the Constitution, FCs were charged with the additional responsibility of recommending measures to augment the *Consolidated Fund of a State* to supplement the resources of local bodies. This has resulted in further expansion in the scope of FC grants. The 10th FC was the first Commission to recommend grants for *rural* and *urban local bodies*. This way, the scope of grants-in-aid has gone for considerable extension, over the time.

Fiscal capacity: The *fiscal capacity* (also called 'income distance') criterion was first used by the 12th FC, measured by per capita GSDP as a proxy for the distance between states in *tax capacity*. When so proxied, the procedure implicitly applies a single average tax-to-GSDP ratio to determine fiscal capacity distance between states. The 13th FC changed the formula slightly and recommended the use of 'separate averages' for measuring tax capacity, one for general category states (GCS) and another for special category states (SCS).

Fiscal discipline: This as a criterion for tax devolution was used by the 11th and 12th FCs to provide an *incentive* to states managing their finances prudently. The criterion was continued in the 13th FC also. The index of fiscal discipline is arrived at by comparing improvements in the ratio of own revenue receipts of a state to its total revenue expenditure relative to the corresponding average across all states in the country.

PC as Collaborator: While the 12th FC (2005–10) was being set up, the GoI decided to make the Planning Commission (PC) function as a 'collaborator' to the FC—one member of the PC was added as an 'additional member' on the panel of the FC (the FC includes four members including the Chairman)—as a link between the bodies. This arrangement was continued with in the 13th and 14 FCs. It is believed that this arrangement was greatly helpful in bringing in a better idea about the revenue imbalances of the states. While the government did set up the NITI Aayog, no announcement came in this regard – there might be some developments in this regard once the 15th FC (2020–25) is set up in future.

DIRECT TAX CODE - 2013

On the recommendations of the *Kelkar Committe* on direct taxes the government started a major reform process in the area, trying to replace the existing direct tax laws, which is more than five decades old, in a sense, archaic. But passing a new direct tax Act has remained a difficult task for the governments (like the proposed GST). The **Union Budget 2014–15** (Interim) appealed to all political parties to resolve to pass the DTC in 2014–15—naturally, leaving the responsibility on the next Parliament and the new government in the Centre.

The first draft of the direct taxes code (DTC) was released in August 2009. Subsequently, the DTC-2010 Bill was tabled in Parliament in August 2010 and then referred to the Standing Committee on Finance (SFC) that submitted its report in March 2012. Due to the large

number of changes that had to be incorporated, the government decided to bring a fresh Bill. Meanwhile, the government has accepted 153 of the 190 recommendations made by the SFC. The revised **Direct Taxes Code-2013** that will serve the country for the next 20 years has been put by the Ministry of Finance on its website for public discussion. The DTC aims at overhauling the existing direct tax regime with an effective and equitable direct tax system that facilitates voluntary compliance and reduces disputes. In the revised draft, the government has been guided by the overarching principle of progressively taxing higher income, bringing greater clarity on applicability of tax provisions and improving the tax administration.

The key changes in the revised Direct Taxes Code-2013 are as given below:

(i) An indirect share transaction will be liable to be taxed in India on foreign companies, if 20 per cent of the assets are based in India.

(ii) New tax slab introduced—individuals earning more than Rs. 10 crore a year to be taxed at 35 per cent.

(iii) No changes in other tax slabs for individuals.

(iv) Age for senior citizens relaxed to 60 years from 65 years.

(v) Levy of an additional 10 per cent if the dividend income exceeds Rs. 1 crore.

(vi) Financial assets included under the ambit of wealth tax as compared to only physical assets at present – to be taxed at the rate of 0.25 per cent. Net wealth not subject to tax proposed to be increased to Rs. 50 crores (up from Rs. 30 lakh).

(vii) Rationalisation of provisions related to non-profit organisations.

(viii) Ring-fencing of losses from business availing investment linked incentives.

(ix) Provision of Settlement Commission removed.

The enactment of most of the provisions of the DTC have already been included in the Income Tax Act by early 2015. Some of the provisions, left out, were included in the *Union Budegt 2015–16*. The Budget adds that the jurisprudence under the IT Act is well evolved and considering all these aspects there is no great merit in going ahead with the DTC as it exists today.

CHAPTER

18

PUBLIC FINANCE IN INDIA

- Introduction
- Budget
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- Limiting Government Expenditure
- Fiscal Consolidation in India
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*How the modern governments manage all money they get–the public money–is the subject matter of public finance. The policy stance taken in this regard is declared annually by the governments via their 'fiscal policy' popularly known as the Budget.**

* *See Amaresh Bagchi (Ed.),* ***Readings in Public Finance,*** *Oxford University Press, N. Delhi, 2005. Also see Paul A. Samuelson and William D. Nordhaus,* ***Economics,*** *The McGraw-Hill Company, New York, 2005, pp. 412, 711. Also see Joseph E. Stiglitz and Carl E. Walsh,* ***Economics,*** *W. W. Norton, New Yok, 4th Edition, 2006, p. 695–697.*

INTRODUCTION

Public finance is a much wider title which includes all those matters which are connected with public money, the money a government gets, spends, borrows, lends, raises or prints. Public finance, i.e., finances of the government, now named as *public economics*, does not only discuss the issue that how much of the country's resources the government should acquire for its own use but also discusses the 'efficiency' with which the money should be used. Public finance gets reference in the ancient treatise ***Arthashastra***[1] of Kautilya which covers 'treasury, sources of revenue, accounts and audit' in a very detailed way. However, the subject has gathered much significance in the post Second World War period once the governments' role in the economy started expanding[2] due to various reasons namely, the rise of public sector, delivery of public goods, law and order, defence, etc. By the Second World War, the importance of the government's role in the economy was uagenthy felt and it was believed that all needs of the people cannot be met if the economy is left to the market (i.e., private sector) in its entireity. For example, national defence, law enforcement and other major areas which must be cared for by the national government besides the supplies of ***affordable or free*** healthcare, education, social security measures, etc., could only be taken care of by the governments (***as they are not profit driven)***. This is why there was an agreement among the experts and the policymakers to expand the government's role in the economy. This led to the ultimate rise of the public sector around the world.[3] Here we will be looking into the major concepts related to the area of public finance with special reference to India.

BUDGET

An annual financial statement of income and expenditure is generally used for a government, but it could be of a firm, company, corporation etc.[4] The 'word' has its origin in the British parliamentary exercise of preparing such statement way back in the mid-18th century from the French word *'Bugeut'* meaning a leather bag out of which the financial statement was brought out and presented in the parliament. Today, this word is used to mean the annual statement in all economies around the world.

The Constitution of India has a provision (Art. 112) for such a document called Annual Financial Statement to be presented in the Parliament before the commencement of every new fiscal year—popular as the Union Budget. Same provision is there for the states too.

DATA IN THE BUDGET

The Union Budget has ***three sets***[5] of data for every concerned sector or sub-sector of the economy:

(i) Actual data of the preceding year (here preceding year means one year before the year in which the Budget is being presented. Suppose the Budget presented

1. L. N. Rangarajan (ed.), ***The Arthashastra,*** Penguin Books, N. Delhi, 1992.
2. The size of government expenditure for the developed economies stood at almost 10 per cent of their GDPs at the begining of the 20th century—which could rise to 18 per cent only at the outbreak of the Second World War—went for a steep rise by 1980 to 40 per cent. The government expenditure was barely 9 percent of the GDP in India at the time of Independence, nearly doubled in 1970s and reach 75 per cent in the 1980s—when questions were raised about their sustainability as revenue receipts failed to grow adequately resulting in rising budgetary deficits (see Amaresh Bagchi (ed.), ***Readings in Public Finance,*** Oxford University Press, N. Delhi, 2005, pp. 1–4).
3. It should be noted here that the world which had the form of the state economy (i.e., the Socialist countries at this time, majority of the economic activities were under government control. As the communist form of the state economy emerged by the late 1940s (i.e., Peoples Republic of China, 1949), it had 100 per cent state control over the economic activities.
4. *Collins Dictionary of Economics,* op. cit., & ***Oxford Dictionary of Business,*** op. cit.
5. Based on the Budgetary documents of the Ministry of Finance, Government of India, N. Delhi.

is for the year 2008–09, the Budget will give the final/actual data for the year 2006–07 because the Budget is presented in February end of financial year 2007–08. After the data either we write '**A**', means actual data/final data or write nothing (India writes nothing).

(ii) Provisional data of the current year (since the Budget for 2008–09 is presented at the end of the fiscal 2007–08, it provides Provisional Estimates for this year (shown as '**PE**' in brackets with the data).

(iii) Budgetary estimates for the following year (here following year means one year after the year in which the Budget is being presented or the year for which the Budget is being presented, i.e., 2008–09. This is shown with the symbol '**BE**' in brackets with the concerned data.).

One comes across certain other kinds of data, too in day-to-day government economic literature. There are such three other kinds of data—

(i) Revised Estimate (RE)

Revised Estimate is basically a current estimation of either the budgetary estimates (BE) or the provisional estimates (PE). It shows the contemporary situation. It is an interim data.

(ii) Quick Estimate (QE)

Quick Estimate is a kind of revised estimate which shows the most latest situation and is useful in the process of going for future projections for some sector or sub-sector. It is an interim data.

(iii) Advance Estimate (AE)

Advance Estimate is a kind of quick estimate but done ahead (is advance) of the final stage when data should have been collected. It is an interim data.

Developmental and Nondevelopmental Expenditure

Total expenditure incurred by the government is classified into two segments—developmental and non-developmental. All expenditures of productive nature are developmental such as on the heads of new factories, dams, bridges, roads, railways, etc.—all *investments*.

The expenditures which are of consumptive kind and do not involve any production are non-developmental, i.e., paying salaries, pensions, interest payments, subsidies, defence expenses, etc.

This classification is not used in the Indian public finance management now (see *Plan* and *Non-Plan Expenditure,* in the next entry).[6]

Plan and Non-Plan Expenditure

Every expenditure incurred on the public exchequer is classified into two categories—the plan and the non-plan. All those expenditures which are done in India in the name of *planning* is the *plan expenditure* and rest of all are *non-plan expenditures*. Basically, all asset creating, and productive expenditures are plan and all consumptive, non-productive, non-asset building are non-plan expenditures and are developmental and non-developmental expenditures, respectively.

Since the financial year 1987–88, there was a terminology change in Indian public finance literature when developmental and non-developmental expenditures were replaced by the new terms plan and non-plan expenditures, respectively. (It was suggested by the Sukhomoy Chakravarti Committee.)[7]

6. ***Union Budget 1987–88,*** MoF, GoI, N. Delhi.
7. ***Review of the Working of the Monetary System,*** headed by Sukhomoy Chaktravarthy, RBI, GoI, N. Delhi, 1985.

Meanwhile, a high-power panel headed by Dr. C. Rangarajan (Chairman, Prime Minister's Economic Advisory Council), in *September 2011* suggested for redefining ***Plan*** and ***Non Plan*** expenditures as ***Capital*** and ***Revenue*** expenditures, as the former set of terms 'blur the classification' —this will facilitate linking expenditure to 'outcomes' and better public expenditure, the panels suggested. *Major* suggestions of the Panel are:

(i) *Plan* and *Non-Plan* distinction in the Budget is neither able to provide a satisfactory classification of 'developmental' and 'non-developmental' dimensions of government expenditure nor an appropriate budgetary framework. It has therefore become 'dysfunctional',

(ii) Suggests for *redefining the roles* of the Planning Commission (PC) and the Finance Ministry (FM). According to which the PC should be responsible for formulation of the five-year plan and the task of firming up the annual budgets should be entrusted to the FM.

(iii) The PC should dispense with the exercise of approving annual plans of states and it could hold a strategy or review meeting with representatives of the states.

(iv) Public expenditures should be split into *capital* and *revenue* expenditures.

(v) Public expenditure should have 'management approach' based on measurable 'outcomes', indicating that the reponsibility should be assigned to the FM.

Analysis of the Situation: While the need for looking beyond the budget is well accepted, there are many factors raising doubts on the 'efficacy' and 'relevance' of the five-year plans as the instrument. The division of expenditure between *Plan* and *non-Plan* is artificial and creates problems, such as :

(i) Plan expenditure tends to get priority especially when austerity and expenditure reduction has to be done periodically for fiscal consolidation. Non-Plan expenditure gets the ***cut*** even if it is vitally needed for economic development, an example is budget provision for maintenance of assets such as hospitals, schools and irrigation dams already created under Plan, but whose maintenance is treated as non-Plan.

(ii) Review and implementation of schemes is another area of direct responsibility for the Ministry of Finance and the Ministry of Statistics and Programme Implementation. The Finance Minister himself had, in the budget speech for 2005–06, promised to ensure that programmes and schemes were not allowed to continue indefinitely from one Plan period to another without an independent and in-depth evaluation. The Planning Commission, serving as the *focal point for Plan allocations*, dilutes the role of the Finance Ministry in this case.

(iii) 'Output' and 'Outcome Budgeting' was introduced by the Central Government from the Budget for 2005–06. Non-Plan expenditure remains out of its purview. This means, for example, the outcome of expenditure on running schools and hospitals will not be evaluated. This again is another fallout of the artificial division into Plan and non-Plan.

The ***dichotomy*** results in *dual* and *confusing* responsibility of the Ministry of Finance and the Planning Commission and adversely affects the whole budget process, formulation and implementation. The Ministry of Finance is

responsible for fiscal consolidation, containing the fiscal deficit and abiding to the FRBM Act. But in formulating the Budget its role in Plan expenditure budgeting is *diluted* by the discussions which the ministries have with the Planning Commission. The finalisation of Plan allocations for the state budgets also suffers from this weakness. Ultimately, the Central Government has to fix the market borrowing by state governments taking the overall sustainable borrowing limits, including the requirements of the Central Government. The Planning Commission tends to have a more optimistic estimate of resources likely to be available for financing the Plan expenditure as 'fiscal deficit' management and control is not its direct responsibility.

REVENUE

Every form of money generation in the nature of income, earnings are revenue for a firm or a government which do not increase financial liabilities of the government, i.e., the tax incomes, non-tax incomes along with foreign grants.

NON-REVENUE

Every form of money generation which is not income or earnings for a firm or a government (i.e., money raised via borrowings) is considered a non-revenue source if they increase financial liablities.

RECEIPTS

Every receiving or accrual of money to a government by revenue and non-revenue sources is a receipt. Their sum is called *total receipts*. It includes all incomes as well as non-income accruals of a government.

REVENUE RECEIPTS

Revenue receipts of a government are of two kinds—Tax Revenue Receipts and Non-tax Revenue Receipts—consisting of the following income receipts in India:

TAX REVENUE RECEIPTS

This includes all money earned by the government via the different taxes the government collects, i.e., all direct and indirect tax collections.

NON-TAX REVENUE RECEIPTS

This includes all money earned by the government from sources other then taxes. In India they are:

(i) *Profits* and *dividends* which the government gets from its public sector undertakings (PSUs).

(ii) *Interests* recieved by the government out of all loans forwarded by it, be it inside the country (i.e., internal lending) or outside the country (i.e., external lending). It means this income might be in both domestic and foreign currencies.

(iii) *Fiscal services* also generate incomes for the government, i.e., currency printing, stamp printing, coinage and medals minting, etc.

(iv) *General Services* also earn money for the government as the power distribution, irrigation, banking, insurance, community services, etc.

(v) *Fees*, *Penalties* and *Fines* received by the government.

(vi) *Grants* which the governments receives—it is always external in the case of the Central Government and internal in the case of state governments.

REVENUE EXPENDITURE

All expenditures incurred by the government are either of *revenue kind* or *current kind* or *compulsive kind*. The basic identity of such expenditures is that they are of consumptive kind and do not involve creation of productive assets. They are either used in running of a productive process or running a

government. A broad category of things that fall under such expenditures in India are:

(i) *Interest* payment by the government on the internal and external loans;

(ii) *Salaries, Pension* and *Provident Fund* paid by the government to government employees;

(iii) *Subsidies* forwarded to all sectors by the government;

(iv) *Defence* expenditures by the government;

(v) *Postal Deficits* of the government;

(vi) *Law and order* expenditures (i.e., police & paramilitary);

(vii) Expenditures *on social services* (includes all social sector expenditures as education, health care, social security, poverty alleviation, etc.) and *general services* (tax collection, etc.);

(viii) *Grants* given by the government to Indian states and foreign countries.

Revenue Deficit

If the balance of total revenue receipts and total revenue expenditures turns out to be negative it is known as revenue deficit, a new fiscal terminology used since the fiscal 1997–98 in India.[8]

This shows that the government's *Revenue Budget* (see the next topic) is running in losses and the government is earning less revenue and spending more revenues—incurring a deficit. Revenue expenditures are of immediate nature (this has to be done) and since they are consumptive/non-productive they are considered as a kind of expenditure which sums up to a heinous crime in the area of fiscal policy. Governments fulfil the gap/deficit with the money which could have been spent/intvested in productive areas.

A government might have its revenue expenditures less than its revenue receipts, i.e., having (*revenue surplus*) budget. Such fiscal policy is considered good where the government has been able to manage some money out of its revenue budget which could be spent for the creation of productive assets. Yes, another thing that should be kept in mind, as how the government has managed this surplus and whether the policies which made this happen are judicious enough or not. In the Second Plan, India emerged as a revenue-suplus state, but experts did not appreciate it as it had many bad impacts on the economy—higher tax rates culminated in tax evasion, corruption, creation of black money, etc.

Revenue deficit may be shown in the quantitative form (as how much the gross/total deficit is in currency terms) or in percentage terms of the GDP for that particular year (shown as percentage of GDP). Usually, it is shown as a percentage of the GDP for domestic as well as international analyses.

Effective Revenue Deficit

Effective revenue deficit (ERD) is a new term introduced in the *Union Budget 2011–12*. Conventionally, 'revenue deficit' is the difference between revenue receipts and revenue expenditures. Here, revenue expenditures includes all the grants which the Union Government gives to the state governments and the UTs—some of which ***create assets*** (though these assets are not owned by the GoI but the concerned state governments and the UTs). According to the Finance Ministry (Union Budget 2011–12), such revenue expenditures contribute to the growth in the economy and therefore, *should not be treated as unproductive* in nature like other items in the revenue expenditures. And on this logic, a new methodology was introduced to capture the 'effective revenue deficit', which is the Revenue Deficit 'excluding' those revenue expenditures of

8. Raja J. Chelliah, 'The Meaning and Significance of the Fiscal Deficit' in Amaresh Baghi (ed.), ***Readings in Public Finance,*** op. cit., pp. 387–88. Also see ***Union Budget 1997–98,*** MoF, GoI, N. Delhi.

the GoI which were done in the form of **GoCA** (grants for creation of capital assets).

The GoCA includes the GoI grants forwarded to the states & UTs for the implementation of the centrally sponsored programmes such as Pradhan Mantri Gram Sadak Yojana, Accelerated Irrigation Benefit Programme, Jawaharlal Nehru National Urban Renewal Mission, etc., these expenses though they are shown by the GoI in its Revenue Expenditures they are involved with *asset creation* and cannot be considered completely 'unproductive' like other items put in the basket of the Revenue Expenditures—the reason why a new 'terminology' has been created.

As per the ***Union Budget 2013–14***, by the fiscal 2016-17, the Revenue Deficit to be 1.5 per cent and the 'effective revenue deficit' to **zero** per cent [it means that by that year the total GoCA forwarded by the GoI will stand at 1.5 per cent of the GDP of the year. The *Union Budgets* of 2014–15 (Full) and 2015–16 do not mention anything about this concept.

Revenue Budget

The part of the Budget which deals with the income and expenditure of revenue by the government.

This presents the annual financial statement of the total revenue receipts and the total revenue expenditure—if the balance emerges to be positive it is a revenue surplus budget, and if it comes out to be negative, it is a revenue deficit budget.

Capital Budget

The part of the Budget which deals with the receipts and expenditures of the capital by the government. This shows the means by which the capital is managed and the areas where capital is spent.

Capital Receipts

All non-revenue reciepts of a government are known as capital receipts. Such receipts are for investment purposes and supposed to be spent on plan-development by a government. But the receipts might need their diversion to meet other needs to take care of the rising revenue expenditure of a government as the case had been with India. The capital receipts in India include the following capital kind of accruals to the government:

(i) Loan Recovery

This is one source of the capital receipts. The money the government had lent out in the past in India (states, UTs, PSUs, etc.) and abroad their capital comes back to the government when the borrowers repay them as capital receipts. The interests which come to the government on such loans are part of the revenue receipts.

(ii) Borrowings by the Government

This includes all long-term loans raised by the government inside the country (i.e., internal borrowings) and outside the country (i.e., external borrowings). Internal borrowings might include the borrowings from the RBI, Indian banks, financial institutions, etc. Similarly, external borrowings might include the loans from the World Bank, the IMF, foreign banks, foreign governments, foreign financial institutions, etc.

(iii) Other Receipts by the Governments

This includes many long-term capital accruals to the government through the Provident Fund (PF), Postal Deposits, various small saving schemes (SSSs) and the government bonds sold to the public (as Indira Vikas Patra, Kisan Vikas Patra, Market Stabilisation Bond, etc.). Such receipts are nothing but a kind of loan on which the government needs to pay interests on their maturities. But they play a role in capital raising process by the government.

Capital Expenditure

All the areas which get capital from the government are part of the capital expenditure. It includes so many heads in India —

(i) Loan Disbursals by the Government

The loans forwarded by the government might be internal (i.e., to the states, UTs, PSUs, FIs, etc.) or external (i.e., to foreign countries, foreign banks, purchase of foreign bonds, loans to IMF and WB, etc.).

(ii) Loan Repayments by the Government of the Borrowings Made in the Past

Again loan payments might be internal as well as external. This consists of only the *capital* part of the loan repayment as the element of interest on loans are shown as a part of the *revenue expenditure.*

(iii) Plan Expenditure of the Government

This consists of all the expenditures incurred by the government to finance the planned development of India as well as the central government financial supports to the states for their plan requirements.

(iv) Capital Expenditures on Defence by the Government

This consists of all kinds of *capital* expenses to maintain the defence forces, the equipment purchased for them as well as the modernisation expenditures. It should be kept in mind that *defence* is a non-plan expenditure which has capital as well as revenue expenditures element in its maintenance. The revenue part of expenditure in the defence is counted in the revenue expenditures by the government.

(v) General Services

These also need huge capital expenditure by the government—the railways, postal department, water supply, education, rural extension, etc.

(vi) Other Liabilities of the Government

Basically, this includes all the repayment liabilities of the government on the items of the Other Receipts. The level of liabilities depends on the fact as to how much such receipts were made by the governments in the past. How much payment liabilities in which year also depends on the fact as to which years in the past the governments had other receipts and for what duration of maturity periods. As for example, the *PF liabilities* were not an item of such liabilities for almost first three decades after the independence. But once the government employees started retiring, it went on increasing. Future India (specially 1960s and 1970s) saw expansion of the PSUs and excessive employment generation in them (devoid of the logic of labour requirement). We see the PF liabilities expanding extensively throughout the 1990s—the governments had been under pressure to manage this segment either by cutting interest on PF or at present trying to make it a matter of market economy. Same thing happened with the element of *pension* and we have been able to devise a market mechanism for it once pension reforms took place and the arrival of a pension regulatory authority for the area.

CAPITAL DEFICIT

There is no such term in public finance or in economics as such. But in practice one usually hears the use of the term capital crunch, scarcity of capital in day-to-day economic news items. Basically, the government in the news is facing the problem of managing as much funds, money, capital as is required by it for public expenditure. Such expenditure might be of revenue kind or capital kind. Such difficulties have always been with the developing economies due to their high level requirement of capital expenditures. Had there been a term to show this situation, it would naturally have been *Capital Deficit.*

FISCAL DEFICIT

When balance of the government's total receipts (i.e., revenue + capital reeipts) and total expenditures (i.e., revenue + capital expenditures)

turns out to be negative, it shows the situation of fiscal deficit, a concept being used since the fiscal 1997–98 in India.[9]

The situation of fiscal deficit indicates that the government is spending beyond its means. To be more simple, we may say that the government is spending more than its income (though in practice all receipts of the government are not income. Basically, receipts are all forms of money accruing to the government, be it income or borrowings).

Fiscal deficit may be shown in the quantitative form (i.e., the total currency value of the deficit) or in the percentage form of the GDP for that particular year (percentage of GDP). In general, the percentage form is used for domestic or international (i.e., comparative economics) studies and analyses.

India has been a country of not only regular but higher fiscal deficits. Moreover, the composition of its fiscal deficit has been more prone to criticism (we will see this in the forthcoming sub-title ahead).

PRIMARY DEFICIT

The fiscal deficit excluding the interest liabilities for a year is the primary deficit, a term India started using since the fiscal 1997–98.[10] It shows the fiscal deficit for the year in which the economy had not to fulfil any interest payments on the different loans and liabilities which it is obliged to—shown both in quantitative and percentage of GDP forms.

This is considered a very handy tool in the process of bringing in more transparency in the government's expenditure pattern. Any two years for example might be compared and so many things can be found out clearly such as, which year the government depended more on loans, the reasons behind higher or lower fiscal deficits, whether the fiscal deficits have gone down due to falling interest liabilities or some other factors, etc.

MONETISED DEFICIT

The part of the fiscal deficit which was provided by the RBI to the government in a particular year is Monetised Deficit, this is a new term adopted since 1997–98 in India.[11] This is shown in both the forms—in quantitative as well as a percentage of the GDP for that particular financial year.

It is an innovation in the fiscal management which brings in more transparency in the government's expenditure behaviour and also in its capabilities concerning its dependence on market borrowings by the RBI. Basically, every year both central and state governments in India had been depending heavily on market borrowings (internal) for its long-term capital requirements. Market borrowings of the government are done and managed by the RBI. Besides, the RBI is also the primary customer for government securities—yet another means of the government to raise long-term capital. This has been a major area of fiscal concern in India. After the process of **fiscal consolidation** was started by the government by the early 1990s, we see a visible improvement in this area. This term is itself arrived as the part of fiscal reforms in India (we will visit the issue of fiscal consolidation in India in the coming pages).

DEFICIT AND SURPLUS BUDGET

When the budgetary proposals of a government for a particular year proposes higher expenditures than the receipts, it is known as a *deficit budget.*

9. Raja J. Chelliah, op. cit., pp. 381 & 387. Also see ***Union Budget 1997–98,*** MoF, GoI, N. Delhi.
10. ***Union Budget 1997–98,*** op.cit.
11. Raja J. Chelliah, op. cit., P. 389. Also see ***Union Budget 1997–98,*** op.cit.

Opposite to this, if the budget proposes lesser expenditures than the receipts, then it is a *surplus budget*.[12]

In practice, governments the world over usually do not present a surplus budget as it symbolises government's lower concerns towards development. But at times as a political weapon a government might come out with such a budget (for example the Uttranchal Budget for 2006–07 was a surplus budget). How can a government propose for a surplus budget in a developing state when even developed countries still need development and are going for deficit budgets? The Union Budget in India had never been presented as a surplus budget.

DEFICIT FINANCING

The act/process of financing/supporting a deficit budget by a government is deficit financing. In this process, the government knows well in advance that its total expenditures are going to turn out to be more than its total receipts and enacts/follows such financial policies so that it can sustain the burden of the deficits proposed by it.

First used in the area of public finance in the early 1930s in USA,[13] today the term is being used by the corporate sector, too and such a financial management of a firm might be followed by it as part of its business strategy. Again, a sick firm might need to follow deficit financing route for many years to come as required by the firm to make it come out of the red (i.e., doing away with the losses).

Need of Deficit Financing: It was in the late 1920s that the idea and need of deficit financing was felt. It is when government needs to spend more money than it was expected to earn or generate in a particular period, to go for a desired level of growth and development. Had there been some means to go for more expenditure with less income and receipts, socio-political goals could have been realised as per the aspirations of the public policy And once the growth had taken place the extra money spent above the income would have been reimbursed or repaid. This was a good public/government wish which was fulfilled by the evolution of the idea of deficit financing.

It was by the early 1930s that the US first tried its hand at deficit financing soon to be followed by the whole Euro-American governments.[14] Through this route the developed world was able to come out of the menace of the Great Depression (1929).[15] The idea became popular around the world by the 1960s. India tried its hand at deficit financing in 1969 and since the 1970s it became a routine phenomenon, till it became wild and illogical, demanding immediate redressal. The fiscal deficits in India did not only peak to

12. In the US economy if tax revenue falls short of government expenditures, the government has a *fiscal deficit,* and it means that the government needs to borrow in the capital market to cover the difference. Opposite to it, if the government runs a *fiscal surplus* (i.e. its tax revenues exceed its expenditure) then the government, like the household sector, will be a net saver and will represent a source of saving for the economy (see Stiglitz and Walsh, ***Economics,*** op.cit., p. 549)
13. J. K. Galbraith, ***A History of Economics,*** Penguin Books, London, 1987, p. 226. (*The whole Chapter XVII on J.M. Keynes pp. 221–36 is interesting to refer on the topic.*)
14. For a detailed discussion on the topic one may refer to Joseph. E. Stiglitz, ***Economics of the Public Sector,*** W.W. Norton, 3rd Ed., New York, 2000.
15. It should be noted here that although the governments had run deficits (i.e., budget deficit) even before the Keynesian idea of the deficit, the pre-Keynesian thinking was that in peacetime the budget should generally be *balanced* (i.e., neither deficit nor surplus), or even in surplus so that the government debt created by wartime deficits could be paid off. For further reference on the topic and its constraints, Stanley Fischer and William Easterly, ***Economics of the Government Budget Constraints,*** World Bank Research Observer, Vol. 5, No. 2, July 1990, pp. 127–42 see (also reproduced in Amaresh Bagchi (ed.), ***Readings in Public Finance,*** op. cit., pp. 301–19).

unsustainable levels but its composition was also not justified and not based on sound fundamentals of economics. Finally, India headed for a slow but confident process of fiscal reforms that is also known as the process of fiscal consolidation (to be discussed in the coming pages).

Means of Deficit Financing: Once deficit financing became an established part of public finance around the world, the means of going for it were also evolved by that time. These means, basically are the ways in which the government may utilise the amount of money created as the deficit to sustain its budget for developmental or political needs. These means are given below in order of their suggested and tried preferences.

(i) *External Aids*[16] are the best money as a means to fulfil a government's deficit requirements even if it is coming with soft interest. If they are coming without interest nothing could be better.

When India went to borrow from the IMF in the wake of the financial crisis of 1990–91, the body advised India to keep its fiscal deficit to the tune of 4.5 per cent of its GDP and noted it to be sustainable for the economy. What was the rationale behind this data? Basically, in those times with the foreign aids (soft loans either from the *WB* or from the *Aid India Forum*) India was able to manage its budget to the tune of 4.5 per cent of its GDP. In 2002, when India's fiscal deficit was around 6 per cent (5.7 per cent to be precise) the IMF validated it to be sustainable, the reasons were two—first, India was able to show a check on fiscal deficit and secondly, at the same time the forex reserves of the country were suitably higher to neutralise the negative impacts of the higher fiscal deficit than the suggested levels (4.5 per cent).

External Grants are even better element in this case (which comes free—neither interest nor any repayments) but it either did not come to India (since 1975, the year of the first Pokhran testings) or India did not accept it (as happened post-Tsunami, arguing grants/aids coming with a tag/conditions). That is why here this segment has not been discussed as a means to manage deficit.

(ii) *External Borrowings*[17] are the next best way to manage fiscal deficit with the condition that the external loans are comparatively cheaper and long-term.

Though external loans are considered an erosion in the nations sovereign decision making process, this has its own benefit and is considered better than the internal borrowings due to two reasons:

(a) External borrowing bring in foreign currency/hard currency which gives extra edge to the government spending as by this the government may fulfil its developmental requirements inside the country as well as from outside the country.

(b) It is prefered over the internal borrowings due to 'crowding out effect'. If the government itself goes on borrowing from the banks of the country, from where will others borrow for investment purposes?

(iii) *Internal Borrowings*[18] comes as the third preferred route of fiscal deficit management. But going for it in a huge

16. Ibid. (*Amaresh Bagchi* ed. op. cit., pp. 305–10).
17. *Ibid.*
18. *Ibid.*

way hampers the investment prospects of the public and the corporate sector. It has the same impact on the expenditure pattern in the economy. Ultimately, economy heads for a double negative impact—lower investment (leading to lower production, lower GDPs and lower per capita income, etc.) and lower demands (by the general public as well as by the corporate world) in the economy—the economy moves either for *stagnation* or for a *slowdown* (one can see them happening in India repeatedly throughout the 1960s, 1970s, 1980s). The situation improved after the mid-1990s.

(iv) *Printing Currency* is the last resort for the government in managing its deficit.[19] But it has the biggest handicap that with it the government cannot go for the expenditures which are to be made in the foreign currency. Even if the government is satisfied on this front, printing fresh currencies does have other damaging effects on the economy:

(a) It increases inflation proportionally. (India regularly went for it since the early 1970s and usually had to bear double digit inflations.)

(b) It brings in regular pressure and obligation on the government for upward revision in wages and salaries of government employees—ultimately increasing the government expenditures necessitating further printing of currency and further inflation—a vicious cycle into which economies entangle themselves.

Now, it remains a matter of choice and availability of the above-given means, and which means a government adopts and in what proportion, for fulfilling its deficit requirement.

Composition of Fiscal Deficit

The Keynesian idea of deficit financing, though he advocated it, had a catch in it also which was usually missed by third world economies or intentionally overlooked by them. The catch is related to the question as to why an economy wants to go for fiscal deficit. And thus it becomes essential to go for an analysis of the composition[20] of the fiscal deficit of a government.

Out of the two broad expenditure obligations of a government—revenue expenditure and capital expenditure—the following combinations of expenditure composition are suggested:

(i) A fiscal deficit with a surplus revenue budget or a zero revenue expenditure is the best composition of fiscal deficit and the most suitable time for deficit financing.

(ii) The deficit requirements for lower revenue expenditures and higher capital expenditures are the next best situation for deficit financing, provided revenue deficit is eliminated soon.

(iii) The last could be the situation when major part of deficit financing is to fulfil revenue expenditures and a minor part to go for capital expenditures. The total money of the deficit might go to fulfil revenue expenditure, which could be the worst form of it.

Basically, there should be a judicious mix of plan and non-plan expenditure as well as revenue

19. L.N. Rangarajan, op. cit., pp. 259–62.
20. J. Cullis and P. Jones, ***Public Finance and Public Choice,*** Oxford University Press, New York, 2nd Ed., 1998.

and capital expenditures in India. Lesser non-plan expenditure or higher plan-expenditure are better reasons behind deficit financing in India (though India has a typical feature of capital expenditure which makes this combination of deficit financing not a suggested form—discussed ahead).

Third world economies (including India) though went for higher and higher fiscal deficits and deficit financing, they either did not address or failed to address the composition of deficit favourable towards capital and non-revenue expenditures.

FISCAL POLICY

The real meaning, significance and impact of fiscal policy emerged in the wake of the Great Depression and the Second World War. Fiscal policy has been **defined** as 'the policy of the government with regard to the level of government purchases, the level of transfers, and the tax structure'—probably the best and the most acclaimed definition among experts.[21] Later, the impact of fiscal policy on macro-economy was beautifully analysed.[22] As the policy has a deep impact on the overall performance of the economy, fiscal policy is also **defined** as the policy which handles public expenditure and tax to direct and stimulate the level of economic activity (numerically denoted by the Gross Domestic Product).[23] It was J. M. Keynes, the ***first*** economist who developed a theory linking fiscal policy and economic performance.[24]

Fiscal policy is also **defined** as 'changes in government expenditures and taxes that are designed to achieve macroeconomic policy goals'[25] (such as growth, employment, investment, etc.). Therefore, we say that 'fiscal policy denotes the use of taxes and government expenditures'.[26]

How the taxes and the government expenditures influence the overall economy, has been explained in a brief discussion here.[27] Let us first discuss the ***taxes*** and their impact on the economy:

(i) Taxes have a direct bearing on people's income affecting their levels of disposable incomes, purchase of goods and services, consumption and ultimately their standard of living;

(ii) Taxes directly affect the savings of individuals, families and firms which affect investment in the economy—as investment affects the output (GDP) thereby influencing the per capita income;

(iii) Taxes affect the prices of goods and services as factor cost (production cost) is affected thereby affecting incentives and behaviour of economic activities, etc.

Government expenditures affect/influence the economy in two ways:

(i) There are some expenditure on government purchases of goods and services, for example construction of roads, railways, ports, foodgrains, etc., in

21. The acclaimed definition first came up in the widely used work *Macroeconomics* by Dornbusch and Fisher which is now available as R.S. Dornbusch, S. Fisher and Richard Startz, *Microeconomics,* Tata McGraw-Hill, N. Delhi, 8th Ed., 2002.
22. John Hicks, the British Nobel Laureate did show it referring changes in taxes and government expenditure using the framework of the famous IS-LM model (*Ibid*).
23. S. R. Maheshwari, ***A Dictionary of Public Administration,*** Orient Longman, N. Delhi, 2002, p. 227.
24. In his acclaimed work ***The General Theory of Employment, Interest and Money,*** 1936.
25. Stiglitz and Walsh, ***Economics,*** op. cit., p. 729.
26. Samuelson and Nordhaus, ***Economics,*** op.cit., p. 412.
27. Based on the elaboration by Samuelson and Nordhaus, ***Economics,*** op. cit., pp. 412–13.

the goods category and salary payments to government employees in the services category; and

(ii) There are some expenditure due to government's income support, to the poor, unemployed and old-age people (known as government ***transfer payments***).

DEFICIT FINANCING IN INDIA

India was declared to be a planned economy right after Independence. As development responsibilities of the government were very high, there was a need of huge funds in rupee as well as in foreign currency forms. India faced continuous crises in managing the required fund to support its Five Year Plans—neither foreign funds came nor internal resources could be mobilised in sufficient amount. (Due to lower tax collections, weaker banks that too privately owned, and negligible saving rate, etc.)[28]

By the late 1960s, the government headed for deficit financing and from the 1970s onwards, India started going for higher and higher fiscal deficits and became more and more dependent on increased deficit financing with every fresh year. We may classify dificit financing in India into three phases.

THE FIRST PHASE (1947–1970)

This phase had no concept of deficit financing and the deficits were shown as Budgetary Deficits. Major aspects of this phase were—

(i) Trying to borrow from inside and outside the economy but unable to meet the target.

(ii) In the 1950s, a serious attempt was made to increase tax collections and check revenue expenditures to be ultimately able to emerge as a surplus revenue budget economy. But huge cost was paid in the form of tax evasion, rise in corruption, stagnating standard of life and a neglected social sector.

(iii) Taking recourse to heavy borrowings from the RBI and finally nationalisation of banks so that their money could be used by the government to support the plans. This not only increased the interest burden of the governments but also ruptured the whole financial system in coming years—banks did not remain commercial entities and became part of the government's political statement.

(iv) Establishing giant PSUs with higher revenue expenditures (salaries) which increased the revenue expenditures of the future governments when the pensions and the PFs needed to be serviced.

(v) Unable to go for the required level of investment even after taking recourse to all the above given means.

THE SECOND PHASE (1970–1991)

This is considered the period of deficit financing, follow up of unsound fundamentals of economics and finally culminating in severe financial crisis by the year 1990–91. Major highlights of this phase may be summed up as follows—

(i) This phase saw the nationalisation policy and simultaneous revival of an increased emphasis on expansion of the PSU (two points should be noted here specially—*first*, many of the South East Asian economies have, officially declared their acceptance of capitalism and privatisation. *Secondly*, China had declared that investment in the government-controlled

28. For data-based detailed discussion refer to Sudipto Mundle and M. Govinda Rao, ***'Issues in Fiscal Policy'*** in Bimal Jalan (ed.), ***The Indian Economy: Problems and Prospects,*** Penguin Books, N. Delhi, Revised Edition, 2004, pp. 258–85.

companies are a loss of money at this time).

(ii) Upcoming PSUs increased the total expenditure of the government's revenue as well as capital.

(iii) Existing PSUs were taking their own due from the economy—the illogical employment creation excessively increased the burden of salaries, pensions and PF; many of them had started fetching huge losses by this time; as the public sector does not have profit as its primary goal; there was a lack of profit and loss analysis; as the PSUs had no connection between their need of labour force and the existing labour force. Ultimately, the responsibility of profit or loss did not remain the onus of the officers, thus making them centres of intentional losses and an institutionalised centre of corruption; etc.

(iv) The governments have failed on both the fronts—checking population rise and mass employment generation—the burden of different *subsidies* went on increasing making them unmanageable and highly illogical. Self-employment programmes could not pick up, or better said, it was politically suitable to go for piece-meal wage-employment programmes with different names.

(v) Planned development remained highly centralised and devoid of any place for local aspirations—frustrations of masses started showing up in the form extremist and radical organisations raising their heads creating a law and order problem and excessive expenditure on them. The outcome was a burdened police force and lagging judicial set up.

(vi) The plan expenditure which governments were going for were through investments in the PSUs which were not committed to profit motive, deficit financing for the PSUs was not based on sound economics. Majority of the plan expenditure in a sense turned out to be non-economic, i.e., non-plan expenditure at the end.

Due to the above-given reasons, it was tough to say whether it was sound to go for huge fiscal deficits in India.[29]

The Third Phase (1991 onwards)

This started with the initiation of the economic reforms process under the conditionalities put forth by the IMF (controlling fiscal deficit was one amongst them). As the economy moved from government dominance to market dominance, things needed a restructuring and public finance also needed a touch of rationality. Till date, the government had been doing pure politics with the public money in the name of development. Now the IMF dictated and the economy headed towards greater and greater fiscal responsibility in the coming times. India is better today in this regard but we cannot say that public finance is based today on the sound principles of economics. But the rigorous process of fiscal reforms aiming at fiscal consolidation started in India.

INDIAN FISCAL SITUATION: A SUMMARY

In December 1985, the Government of India presented a discussion paper in the Parliament titled 'Long-term Fiscal Policy'. It was for the ***first time*** in the fiscal history of India that we see a long-term perspective coming on the fiscal issue from the government. This also included the policy of government expenditure. The paper was bold

29. This was the general feeling among the experts, policymakers and the IMF, alike.

enough to recognise the deterioration in India's fiscal position and accepted it among the most important challenges of the eighties—the paper set specific targets and policies to set the things right. This paper was followed by a country-wide debate on the issue and it was in 1987 that the government came ahead with ***two*** bold steps in the direction—

(i) a virtual freeze was announced on government expenditure, and

(ii) a ceiling on the budgetary deficit.

The above steps had a positive impact on the situation but it was temporary as since mid-1988 the situation again started deteriorating. The BoP crisis at the end of 1990 was generated partly by the alarmingly high ***fiscal deficit***[30] and due to a high level of external borrowings. The IMF support to fight the crisis came in but with many macro-economic conditionalities, checking the fiscal meance being a major one among them. With the process of economic reforms which started in 1991–92, the government also announced its commitment to reduce fiscal deficit to 3–4 per cent (of GDP) by the mid-1990s (from the level of about 8 per cent during 1987–90). This step was among the many measures which the government started with the objective of stabilising the economy. We may have a look at India's fiscal situation upto the 1990–91 in the following way:

(i) The fiscal deficits of the central government, after averaging below 4 per cent of the GDP till the 1970s started climbing up by being 5.77 per cent in 1980–81, 8.47 per cent in 1986–87 ending up at 7.85 per cent in 1990–91 after being above 7 per cent in the second half of the 1980s.[31]

(ii) The revenue (i.e., current) expenditure of the government (Centre and states combined) increased from 11.8 per cent of GDP to 23 per cent between 1960 and 1990. The revenue receipts of the government also went up on an average of 14.6 per cent in 1971–75 to 20 per cent in 1986–1990. But the gap between revenue receipts and expenditures remained negative—financed largely by domestic borrowings (as a result the interest payments on domestic debt increased from 0.5 to 2.5 per cent of the GDP during 1975–90.[32] The revenue deficit went on increasing after 1979–80 and reached the highest level of 3.26 per cent of the GDP in 1990–91.[33]

(iii) The fiscal situation of the states was not good either. State governments which are primarily responsible for health, education and other social services had an aggregate revenue expenditure of 5 per cent of GDP on these accounts while their capital expenditure accounted for 2.5 per cent on social and other sectors.[34] The states' expenditure on the social sector went down while their interest payments

30. The proximate cause of the payment crisis in the mainstream perspective, was faulty macroeconomic policies, specially large fiscal deficits of the government during 1984–91, deficits that spilled over in country's current account of the balance of payment. (Mihir Rakshit, 'The Micro-economic Adjustment Programme: A Critique', ***Economic and Political Weekly*** *26,* no. 34 (August), quoted by Mihir Rakshit, *'Some Microeconomics of India's Reform Experience'* in Kaushik Basu (ed.), ***India's Emerging Economy: Performance and Prospects in the 1990s and Beyond,*** Oxford University Press, N. Delhi, 2004, p. 84.

31. S. D. Tendulkar and T.A. Bavani, ***Understanding Reforms,*** Oxford University Press, N. Delhi, 2007, p. 73.

32. Bimal Jalan, ***India's Economic Policy,*** Penguin Books, N. Delhi, 1992, p. 48.

33. ***Handbook of Statistics on the Economy 2002–03,*** RBI, Table 221 (cited by **Tendulkar** and **Bhavani,** 2007, op. cit., p. 74)

34. Bimal Jalan, 1992, op. cit., p. 50

had increased during the 1980s.[35]

As per the experts, the debt situation in the states would have been even worse, but for the fact that the states, unlike the Centre, did not have independent powers to borrow either from the RBI or the market because of the statutory overdraft regulatory scheme.[36] Thus, their deficits have been self-limiting—whenever the states tried to cut down their deficits the care of the social sector and capital expenditure suffered and development prospects in the states also suffered.

Now the question arises that why the government has not been able to check the menace of fiscal deficits even though there has been a consensus to do so? ***There are reasons***[37] which can be cited for it:

(i) ***Political factor:*** The political lobbies and sectional politics as well as the subsidies are supposed to be one big factor for rising government expenditure. We see this on a higher scale if there is a probable mid-term election or closer to a general election.

(ii) ***Institutional factor:*** The administrative size combined with the processes of reporting, accounting, supervising and monitoring getting greater importance than the production and delivery of goods and services.[38]

(iii) ***Ethical factor:*** This is a more powerful factor as it easily generates wide public support for the government expenditure. There are many heads of such expenditures such as subsidies (food, power, fertilizer, irrigation, etc.) poverty alleviation programmes, employment generation programmes, education, health and social services. The logic for such expenditure comes from the idea that the government should function as protector of the poor and provider of jobs for them implying that such government expenditures benefit the poor.

It was in 2000 that the double menace of revenue and fiscal deficits got attention from the government at the Centre and some constitutional/statutory safeguards looked necessary. Consequently, the Fiscal Responsibility and Budget Management Bill, 2000 was proposed in the Parliament.

FRBM Act, 2003

The fiscal policy of an economy has been considered as the building block for enabling macro-environment by economists, policymakers and the IMF, alike. It does not only provide stability and predictability to the policy regime, but also ensures that national resources are allocated in terms of their defined priorities through the tax transfer mechanism.

Unproductive government expenditures, tax distortions and high deficits are considered to have constrained the Indian economy from realising its full growth potential. At the begining of the fiscal reforms in 1991, the fiscal imbalance was identified as the ***root cause*** of the twin problems of inflation and the difficult balance of payments (BoPs) position.[39] Since then the ***medium-term fiscal policy stance*** of the government has been on the following lines:[40]

35. ***The Report of Tenth Finance Commission,*** N. Delhi, 1994 (**quoted by Bimal Jalan, 1992, op. cit., p. 50).**
36. This scheme has changed now. After the implementation of the suggestions of the ***12th Finance Commission*** states are now allowed to go for market borrowings to take care of their plan expenditures once they have passed and enacted their Fiscal Responsibility Acts (FRAs) in consonance with the FRBM Act, 2003.
37. Based on the points raised by Bimal Jalan, 1992, op. cit., p. 49.
38. This factor seems getting redressal with the starting of ***outcome*** and ***performance*** budgeting 2004–05 onwards.
39. ***Economic Survey 2006–07,*** MoF, GoI, N. Delhi, p.18.
40. Ibid.

(i) reducing the deficits (revenue and fiscal);

(ii) prioritising expenditure and ensuring that these resulted in intended outcomes; and

(iii) augumenting resources by widening tax base and improving tax-compliance while maintaining moderate rates.

The fiscal consolidation which followed in 1991 failed to give the desired results as there was no defined mandate for it. Neither was there any statutory obligation to do so.[41] This is why the Fiscal Reforms and Budget Management Act (FRBMA) was enacted on August 26, 2003 to provide the support of a strong institutional/ statutory mechanism. Designed for the purpose of medium-term management of the fiscal deficit, the FRBMA came into effect on July 5, 2004.

The FRBM Bill, 2000 was passed by the Parliament with all political parties voting in favour, and is considered a watershed in the area of fiscal reforms in the country. Main highlights of the FRBMA, 2003 are as given below:[42]

(i) GoI to take measures to reduce fiscal and revenue deficit so as to eliminate revenue deficit by March 31, 2008 (which was revised by the UPA Government to March 31, 2009) and thereafter build up adequate ***revenue surplus.***

(ii) Rules to be made under the Act to specify ***annual targets*** for the reduction of fiscal deficit (FD) and revenue deficit (RD) contingent liabilities and total liabilities (***RD to be cut by 0.5 per cent per annum and FD by 0.3 per cent p.a.***).

(iii) FD and RD may exceed the targets only on the grounds such as national security, calamity or on exceptional grounds.

(iv) GoI not to borrow from RBI except by Ways and Means Advances (WMAs).

(v) RBI not to subscribe to the primary issue of the GoI securities from 2006–07 (it means that these government bonds/ papers will become market—based instrument to raise long-term funds by the government).

(vi) Steps to be taken to ensure greater transparency in fiscal operations.

(vii) Along with the Budget and Demands for Grants, the GoI to lay the following ***three statements*** before the Parliament in each financial year:

(a) Fiscal Policy Strategy Statement (FPSS);

(b) Medium Term Fiscal Policy Statement (MTFPS); and

(c) Macroeconomic Framework Statement (MFS).

(viii) The Finance Minister to make ***quarterly review*** of trends in receipts and expenditure in relation to the Budget and place the review before the Parliament.

FOLLOW-UP TO THE FRBMA

The process of fiscal consolidation under FRBMA has been continuous and essentially an incremental one. Some of the important fiscal measures[43] that are being implemented by the government are as given below:

(i) reducing the peak rates of custom duties;

(ii) rectifying anomalies like ***inverted duty structure;***

41. Ibid.
42. ***Economic Survey 2003–04,*** MoF, GoI, N. Delhi.
43. ***Economic Survey 2006–07,*** op. cit., p. 18.

(iii) rationalising excise duties with a movement towards a ***medium CENVAT rate;***

(iv) revisiting the tax ***exemptions;***

(v) relying on voluntary tax compliance through taxpayer ***facilitation;***

(vi) introduction of state-level VAT for achieving a ***non-cascading, self-enforcing,*** and ***harmonised*** commodity tax regime;

(vii) increasing productivity of expenditure through an ***outcome budget*** framework (which seeks to translate outlays into better outcomes through monitorable performance indicators);

(viii) innovative financing mechanism like creation of Special Purpose Vehicle (SPV) for infrastructure projects; and

(ix) states have also joined the process of fiscal consolidation in line with the Twelfth Finance Commission's (TFC) recommendations and are complementing the efforts of the central government.

In 2006–07, in case of the ***central government,*** proposed reduction in revenue and fiscal deficits were put at 0.6 per cent and 0.5 per cent, respectively (higher than the FRBMA Rules), though the reduction suffered in 2005–06 due to higher devolution to states by the Centre on account of the TFC recommedations.[44]

States also showed considerable improvement (in fact, even better then the central government). The fiscal deficit of the states declined by 1.6 per cent post FRBMA from 4.5 per cent in 2003–04 to 2.6 per cent in 2006–07 of their GDP. Revenue deficit, on an aggregate basis, was budgeted to get eliminated by 2006–07, two years ahead of the target. (***A strong incentive-based restructuring scheme of fiscal transfers to states suggested by the TFC appears to have succeeded.***)[45]

LIMITING GOVERNMENT EXPENDITURE

Elected governments are composed of different interest groups and lobbies. At times, such governments might intend to use its economic policies in a highly populist way for greater political mileage without caring for the national exchequer. Such acts might force the governments to go in for excessive internal and external borrowing and printing of currency. Governments generally avoid to increase tax or impose new taxes for their revenue increase as such acts are politically unpopular. On the other hand, borrowings and printing of currency impose no immediate economic or political costs. A government in the election-year usually spends money frugally by borrowings (from the RBI in India) because it is the coming government after the elections who is supposed to repay them. Government expenditures remain higher and expanding due to some economic reasons also—by doing so extra employment is generated and the output (GDP) of the economy is also boosted. If governments go for anti-expansionary fiscal and monetary policies with the objective of reducing its expenditures the employment as well as the GDP both will be hampered. This is considered a ***bias*** in the economic policies of the elected governments. But there has always been a consensus among the experts and policymakers that an external (i.e., outside the government) and some form of a statutory check must be over the government on its powers of money creation (i.e., by borrowings or printing). With the objective of removing the bias—to make fiscal policy less sensitive to electoral considerations, several countries had introduced some legal provisions on their governments before

44. Ibid.
45. Ibid.

India enacted its FRBMA. We see mainly ***three variants*** of it around the world:

(i) It was *New Zealand* which ***first*** introduced such a legal binding on the government's powers of money creation. Here the central bank is legally bound to ensure that money creation by the government does not increase the rate of ***inflation target***—it means that the central bank has the overriding powers on the government there in the area of extra money creation.[46]

(ii) The ***second variant*** is putting some firm legal or constitutional limit on the size of government deficits or the power of the government to borrow. *Germany* and *Chile* had such an arrangement—today Germany is bound to the fiscal limits prescribed by the Maastricht Treaty. In the late 1990s, an upper limit on the government's powers to create deficit was introduced.[47]

(iii) Some countries introduced the so-called ***'Currency Board'*** type of arrangement to serve the same purpose—this is the ***third variant.*** In this arrangement, money supply in the economy is directly linked to changes in the supply of foreign assets—neither the government nor the central bank has any independent powers to create money, as growth in money supply is not allowed to exceed growth in the foreign assets.[48]

It was in 1994 that India took the first step in this direction when the central government had a formal agreement with the RBI to limit its borrowing through ***ad hoc*** treasury bills to a predetermined amount (Rs. 6,000 crores in 1994–95).[49] However, it was a highly liberal arrangement with the government having the ultimate powers to revise the aforesaid predetermined amount by a fresh agreement with the RBI. The importance this beginning had was finally in the enactment of the FRBMA 2003—a historic achievement in the area of fiscal prudence in the country.

FISCAL CONSOLIDATION IN INDIA

The average combined fiscal deficits, of the Centre and states after 1975, had been above 10 per cent of the GDP till 2000–01. More than half of it had been due to huge revenue deficits. The governments were cautioned by the RBI, the Planning Commission as well as by the IMF and the WB about the unsustainability of the fiscal deficits. It was at the behest of the IMF that India started the politically and socially painful process of fiscal reforms, a step towards fiscal consolidation.[50] A number of steps were taken by the government at the Centre in this direction and there had been incessant attempts to do the same in the states' public finances too. Major highlights in this direction can be summed up as given below:

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46. Opposite to it, in the U.K., the government has overriding powers on the central bank and there is absence of any legal checks on money creation powers of the government. Once the UK becomes part of the European Union it will come under such a check through the Maastricht Treaty. Before the enactment of the FRBMA, 2003. India was like the U.K, however, the Constitution of India has a provision for imposing a statutory limit on the centre's borrowing powers under *Article 292.* But the Article is not mandatory and has not been invoked by any of the governments till date.
47. By the Congress passing the Balanced Budget Act, 1997 which promised to eliminate federal deficit spending by 2002 (see Nicholas Henry, ***Public Administration and Public Policy,*** Prentice-Hall, N. Delhi, 8th Ed., 2003, p. 217).
48. Argentina introduced this arrangement in the late 1990s.
49. ***Economic Survey 1994–95,*** MoF, GoI, N. Delhi.
50. IMF imposed some macro-economic conditions on the economy while India borrowed from it for its BoP correction in 1990–91. One among the conditions was cutting down the government expenditure (i.e., salaries, pensions, interest and subsidies, etc.) by 10 per cent every year.

1. Policy initiatives towards cutting revenue deficits:

(i) Cutting down expenditure—

(a) Cutting down the burden of salaries, pensions and the PFs (down-sizing/right-sizing of the government, out of every 3 vacancies 1 to be filled up, interest cut on the PF, pension reforms-PFRDA, etc.);

(b) Cutting down the subsidies (Administered Price Mechanism in petroleum, fertilizers, sugar, drugs to be rationalised, it was done with mixed successes);

(c) Interest burden to be cut down (by going for lesser and lesser borrowings, pre-payment of external debts, debt swaps, promoting external lending, minimal dependence on costlier external borrowings, etc.);

(d) Defence being one major item of the expenditure bilateral negotiations initiated with China and Pakistan (the historical and psychological enemies against whom the Indian defence preparedness was directed to, as supposed) so that the defence force cut could be completed on the borders, etc.;

(e) Budgetary supports to the loss-making PSUs to be an exception than a rule;

(f) Expenditure reform started by the governments in different areas and departments;

(g) General Services to be motivated towards profit with subsidised services to the needy only (railways, power, water, etc.);

(h) Postal deficits to be checked by involving the post offices in other areas of profit;

(i) Higher education declared as non-priority sector; fees of institutions of professional courses revised upward; etc.

(ii) Increasing *revenue receipts*:

(a) Tax reforms initiated (Cenvat, VAT, Service Tax, GST proposed, etc.);

(b) The PSUs to be disinvested and even privatised (if a political concensus reached which alludes today);

(c) Surplus forex reserves to be used in external lending and purchasing foreign high quality sovereign bonds, etc.

(d) State governments allowed to go for market borrowing for their plan expenditure, etc.

2. The borrowing programme of the government:

(i) The Ways and Means Advances (WMA) scheme commenced in 1997 under which the government commits to the RBI about the amount of money it will give as part of its market-borrowing programme, to bring transparency in public expenditure and to put political responsibility on the government.

(ii) The RBI will not be the primary subscriber to government securities in the future—committed way back in 1997.

3. The fiscal responsibility on the governments:

(i) The Fiscal Responsibility and Budget Management (FRBM) Act was passed in 2003 (voted by all political parties) which puts constitutional obligation on the government to commit so many

things as fiscal responsibility comes in the public finance—fixing annual targets to cut revenue and fiscal deficits; the government not to borrow from the RBI except by the WMA; government to bring in greater transparency in fiscal operations; along with the Budget the government to lay statements regarding fiscal policy strategy in the House and Quarterly Review of trends of receipts and expenditures of the government.

(ii) A mechanism (to include state governments under the umbrella of fiscal responsibility) was advised (now implemented, too) by the 12th Finance Commission which allows the state governments to go for market borrowing (without central permission) for their need of plan development provided they pass their fiscal responsibility acts (FRAs) and commit to the fiscal responsibility regarding cutting their revenue and fiscal deficits. As many as 19 states have already passed their FRAs by now.

At present, we cannot conclude that once the FRBM Act is passed the fiscal abberations will be automatically checked. At the same time, we cannot say whether it will hamper the social cause. But experts agree upon that at least a legislative beginning has taken place and the opposition in the House must have got a tool (and so the people) to create enough democratic pressure on the governments of the time regarding fiscal prudence.

ZERO-BASE BUDGETING

The idea of zero-base budgeting (ZBB) first came to the privately owned organisation of the USA by the 1960s. This basically belonged to a long list of guidelines for managerial excellence and success, others being Management by Objectives (MBO), Matrix Management, Portfolio Management, etc to name a few.[51] It was the US financial expert ***Peter Phyrr*** who first proposed this idea for government budgeting and Jimmy Carter, Govornor of Georgia, USA was the first elected[52] executive to introduce ZBB to the public sector. When he presented the US Budget in 1979 *as the US President* it was the first use of the ZBB for any nation state. Since then many governments of the world have gone for such budgeting.

Zero-base budgeting is the allocation of resources to agencies based on periodic re-evaluation by those agencies of the need for all the programmes for which they are responsible, justifying the continuance or termination of each programme in the agency budget proposal—in other words, an agency reassesses what it is doing from top to bottom from a hypothetical ***zero base.***[53]

There are three essential principles of ZBB. Some experts say it in a different way, there are three essential questions which must be answered objectively before going for any expenditure as per the techniques of ZBB:

(i) Should we spend?
(ii) How much should we spend?
(iii) Where should we spend?

51. George R. Terry and Stephen G. Franklin, ***Principles of Management,*** AITBS, N. Delhi, 8th Ed., 2002, pp. 9–10.
52. See Peter A. Phyrr, ***The Zero Base Approach to Government Budgeting,*** Public Administration Review, 37 (Jan./Feb., 1977), p. 7 and Thomas P. Lauth, ***Zero-Base Budgeting in Georgia State Government: Myth and Reality,*** Public Administration Review, 38 (Sept./Oct., 1978) pp. 420–30 (cited in Nicholar Henry, ***Public Administration and Public Affairs,*** Prentice-Hall, N. Delhi, 8th Ed., 2003, p. 217).
53. Nicholas Henry, 2003, op. cit., p. 218.

There are *three* special features of this budgeting which distinguishes it from the traditional budgeting. These features, in brief, are as under:

(i) The conventional aggregate approach is not applied in it, in which each department of the government prepares their own budget for many activities in the aggregate and composite form, making it difficult to scrutinise each and every activity. In place of it every department needs to justify its existence and continuance in the budget document by using the mathematical technique of econometrics, i.e., cost-benefit analysis. In a nutshell, every activity of each department is 'X-rayed' and once the justification is validated they are allocated the funds.

(ii) *Economy* in public expenditure is the *raison d'etre* of this budgeting. This is why the ZBB has provisions of close examination and scrutiny of each programme and public spending. Finally, the public spending is cut without affecting the current level of benefits of various public services accruing to the public.

(iii) *Prioritising* the competing needs is another special feature of ZBB. Before allocating funds to the different needs of the economy, an order of priority is prepared with utmost objectivity. As the resources/funds are always scarce, in the process of prioritised allocation, the item/items at the bottom might not get any funds.

Side by side its benefits, there are certain ***limitations*** too before the ZBB which prohibits its assumed success, according to experts. These limitations have made it subject to criticisms. The limitations are as given below:

(i) There are certain expenditures upon which the government/parliament does not have the power of scrutiny (as the 'Charged Expenditure' in India).

(ii) There are certains public services which defy the cost-benefit analysis—defence, law and order, foreign relations, etc.

(iii) Scrutiny is a subjective matter and so this might become prey to bias. Again, if the scrutinisers have a complete utilitarian view many long-term objectives of budgeting and public policy might get marginalised.

(iv) It has scope for emergence of the Ministry of Finance as the all-powerful institution dictating other ministries and departments.

(v) Bureaucracy does not praise it as it evaluates their decisions and performances in a highly objective way.

Despite the above-given strong limitation, the ZBB has a sound logic and should be considered a long-term budgetary reform process. The basic idea of this form of budgeting is to optimise the benefits of expenditure in every area of activity and in this sense it is exceptional. To the extent the corporate world is concerned, this has been a very successful financial management tool.

In India, it is believed to be in practice since 1997–99. We cannot say that India is a success in ZBB, but many of the profit-fetching PSUs have been able to use it successfully and optimise their profits.

RESULTS-FRAMEWORK DOCUMENT (RFD)

In September 2009, the Indian PM approved the outline of a ***Performance Monitoring and Evaluation System (PMES)*** for government ministries/departments. Under PMES, each ministry/department is required to prepare a

Results-Framework Document (RFD). It has been adopted by the GoI to monitor the performance management of various ministries/departments. The RFD system is being implemented in various ministries/departments in phased manner – was implemented to 59 ministries/departments for the year 2009–10, increasing every year in 2013–14 it will get implemented in 84 ministries/departments. ***Performance Management*** in the government is a *new concept* which determines the performance index based upon the agreed objectives, policies, programme and projects/schemes. To ensure the success in achieving the agreed objectives and implementing agreed policies, programme and projects, the RFD also includes a commitment for required resources and necessary operational autonomy.

'RFD provides a summary of the most important results that an organisation expects to achieve during the financial year'. The document has two main purposes :

(i) Move the focus of the organisation 'from process-orientation to results-orientation'; and

(ii) provide an objective and fair basis to evaluate the organisation's overall performance at the year-end.

The RFD Guidelines are divided into ***three broad sections:*** **1.** Format of RFD; **2.** Methodology for Evaluation; and **3.** RFD Process and Timelines

1. Format of RFD

An RFD is essentially a record of understanding between a department/ministry representing the people's mandate, and the head of the organisation responsible for implementing this mandate. This document contains not only the agreed objectives, policies, programme and projects but also success indicators and targets to measure progress in implementing them. To ensure the successful implementation of agreed actions, RFD may also include necessary operational autonomy. In the case of the Responsibility Centres (attached offices, subordinate offices, and autonomous organisations), the RFD will represent a record of understanding between the parent department/ ministry and the Responsibility Centre. The RFD seeks to address ***three basic questions***:

(i) What are organisation's main objectives for the year?

(ii) What actions are proposed to achieve these objectives?

(iii) How would someone know at the end of the year the degree of progress made in implementing these actions? That is, what are the relevant success indicators and their targets?

The RFD should contain the following ***five sections***:

(i) Organisation's vision, mission, objectives and functions.

(ii) *Inter se* priorities among key objectives, success indicators and targets.

(iii) Trend values of the success indicators.

(iv) Description and definition of success indicators and proposed measurement methodology.

(v) Specific performance requirements from other departments/organisations that are critical for delivering agreed results.

2. Evaluation Methodology

At the end of the year, the parent ministry/ department will look at the achievements of the organisation, compare them with the targets, and determine the composite score. The composite score shows the degree to which the organisation in question was able to meet its promised results, i.e., *objective*. Various agencies will have diverse sets of objectives and corresponding success indicators.

Yet, at the end of the year every organisation will be able to compute its composite score for the past year.

3. RFD Process and Timelines

Beginning of the Year: At the beginning of each financial year, each organisation to prepare a RFD. And as per the priorities listed in the RFD, proposed activities and the corresponding success indicators to be approved. The RFDs draft has to be completed by 5th of March for feedback and finalised by 31st March every year – the final versions of all RFDs to be put on the websites by 15th of April each year. The final RFD to take into account budget provisions and in particular the *Outcome Budget*. The RFDs to be drawn up in such manner that quarterly monitoring is possible.

During the Year: After six months, the Results-Framework as well as the achievements to be reviewed—the RFDs may be reviewed and the goals reset, taking into account the priorities at that point of time (this will enable to factor in unforeseen circumstances such as drought conditions, natural calamities or epidemics). Cabinet Secretariat to select about 24 RFDs using a stratified random sampling procedure to examine them.

End of the Year: At the end of the year, all RFDs to be reviewed, a report listing the achievements of their respective organisations against the agreed results in the prescribed format. This report is required to be finalised by 1st of May each year. After scrutiny by the concerned administrative ministry/department, these results will be placed on the website by 1st of June each year.

The RFD is among the attempts by which the government have been trying to bring in higher performance in its ministries/departments together with 'transparency', 'accountability' and 'responsibility'. This is in the series of other such initiatives like 'Outcome Budgeting' and 'Performance Budgeting'. The 'Zero-Base Budgeting' was a similar and first such initiative in this direction taken by the GoI in mid-1990s.

CHARGED EXPENDITURE

It is the public expenditure which is beyond the voting power of the Parliament and is directly withdrawn from the Consolidated Fund of India.[54] The emoluments of the President, Speaker and Deputy Speaker of the Lok Sabha, Chairman and Deputy Chairman of the Rajya Sabha, Judges of the Supreme Court and the High Courts, etc., in India, for example.

TYPES OF BUDGETS

GOLDEN RULE

The proposition that a government should borrow only to invest (i.e., plan expenditure in India) and not to finance current spending (i.e., revenue expenditure in India) is known as the golden rule of public finance. This rule is undoubtedly prudent but provided spending is honestly described as investment, investments are efficient and does not crowd out the important private sector investments.[55]

BALANCED BUDGET

A budget is said to be a balanced budget when total public-sector spending equals total government income (revenue receipts) during the same period from taxes and charges for public services.[56] In

54. In the Constitution of India it is deliberated in the *Article 112 (3), a - g* where it is referred as *'expenditure charged'* on the consolidated fund of India—popular as the 'charged expenditure' (see ***The Constitution of India,*** Ministry of Law, Justice and Company Affairs, GoI, N. Delhi, 1999, pp. 38–39).
55. See Samuelson and Nordhaus, ***Economics,*** op.cit., p. 710; Stiglitz and Walsh, ***Economics,*** op. cit., pp. 552–54.
56. Mathew Bishop, ***Pocket Economist,*** op. cit., p. 104.

other terms, a budget with zero revenue deficit is balanced budget. Such budget making is popularly known as *balanced budgeting*.

GENDER BUDGETING

A general budget by the government which allocates funds and reponsibilities on the basis of gender is gender budgeting. It is done in an economy where socio-economic disparities are chronic and clearly visible on a sex basis (as in India).

Gender budgeting started in India with the Union Budget 2006–07 which proposed an outlay of Rs. 28,737 crore dedicated to the cause of women and created gender budgeting cells in 32 ministries and departments.[57]

OUTCOME AND PERFORMANCE BUDGETS[58]

The concepts are part of result-oriented budgeting. While outcome budget is presented by different departments and divisions of a ministry or the government, the performance budget is presented by the Ministry of Finance on behalf of the government. Both go for 'quantitative' as well as 'qualitative' progress reports of the performance. The outcome budget is a micro level process while performance budget is a macro level process in budgeting. There are many outcome budgets in any one performance budget.

The basic objective of such budgeting is to bring in transparency and thereby making the government more and more responsible to the House and the public. Naturally, they bring in prudence and optimisation elements in public spending (also see entry 'Outcome Budget' in Chapter 23).

CUT MOTION

In democratic political systems, there is a provision of Cut Motion in the House/Parliament (usually it is the opposition but floor might be crossed by members of the House belonging to the government due to presence of inner-party politics). In the US, the budget provisions presented by the government must be passed by the Congress. Only then they can be enacted. Unlike this, in the British parliamentary system though the budget of the government is voted by the House usually this is considered a political document and passed unchanged. India has mixed provisions of voting on the budget after discussion in both the Houses. There are different constitutional provisions by which the Parliament starts discussion to reduce the demands, grants, etc. proposed by the government in the Budget[59]—

- **(i) Token Cut:** This motion intends to *'reduce the demand by Rs. 100'*. Such a motion is moved in order to express a specific grievance which is within the sphere of the responsibility of the Government of India—the discussion remains confined to the particular grievance specified in the motion.
- **(ii) Economy Cut:** This motion intends to *'reduce the demand by a specified amount'* representing the economy (in expenditure) that can be affected. Such specified amount may be either lump sum reduction in the demand or omission or reduction of an item in the demnd—the discussion remains confined to the matter in which the economy can be affected.
- **(iii) Disapproval of Policy Cut:** This motion intends to *'reduce the demand to Re. 1'*.

57. ***Union Budget 2006–07,*** MoF, GoI, N. Delhi.
58. Based on the notes released by the Ministry of Finance, GoI, October 2006 while releasing the ***Quarterly Review*** of the Union Budget 2006–07.
59. Rules of Procedure and Conduct of Business in Lok Sabha, Parliament Secretariat, N. Dehli.

This represents *disapproval* of the policy underlying the demand—the discussion remains confined to the particular policy and is open to members to advocate an alternate policy.

(iv) **Guillotine** is the process in which the Speaker puts all the outstanding demands made by the Budget *directly to vote* in the House—ending further discussions (intended to cut short the discussion on the Budget). Through this, the Speaker may put the whole Budegt to vote (i.e., allowing 'no discussion' on the Budget by the House). In recent years, this route was taken time and again by the Government of India, to avoid the aggressive mood of the Opposition.

Though, this is a *short route* to get the Budget passed by the House (avoiding criticism by the Opposition benches), it may turn out to be very dangerous —as the voting process may take the form of 'no confidence motion' and the government may be routed out of power. But, till date, *Guillotines* never resulted into routing a government out of power in India (as India follows the British Model of Parliamentary system).

TRILEMMAS

Putting the right kind of fiscal policy has always been the most challenging policy decision to be taken by the democratic governments around the world, there are some famous 'trilemmas' related to this aspect. Economics have by now many 'trilemmas' developed and articulated by economists from time to time and the process still continues. Let us see some highly popular and newsmaking ones:

(i) The **'financial stability trilemma'** put forward by Dirk Schoenmaker[60] (2008), explains the incompatibility within the Euro zone of: **(a)** a stable financial system, **(b)** an integrated financial system, and **(c)** national financial stability policies.

(ii) By far the most high profile current trilemma of the Eurozone (by Edward Chancellor[61]) was believed to be the seeming irreconcilability between its **three wishes,** namely, **(a)** a single currency, **(b)** minimal fiscal contribution to bail outs, and **(c)** the ECB's commitment to low inflation.

(iii) Martin Wolf[62] spoke about the US Republican Party's **fiscal policy trilemma:** **(a)** large budget deficits are ruinous; **(b)** a continued eagerness to cut taxes; and **(c)** an utter lack of interest in spending cuts on a large enough scale.

(iv) Then we have the **Earth Trilemma** (EEE), which posits that for: **(a)** economic development (E), **(b)** we need increased energy expenditure (E), **(c)** but this raises the environmental issue (E).

(v) Above all these more recent trilemmas in economics, the prima donna of all of them is Mundell's **'impossible trinity'**. This old trilemma asserts that a country cannot maintain, simultaneously, all three policy goals of – **(a)** free capital flows, **(b)** a fixed exchange rate, and **(c)** an independent monetary policy. The impossible trinity, has seen enough waters flowing down the time since it was articulated almost five decades ago which has a strong theoretical foundation in the

60. Dirk Schoenmaker, "A New Financial Stability Framework for Europe", ***The Financial Regulator,*** Vol.13 (3), 2009.
61. Edward Chancellor, "Germany's Eurozone trilemma", ***Financial Times,*** Nov. 6, 2011.
62. Martin Wolf, "The political genius of supply side economics", ***Financial Times,*** July 25, 2010.

Mundell-Fleming Model developed in the 1960s.

Dani Rodrik [63] argued that if a country wants more of globalisation, it must either give up some democracy or some national sovereignty. Niall Ferguson[64] highlighted the **trilemma** of a choice between commitment to globalisation, to social order and to a small state (meaning limited state intervention).

TREASURY COMPUTERISATION OF STATE GOVERNMENTS

A scheme for implementation of the mission mode project[65] 'Computerisation of State Treasuries' was put in place by the GoI in June 2010 under the ***National e-Governance Plan (NeGP)***. The states and UTs are required to complete their projects in about three years beginning 2010–11. The funds are released against deliverables. The scheme will support states and UTs to fill the existing gaps in their treasury computerisation, upgradation, expansion and interface requirements, apart from supporting basic computerisation. The scheme covers installation of suitable hardware and application software systems in a networked environment on a wide area basis and building of interfaces for data sharing among various stakeholders.

The scheme for treasury computerisation is expected to make the budgeting process more efficient, improve cash flow management, promote real-time reconciliation of accounts, strengthen management information systems (MIS), improve accuracy and timeliness in accounts preparation, bring about transparency and efficiency in public delivery systems, help bring about better financial management along with improved quality of governance in states and UTs. The overall estimated cost of the scheme is Rs. 626 crore at Rs. 1 crore per district in existence on April 1, 2011. Financial support is up to 75 per cent (90 per cent in case of northeastern states) of the individual project cost of admissible components limited to Rs. 75 lakh per district (Rs. 90 lakh per district for north-eastern states). Funds will be released as central assistance in three instalments of 40 per cent, 30 per cent, and 30 per cent each, subject to satisfactory receipt of utilisation certificates.

CRIS OF INDIA

The Finance Ministry of India has developed and released *(January 31, 2012)* the ***Comparative Rating Index of Sovereigns (CRIS)*** – *a new index of sovereign credit rating.* Together with it, the ministry has also released an estimation of CRIS over the **last five years**, for **different nations** belonging to different blocks of the global economy.

Major credit rating agencies give out the sovereign credit rating of each nation as an absolute grade. How other nations fare does not matter in a particular nation's rating score. The CRIS is very different from a comparative rating. An example of comparative rating is the percentile score – the way *GRE (Graduate Record Examination)* results are at times given. If a student is described as belonging to the 99th percentile, it clearly says something about this student's performance vis-á-vis other students.

It is arguable that even for sovereign credit ratings, there is a case for providing some kind of

63. Dani Rodrik, "The inescapable trilemma of the world economy", June 27, 2007, *(rodrik.typepad.com/dani_rodriks_weblog.)*
64. *Niall Ferguson,* "Conservatism and the Crisis: A Transatlantic Trilemma", Centre for Policy Studies, Ruttenberg Lecture, March 24, 2009.
65. ***Economic Survey 2011–12,*** op. cit., p. 69

a comparative score. When an investor searches across nations for a place to put her money, the relative rating of nations is important. If nation **y's** rating remaining the same, other nations' ratings improve over time, there may well be a case to invest less in nation **y.**

The computation of CRIS is based on nothing apart from ***Moody's*** ratings and data on the GDPs of different nations as given by the ***IMF***. In the paper, the ministry defines the CRIS formally and then track how nations have done over time. In order to capture this impact, the Ministry of Finance developed a new system for comparing the relative ratings of sovereign debt based on the historical evolution of their ratings over five years and the volume of their economic activity as measured by their GDP (not adjusted for Purchasing Power Parity (PPP)). The Finance Ministry develops a relative rating index and rank 101 economies according to this for the years 2007 to 2011. The index uses external data on GDP and ratings combined in terms of pure mathematical and statistical methods without interventions or interpretations.

DIRECT BENEFIT TRANSFER (DBT)

The DBT plan was introduced on ***January 1, 2013*** with seven schemes in 20 districts. India has embarked on a DBT scheme in selected districts wherein it has been envisaged that benefits such as scholarships, pensions, and MGNREGA (Mahatma Gandhi National Rural Employment Guarantee Act) wages will be 'directly credited' to the bank or post office accounts of identified beneficiaries. The DBT scheme *will not substitute* entirely for delivery of public services for now. It will replace neither food and kerosene subsidies under the TPDS nor fertilizer subsidies. The DBT is ***designed*** to—

(i) improve targeting,
(ii) reduce corruption,
(iii) eliminate waste,
(iv) control expenditure, and
(v) facilitate reforms.

Electronic transfer of benefits is a simple design change and transfers that are already taking place through paper and cash mode will now be done through electronic transfers. This has been enabled by rapid roll out of *Aadhar* (Unique Identity) now covering 200 million people and rapidly growing to cover 600 million (nearly half of our population), with the *National Population Register (NPR)* covering the other half of the populace. The DBT in tandem with such unique identification will ensure that the benefits reach the target groups faster and minimize 'inclusion' and 'exclusion' errors as well as 'corruption' that are associated with manual processes.

EXPENDITURE MANAGEMENT COMMISSION

By early September 2014, the GoI constituted an Expenditure Management Commission (EMC) through a Resolution. The EMC will look into various aspects of expenditure reforms to be undertaken by the Government and other issues concerning Public Expenditure Management. The Commission has one full time, one part time and one ex-officio members other than Chairman (of Cabinet rank). Dr Bimal Jalan is its first Chairman. The terms of reference of the Commission are as given below:

(i) Review the major areas of Central Government expenditure, and to suggest ways of creating fiscal space required to meet developmental expenditure needs, without compromising the commitment to fiscal discipline.

(ii) Review the institutional arrangement, including budgeting process and FRBM rules, for enforcing aggregate fiscal

discipline and suggest improvements theirin;

(iii) Suggest measures to improve allocative effeciencies in the existing expenditure classification system, including focus on capital expenditure;

(iv) Design a framework to imrpove operational efficiency of expenditures through focus on utilization, targets and outcomes;

(v) Suggest an effective strategy for meeting reasonable proportion of expenditure on services through user charges;

(vi) Suggest measures to achieve reduction in financial costs through better Cash Management Ssystem;

(vii) Suggest greater use of IT tools for expenditure management;

(viii) Suggest improved financial reporting systems in terms of accounting, budgeting, etc., and

(ix) Consider any other relevant issue concerning Public Expenditure Management in Central Government and make suitable recommendations.

The Commission submitted its *interim report* before the *Union Budget 2015–16* (as per the mandate given to it). The *final report* is to be submitted before the *Union Budget 2016–17*.

FISCAL PERFORMANCE OF STATES

States have been performing[66] better on their fiscal fronts since they put in place their respective fiscal responsibility acts (FRAs). Fiscal consolidation of states during recent years was largely *revenue-led*, with significant increases in both own tax revenue as well as current transfers from the centre, the latter reflecting the enhancements recommended by the 13th Finance Commission. However, some deterioration in state government finances was seen in 2013–14, while improvement is budgeted in 2014–15. The fiscal performance of states has been as given below (as per the *Economic Survey 2014–15*):

- Revenue surplus as a proportion of GDP during 2013–14 (RE) was negligible compared to the previous year's 0.2 per cent. For the year 2014–15, the consolidated revenue surplus is projected to increase to 0.4 per cent of the GDP.
- Capital outlay-GDP ratio during 2013–14 (RE) increased marginally by 0.4 per cent over the previous year, indicating improvement in the quality of expenditure.
- Gross fiscal deficit (GFD) and primary deficit as proportions to GDP are budgeted to decline to 2.3 per cent and 0.8 per cent respectively in 2014–15 from 2.4 per cent and 0.9 per cent respectively in 2013–14 (RE) pointing out the intent for fiscal consolidation by states.
- The projected decline in GFD-GDP ratio in 2014–15 is mainly due to an increase in the revenue receipts resulting from current transfers from the centre.
- The expenditure pattern shows that the committed expenditure-GDP ratio (comprising interest payments, administrative services, and pension) will broadly remain unchanged during 2014–15 (BE), while overall expenditure as a ratio to GDP is budgeted to increase.

After the recommendations of the *14th Finance Commission* are implemented, the fiscal

66. Based on Budgets of 26 states (five based on Vote on Account.). *Source:* ***Economic Survey 2014–15.***

space and performance of states are expected to get strengthened.

CONSOLIDATED GENERAL GOVERNMENT

The fiscal performance of the economy (centre and states taken together) have shown improvements in recent years. The fiscal deficit of the centre was estimated to be **4.6** per cent in 2013–14. With the fiscal deficit of states at **2.4** per cent of GDP in RE 2013–14, the fiscal deficit of consolidated general government (centre and states combined) was placed at 7.0 per cent of GDP in 2013–14 (RE) and estimated to decline to **6.4** per cent of GDP in 2014–15(BE).

MAJOR ISSUES IN 2015–16

As per the *Economic Survey 2014–15*, the following concerns and prospects in the area of Public Finance in the fiscal 2015–16:

1. The GoI adhered to fiscal consolidation in 2013–14, despite domestic challenges and external vulnerabilities. The 4.1 per cent fiscal deficit target of 2014–15 seems achievable in spite of slow growth of revenues and delayed disinvestment. Though, to meet this target, the some expenditure compression might be needed (which has been seen in the *Union Budget 2015–16*).
2. *Fuel subsidy* bill is expected to fall in 2015–16, led by the following factors:
   (a) declining global oil prices,
   (b) diesel-price deregulation and
   (c) direct transfer of domestic LPG subsidies to bank accounts,
   (d) inncreased revenues via increase in excise duties on petroleum and diesel.
3. Enhanced *revenue generation* is a priority for the government. To some extent this will be helped by raising the growth rate of the economy. The implementation of a well-designed GST and other tax reforms would also play a crucial role in this regard.
4. *Expenditure rationalization* is the need of the hour. In this regard, the subsidy regime of India needs 'overhauling'. The following steps can play a big role towards this aim—
   (a) Further reduction in fuel (LPG and Kerosene) subsidies,
   (b) Tackling fertilizer subsidies, and
   (c) Moving to Aadhaar-based direct cash transfers of food subsidy and other transfers.
5. *Fiscal consolidation* is a necessity but the quality of consolidation is imperative to make it sustainable. To achieve this end, it would be necessary to put in place a medium-to-long-term fiscal policy framework with explicit revenue, expenditure, and deficit targets.

NEED OF PUBLIC INVESTMENT

We see the new government at the Centre initiating several reforms. Together with the experts, the GoI also believe that this has revived the *investor sentiment*. But a real investment flow is yet to pick-up, especially from the private sector. The cause for such a situation has been identified as the "balance sheet syndrome with Indian characteristics". The *Economic Survey 2014–15* has analysed this situation in greater details.

In such a scenario, together with other measures, the most important action which has been suggested is "boosting the public investment". Merit of such an action has been emphasised by the *Mid Year Economic Analysis 2014–15,* too. The document says that reviving 'targeted public investment' will work as an engine of growth in short-term and will lead to investment flows

coming in from the private sector. It has not suggested public investment as a substitute for private investment but as a means to complement and kick start investment flows from the latter.

Role of Public Investment

Several recent studies, from India and abroad, have been quoted by the Economic Survey 2014–15 to suggest an increase in the public investment—in a targeted way. Here, 'tergeted' public investment means, government investment in the sector which can generate the largest 'spillover effects' to the economy. In present time, the Railways has that level of spillover potential. The Survey agrres with the famous observation of W. W. Rostow – 'the introduction of the railways has been historically the most powerful single initiator of take-offs'[67]. The rational for such a policy action has been emphasised by referring to the follwoing documents and studies:

1. It has been found that there has been a 'link' between public and private investment in past which caused either rise or fall in the growth rate. The Central Statistics Office (CSO) data indicate that a 'boom' in private corporate investment in the high growth phase of 2004–08 was accompanied by an increase in public investment by about 1.5 per cent.

   Similarily, a decline in public investment by more than 1 percentage point between 2008–13, is accompanied by a general decline in private corporate investment by more than 8 percentage points (except an increase during 2009–10 and 2010–11).

2. The *World Economic Outlook-2014* (an IMF report)[68] noted that increases in public infrastructure investment, if efficiently implemented, affects the economy in two ways:
   (i) In the short run it boosts aggregate demand and crowds in (increases) private investment due to the complementary nature of infrastructure services.
   (ii) In the long run, a supply side effect also kicks in as the infrastructure built feeds into the productive capacity of the economy (infrastructure being the lifeline of an economy that bringing positive effects to all sectors).

   The studies of the *IMF* confirm that increase in public investment can have positive effects on output. The medium-term public investment multiplier for developing economies is estimated to be between 0.5 and 0.9, however, the magnitudes depend on the efficiency of implementation.

3. In order of boosting public investment there are the *two challenges* in this regard are—
   (i) Mobilisation of the financial resources to enhance public investment, and
   (ii) Implementation capacity.

   To the extent implementation capacity is concerned, a sector with the maximum positive 'spillovers' together with proven capacity for investing quickly and efficiently, can serve the purpose. Two such sectors are: rural roads and

67. W. W. Rostow, ***The Process of Economic Growth***, Oxford, Clarendon Press, 2d edition, 1960, pp. 302-303 cited in B. R. Mitchell,The Coming of the Railway and United Kingdom Economic Growth, ***The Journal of Economic History,*** 24(3), September 1964.

68. ***World Economic Outlook-2014,*** IMF, *Is it Time for an Infrastructure Push? The Macroeconomic Effects of Public Investment*, Chapter 3, October 2014.

railways. Enhancing road connectivity can have a huge positive spillover on the economy—this has been shown by recent studies[69]—the examples in case are the National Highways Development Project and the PM Gram Sadak Yojana of early 2000s. These public investment moves encouraged rurl employment and earnings.

The *Survey* believes that the present government should encourage public investment in the hetherto neglected railways sector—it has the potential to have similar effects on the economy as the road sector could do in past. This has the potential to *crowd in* greater private investment and without jeopardising India's public debt dynamics.

4. Public investment has direct positive bearings on the growth prospects, as per the empirical studies. India's productivity surge around 1980 was due to boost in productivity led by enhanced public investments in the infrastructure sector (in contrast to the demand creating effects).[70] The study analyses the effects on overall growth using a framework[71] where government infrastructure services are an input into private production. The results of the study indicate that allowing for the appropriate lag (of around five years) between public infrastructure spending and growth, the former can explain around 1.5-2.9 percent of overall growth.
5. A study[72] by the RBI reports the *long run* multiplier (of capital outlays on GDP) to be 2.4. The study also confirms that the effect of revenue expenditure on GDP, though high, fades out after the first year, suggesting gains from reprioritizing expenditures.

Thus, the Survey has emphasised abig role of enhancing public investment in the railways sector. It could be started as only public investment. But soon, the impetus given by the government will generate enough avenues and new possibilities that the sector will start attracting enough investment flows from the privates sector. Once such an effect is visible then there are several possible alternatives to promote investment—the PPP to dedicated private inevstments. Railways being a lead infrastructure sector it will bring in multi-dimensional positive spillovers in the economy. Linking people and places has great potential in creating great many numbers of openings in the economy.

69. Asher, Sam & Paul Novosad, *The Employment Effects of Road Construction in Rural India*, 2014, Working Paper, quoted by the ***Economic survey 2014-15***.
70. Rodrik, D. & A. Subramanian, *From* 'Hindu Growth' to Productivity Surge: The Mystery of the Indian Growth Transition, 2005, ***IMF Staff Papers,*** 52(2).
71. Robert Barro ("Government Spending in a Simple Model of Endogenous Growth", 1990, ***Journal of Political Economy,*** 98(5))
72. Reserve Bank of India, *Fiscal Multipliers in India,* Box II.16, ***Annual Report 2011-12***.

CHAPTER

19

SUSTAINABILITY AND CLIMATE CHANGE: INDIA AND THE WORLD

*"... this is the only home we have and, as environmentalists are fond of saying, Mother Nature doesn't do bailouts ... so we better find a better way to grow."**

- Introduction
- Sustainable Development and Climate Change in the Indian Context
- Climate Change at a Glance
- International Collaboration And Efforts
- Rio+20
- COP20 at Lima
- IPCC Assessment Report
- Financing Climate Change
- Problems & Prospects
- Epilogue

*Thomas L. Friedman, ***Hot, Flat, & Crowded***, Penguin Books, London, 2009,p. 23

INTRODUCTION

Improving living standards for mankind has been the single minded goal of all nations and world bodies. After defining development in numerous ways for over two decades, there seems to be a consensus on 'Human Development'. While a large popculation on the earth is still to get the 'bare minimum' for development, humanity is at the crossroads where it is faced with the first of its kind challenge—the challenge of 'climate change'. The dilemma is that whatever we can do for our development, there has to be a repercussion on nature. An even bigger dilemma is in achieving a global consensus on how to check or restrict and finally reverse the process of climate change.

We may consider the year 2012, arguably, a high water mark in the field of environment and sustainable development initiatives. The global community met at the *UN Conference on Sustainable Development* that took place in **Rio** in June 2012, also marking the 20th anniversary of the first Earth Summit held in 1992. The conference reviewed the progress made, identified implementation gaps, and assessed new and emerging challenges, which resulted in a political outcome called the *'The Future We Want'*. In India, the Twelfth Five Year Plan was launched with a focus on sustainable growth. This along with sustainable development policies and programmes, which are being followed signalled to citizens at home and the world at large that India is committed to sustainable development with equal emphasis on its three dimensions—social, economic and environmental.

A survey of the global comparative opinion shows that people in India and indeed all countries, have a marked and rising concern about sustainable development and climate change *(cited by the Economic Survey 2014–15)*. However, the challenges are also formidable, especially in the context of finding the matching resources of the required magnitude given the economic conditions. Climate science has rightly taken up an important position in the public debate. Even as the science of climate change grapples with uncertainties, the world is witnessing more extreme events. With rising extreme events, and rising citizen demand, the world has little option but to listen to the voice of evolving science and respond adequately with strategies and policy rooted in the principles of multilateralism with equitable and fair burden sharing.[1]

The *Economic Survey 2011–12,* for the first time, introduced a new chapter entitled 'Sustainable Development and Climate Change'. These topics remained headline news with extreme weather events both at home and abroad. Efforts to arrive at a consensus on what to do at home and abroad gathered momentum, even as they sailed through some rough waters and fickle seas in many respects. In 2012, science and nature voiced a sense of urgency for action. Yet the relevant statistics have a mixed story to tell. It strongly accepts science but weakly reflects on the corresponding multilateral actions, suggesting that a lot remains to be done on the latter. Till the world stops to introspects and accepts that we are a product of the ecological surrounding we are living in, there seems no durable outcome from the international deliberations.

A volatile mix of erratic weather, natural disasters and enormous pressure on the availability of clean air, water, and energy together with the problems of poverty and hunger continues to be of great concern for policymakers particularly in the developing countries. There was building of the forward momentum both globally and domestically with three high-profile events in the

1. Oliver Morton in **'Megachange: The World in 2050'**, edited by Daniel Franklin & John Andrews, ***The Economist***, London, 2012, pp. 92–110.

Climate Change at a Glance

Since the industrial revolution, manmade activities have added significant quantities of greenhouse gases (GHG)[2] into the atmosphere. Climate change is a global negative externality primarily caused by the building up of GHG emissions in the atmosphere. The efforts needed to address the climate change include mitigation of GHG emissions on the one hand, and building of adaptive capacities to cope with the adverse impacts of climate change on the other. From a developing country perspective, adaptation is of utmost importance as they are the ones who are most vulnerable to the adverse impacts of climate change.

The incremental impact of a ton of GHG on climate change is independent of where in the world it is emitted. These emissions impose a cost on both the present and future generations, which are not fully recouped from the emitters of these emissions. This formed the starting point for a globally coordinated policy action and the need for an international climate change negotiating regime. UNFCCC, set up in 1992, although global in scope, differentiates the commitments/responsibilities of parties on the basis of historic responsibilities, economic structures, and on the basis of the principle of 'equity' and CBDR which is at the core of the climate change debate.

The largest share of historical and current global emissions of GHGs has originated in developed countries. Scientists attribute the global problem of climate change not to the current of GHG emissions but to the stock of historical GHG emissions. Most of the countries, particularly the industrialised countries, having large current emissions are also the largest historic emitters and the principal contributors to climate change. The convention therefore lays down legally binding commitments for the developed countries, taking into account their historical responsibilities and also squarely puts the responsibilities on developed countries for providing financial resources, including for the transfer of technology, needed by the developing countries. The convention also acknowledges that climate change actions taken by developing countries are contingent on the resources made available to them.

global arena in 2012 and launch of the Twelfth Five Year Plan at home. The Earth Summit in Rio also popularly known as Rio+20 celebrated its 20th anniversary, next the 11th session of the Conference of Parties (**COP 11**) to the Convention on Bio Diversity (CBD), hosted by India in Hyderabad, and finally the year closed with the 18th session of the COP to the United Nations Framework Convention on Climate Change (UNFCCC) in **Doha** in December. These international collaborations came out with balanced packages though short on ambition but proceeding on efforts. At home, we launched the Twelfth Five Year Plan whose explicit theme was a 'faster, more inclusive and sustainable growth' process. It is the first time that a five year plan has sustainability as a prominent focus. The Twelfth Plan outlined lower carbon growth strategies adding momentum to the ongoing policies and programmes of the government on environment and climate change. To add to this, State Action Plans on Climate Change (SAPCC), a recent initiative, will tune national initiatives on the National Action Plan on Climate Change (NAPCC) to regional, socio- economic and ecological conditions. The SAPCC is expected to take off as part of the plan scheme for states. With these developments, it is clear that sustainable development and climate change issues are being addressed on a priority basis.

The course for international development and environmental policy agenda for the global

2. **'Megachange: The World in 2050'**, op. cit., pp. 94-96.

community for the next fifteen years is being decided in the year **2015**. The negotiations under the United Nations Framework Convention on Climate Change (UNFCCC) are expected to result in a global agreement by December 2015, applicable to all countries, to take action on climate change from 2020. Simultaneously, governments are due to agree on a new post 2015 development agenda including a set of Sustainable Development Goals (SDGs), replacing the *Millennium Development Goals*, which are coming to an end in 2015.

A major development attracting attention worldwide has been the *Joint Announcement* on Climate Change by the **United States & China** – the world's two largest emitters – in November 2014. As per this announcement, the US intends to achieve an economy-wide target of reducing its emissions by 26–28 per cent below its 2005 level in 2025 and to make best efforts to reduce its emissions by 28 per cent. China intends to achieve the peaking of carbon dioxide emissions around 2030 and to make best efforts to peak early and intends to increase the share of non-fossil fuels in primary energy consumption to around 20 per cent by 2030. This has great political significance in the run-up to the post 2015 climate change agreement. The announcement is expected to provide a boost to the renewable energy sector globally.

India has also taken several measures to address climate change. Most importantly, India's national solar mission is being scaled up fivefold from 20,000 MW to 100,000 MW by 2022. The clean energy cess on coal has also been doubled to Rs. 100/tonne in 2014. India has set a target of producing green energy of 1,75,000 MW by the year 2022.

SUSTAINABLE DEVELOPMENT AND CLIMATE CHANGE IN THE INDIAN CONTEXT

In the past two decades, the key environmental challenges in India have been sharper. *The State of the Environment Report* by the MoEF clubs the issues under five key challenges faced by India—

(i) Climate Change,
(ii) Food Security,
(iii) Water Security,
(iv) Energy Security, and
(v) Managing Urbanisation.

SAPCC (State Action Plans on Climate Change)

After the NAPCC was launched,[3] there have been serious efforts to dovetail national programmes of action to regional and local levels consistent with varying socio-economic and ecological conditions. At the Conference of State Environment Ministers held on 18 August 2009, the Prime Minister of India requested all state governments to prepare SAPCCs. The State Action Plans took their lead from National Mission documents while formulating mitigation/adaptation strategies. So far, 21 states have prepared documents on the SAPCC focused on approaches that are sectoral but with regional ramifications. The State Action Plans include strategies and a list of possible sectoral actions that would help the states achieve their adaptation and mitigation objectives. The common threads that bind these State Plans together are the principles of territorial approach to climate change, sub-national planning, building capacities for vulnerability assessment, and identifying investment opportunities based on state priorities. This framework provides a broad, systematic, and step-wise process for the preparation of SAPCCs and advocates a participatory approach so that states have enough ownership of the process and final plan. The major sectors for which adaptation strategies envisaged are agriculture, water, forests, coastal zone, and health.

3. **NAPCC**, Ministry of Forest & Environment, GoI, Final Draft March 31, 2011, N. Delhi.

Climate change is disturbing the natural ecosystems and is expected to have substantial adverse effects in India, mainly on agriculture (on which 58 per cent of the population still depends for livelihood), water storage in the Himalayan glaciers which are the source of major rivers and groundwater recharge, sea-level rise, and threats to a long coastline and habitations. Climate change will also cause increased frequency of extreme events such as floods, and droughts. These in turn will impact India's food security problems and water security. As per the *Second National Communication* submitted by India to the UNFCCC, it is projected that the annual mean surface air temperature rise by the end of the century ranges from **3.5^0 C to 4.3^0 C,** whereas the sea level along the Indian coast has been rising at the rate of about **1.3 mm/year** on an average. These climate change projections are likely to impact human health, agriculture, water resources, natural ecosystems and biodiversity.

Concerned of the threats imposed by climate change and pressures on natural resources, sustainability and environment are increasingly taking centrestage in the Indian policy domain. India has been part of 94 multilateral environmental agreements. India has also voluntarily agreed to reduce its emission intensity of its GDP by 20–25 per cent over 2005 levels by 2020, and emissions from the agriculture sector would not form part of the assessment of its emissions intensity. Indian economy is already moving along a lower carbon and sustainable path in terms of declining carbon intensity of its GDP which is expected to fall further through lower carbon strategies. It is estimated that India's per capita emission in 2031 will still be lower than the global per capita emission in 2005 (in 2031, India's per capita GHG emissions will be under 4 tonnes of carbon dioxide equivalent (CO 2 eq.) which is lower than the global per capita emissions of 4.22 tonnes of CO_2 eq. in 2005).

Together with the national efforts in different sectors, India also recognises that rural areas are equally prone to stress and pressures from natural resource exploitation. In this context, schemes for rural development and livelihood programmes are very relevant. A vast majority of the works under the Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS) are linked to land, soil, and water. There are also programmes for non- timber forest produce-based livelihood, promotion of organic and low-chemical agriculture, and increased soil health and fertility to sustain agriculture-based livelihoods. These schemes help mobilise and develop capacities of community institutions to utilise natural resources in a sustainable manner and their potential can be further developed.

Along with efforts to incorporate sustainability in the rural development process, India is increasingly making efforts to integrate the three pillars of sustainable development into its national policy space. In fact, environment protection is enshrined in our Constitution (Articles 48 A and 51 A [g]). Various policy measures are being implemented across the domains of forestry, pollution control, water management, clean energy, and marine and coastal environment. Some of these are policies like Joint Forest Management, Green Rating for Integrated Habitat Assessment, Coastal Zone Regulation Zone, Eco Labelling and Energy Efficiency Labelling, Fuel Efficiency Standards etc. Over a period of time, a stable organisational structure has been developed for environment protection. The country has been making fast progress in increasing its renewable energy capacity and has displayed the fastest expansion rate of investment of any large renewables market in the world in 2011, with a 62 per cent increase to $12 billion (Frankfurt School of Finance and Management *Global Trends in Renewable Energy investment 2012*). The 12th Plan with a prominent focus on

sustainability makes provision and provides for many more opportunities like these.

Working on the social and economic pillars (sustainable development policies, programmes and targeted schemes) have been introduced to eradicate poverty either through a direct focus on economic indicators like employment generation, youth mobilisation, and building up assets of the poor; or indirectly through social indicators of human development with emphasis on health, education, and women's empowerment. As per the **Census 2011**, many parameters on this front have shown improvement, however, India is still not on target to meet some key MDGs by 2015—

(i) The *poverty* head-count ratio declined by 7.3 percentage points from 2004–05 to 2009–10;

(ii) The *MMR* (maternal mortality rate) dropped from 301 per 100,000 live births in 2001–13 to 212 in 2007–09; and

Sustainable Development and Lower Carbon Strategies of the 12th Plan

The Twelfth Plan strategy[4] suggests that there are significant ***'co-benefits'*** for climate action with inclusive and sustainable growth. India as a large responsible player with very low income has also to ensure that these efforts are matched by equitable and fair burden sharing among countries, taking into account the historical responsibilities for emissions. These issues are being discussed in the UNFCCC.

India's approach to a lower-carbon growth strategy explicitly recognises that policies have to be inclusive and differentiated across sectors according to national priorities, so as to lower the transaction costs of implementing the policy, and conform with a nationally fair burden-sharing mechanism. An Expert Group on Low Carbon Strategies appointed by the ***Planning Commission*** has outlined the lower carbon strategies for major potential carbon mitigation sectors.

(i) **Power:** On the supply side, adopt super-critical technologies in coal-based thermal power plants; use gas in combined heat and power systems; invest in renewable technologies; and develop hydropower in a sustainable manner. On the demand side, accelerate adoption of super-efficient electrical appliances through market and regulatory mechanisms; enhance efficiency of agricultural pump sets and industrial equipment with better technology; modernise transmission and distribution to bring technical and commercial losses down to world average levels; universalise access to electricity; and accelerate power-sector reforms.

(ii) **Transport:** Increase the share of rail in overall freight transport; improve the efficiency of rail freight transport; make it price competitive by bringing down the levels of cross-subsidisation between freight and passenger transport; complete dedicated rail corridor; improve share and efficiency of public transport system; and improve fuel efficiency of vehicles through both market-based and regulatory mechanisms.

(iii) **Industry:** Greenfield plants in the iron and steel and cement sectors adopt best available technology; existing plants, **particularly small** and medium ones, modernize and adopt green technology at an accelerated pace, with transparent financing mechanisms.

(iv) **Buildings:** Evolve and institutionalise green building codes at all levels of government.

(v) **Forestry:** 'Green India Mission' to regenerate at least 4 million ha of degraded forest; increase density of forest cover on 2 million ha of moderately dense forest; and overall increase the density of forest and tree cover on 10 million ha of forest, waste, and community lands.

4. ***Twelfth Five Year Plan 2012–17***, Planning Commission, GoI, N Delhi, 2012.

(iii) *literacy* rates have been constantly rising and are estimated to be 82.14 per cent for men and 65.46 per cent for women.

Over the years, arguments in favour of looking beyond the conventional measure of GDP and taking into account the environmental damage caused by production of goods and services received attention. An expert group under the chairmanship of Prof Sir Partha Dasgupta has been set up to develop a framework for 'Green National Accounts' for India. In fact, the Central Statistics Office (CSO) under the Ministry of Statistics & Programme Implementation (**MOSPI**) has been publishing comprehensive environment statistics since 1997. The process of putting in place a system for natural resources accounting was initiated by MOSPI way back in 2002.

Despite all these efforts, the reality that confronts us on the environmental front continues to be harsh and complex. Increasing population, urbanisation, and growing demand for water and land resources have severely impacted the quality and availability of water and soil resources. Rising energy needs is another area of concern. Besides, rapid growth will require corresponding growth in energy supply.

Presently, a large share of our energy demand is met through coal and oil and this trend will continue, given the unprecedented surge in energy demand and resource constraints. Energy issues become more complex with existing energy poverty and rise in energy prices. There is considerable scope for increasing efficiency in the use of energy and water in India together with other development indicators like infant mortality rate, MMR, sanitation facilities, and public health services. Economic instruments, regulatory measures, and market mechanisms can play an important role in helping to achieve development and growth in a sustainable manner.

INTERNATIONAL COLLABORATION AND EFFORTS

Admitting the well-founded concerns on the need to redress environmental problems, there were global calls for cooperation, action, and innovation. World leaders in 2012 continued to engage and deliberate in international forums dedicated to climate and environment and also in forums like the G20 where sustainable development and climate change were an integral part of the discussions. Ambition or goal setting to reach targets, provision of finance and technology for developing countries, and institutions and mechanisms for capacity building were the common threads of negotiations running through all these forums. Some of the high-profile events which the world was watching are discussed in the following paragraphs.

Rio+20

The United Nations Conference on Sustainable Development (UNCSD), was held in June 2012, at Rio de Janeiro, Brazil, (also known as **Rio+20**) and was attended at the heads of states level. The objective of the Rio+20 Conference was to secure renewed political commitment for sustainable development, review progress made and identify implementation gaps, and assess new and emerging challenges since the UNCSD held 20 years ago in Rio de Janeiro in 1992. Towards the end, the Conference had two **themes**—

(i) Green economy in the context of sustainable development & poverty eradication; and

(ii) Institutional framework for sustainable development.

The most significant outcomes of the Rio Summit have been the restoration of

the principles of equity and of common but differentiated responsibilities (CBDR) in the global environmental discourse and placing poverty eradication at the centre of the global development agenda. The ***outcome*** also ensures the required domestic policy space to countries on a green economy and launched four processes/ mechanisms, i.e., developing SDGs, financing strategy, technology transfer, and defining the format and organisational aspects of the proposed high- level political forum to follow up on the implementation of sustainable development.

'Fairness' as an issue received attention. It is a matter of satisfaction and achievement for India that the Rio outcome document reaffirms equity and the principle of CBDR among other Rio principles. India together with other developing countries played an instrumental role in this. CBDR is especially important for developing countries, as it implies that while all countries should take sustainable development actions, the developed countries have to take the leading role in environmental protection, as they have contributed the most to environmental problems. Also they should support developing countries with finance and technology in their sustainable development efforts. India has always held that the eradication of poverty should be the overarching goal of sustainable development. This was given due recognition in the deliberations at the Rio Summit and in the outcome document.

On the issue of ***Green Economy***, the outcome document affirms that there are different approaches, visions, models, and tools available to each country, in accordance with its national circumstances and priorities, for achieving sustainable development. It identifies green economy in the context of sustainable development and poverty eradication as one of the important tools for achieving sustainable development but specifies that while it could provide options for policymaking it should not be a rigid set of rules. The outcome document clearly states what green economy policies should result in and what they should not. It is a matter of satisfaction that the document firmly rejects prescriptive policies, unilateral measures, and trade barriers as well as unwarranted conditionality on **ODA** (Official Developmental Assistance) in this context.

The Rio+20 Conference will also be remembered for kick-starting the process on developing SDGs. The SDGs would address and incorporate in a balanced way, all the three dimensions of sustainable development and their inter-linkages. The SDGs would be universal, global, and voluntary. Since the SDGs are expected to become a part of the post-2015 UN development agenda, they would hopefully guide the international community towards inclusive sustainable development.

From India's point of view, SDGs need to bring together development and environment into a single set of targets. The fault line, as ever in global conferences, is the inappropriate balance between environment and development. Developing countries do not want any bindings on their efforts towards poverty eradication or any agreement that comes with such a price tag. Therefore, we could also view the SDGs and the post 2015 agenda as an opportunity for revisiting and fine-tuning the MDG framework and sustainably regaining focus on developmental issues. India and many developing countries are slow or off track in achieving targets under some of the MDGs, which have concrete areas of overlap between environment and development. This is another reason why these MDGs should continue to be a part of the post 2015 global policy architecture.[5]

5. ***Economic Survey 2012-13,*** MoF, GoI, N. Delhi, p. 259.

There has been a growing political drive towards the post 2015 development agenda due for agreement in September 2015. In this direction, the thirty-member Open Working Group mandated by the Outcome Document—The Future We Want"—of the UN Conference on Sustainable Development **(Rio+20)** held in June 2012 at Rio came out with a set of 17 SDGs in July 2014. The Sustainable Development Goals (SDGs) cover a broad range of sustainable development issues and the means of thier implementation. These are expected to be integrated into the UN's post-2015 Development Agenda. At present, the post-2015 agenda and SDG processes are moving rapidly towards their conclusion in 2015. The **17 SDGs** are as given below:

1. End poverty in all its forms everywhere
2. End hunger, achieve food security and improved nutrition, and promote sustainable agriculture
3. Ensure healthy lives and promote well-being for all at all ages
4. Ensure inclusive and equitable quality education and promote life-long learning opportunities for all
5. Achieve gender equality and empower all women and girls
6. Ensure availability and sustainable management of water and sanitation for all
7. Ensure access to affordable, reliable, sustainable, and modern energy for all
8. Promote sustained, inclusive and sustainable economic growth, full and productive employment, and decent work for all
9. Build resilient infrastructure, promote inclusive and sustainable industrialisation, and foster innovation
10. Reduce inequality within and among countries
11. Make cities and human settlements inclusive, safe, resilient, and sustainable
12. Ensure sustainable consumption and production patterns
13. Take urgent action to combat climate change and its impacts
14. Conserve and sustainably use the oceans, seas, and marine resources for sustainable development
15. Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss
16. Promote peaceful and inclusive societies for sustainable development, provide access to justice for all, and build effective, accountable and inclusive institutions at all levels
17. Strengthen the means of implementation and revitalise the global partnership for sustainable development.

COP20 AT LIMA

The 20th Session of the Conference of Parties to the *UNFCCC (COP20)* in December 2014 in **Lima**, Peru, was an important milestone as it came out with a 'Lima Call for Climate Action' after long deliberations and intense negotiations. With less than a year left to conclude the deal in Paris later this year, nations are working hard towards finalizing the agreement by December 2015 at the *COP 21* session in **Paris**.

The UNFCCC negotiations focused on the finalization of elements of the draft negotiating text for the 2015 Paris agreement, identification of information to be submitted by Parties under the Intended Nationally Determined Contributions (INDCs), and enhancement of pre 2020 actions. Some of the important outcomes of the Lima Conference are the following:

1. The Lima Conference has decided that the new agreement will be under the UNFCCC and will reflect the principle of CBDR in the light of different national circumstances. It also addresses all elements, i.e., mitigation, adaptation, finance, technology development and transfer, capacity building, and transparency of action and support in a balanced manner.
2. The draft text has to be finalized by May 2015 in order to be placed for consideration and adoption of Parties at COP 21.
3. Another key decision was that countries should not backslide from current pledges under the INDCs (Intended Nationally Determined Contributions) and their contribution has to be more than their current commitments. The final decision successfully ensured that countries can include adaptation, finance, technology development and transfer, capacity building, and transparency of action and support also in their INDCs, in addition to mitigation. There is also no 'ex-ante assessment' to be undergone.
4. Now countries have to submit quantifiable information on the reference point (base year), time frames, scope and planning process, assessments, etc. related to the INDCs. This will be published on the UNFCCC website and a Synthesis Report of the aggregate effect of the INDCs prepared.
5. It was decided to accelerate action on enhancing the pre-2020 actions like early ratification of the *Kyoto Protocol* second commitment period, revisiting of targets and conditionalities associated with it, and provision of finance, technology, and capacity building support by developed countries to developing countries.
6. On the issue of finance, developed countries have been invited to provide clarity on reaching the US$ 100 billion goal by 2020, by way of enhanced information and greater transparency and predictability for scaling up climate finance. On the *Green Climate Fund* (GCF), pledges amounting to US$ 10.2 billion for initial capitalization of the Fund have been acknowledged. It was further decided to urge contributors to confirm these pledges in the form of fully executed contribution agreements so that at least 50 per cent of pledges made till November 2014 are reflected as fully executed contribution agreements by April 2015.

India's Stand at Lima

India has been following action-oriented policies to bring rapid development to its people while purposefully addressing climate change. India has been one of the foremost advocates of long-term global cooperation in combating climate change in accordance with the principles and provisions of the UNFCCC.

Climate change impacts being witnessed today are a result of the total accumulated greenhouse emissions for which the major responsibility lies with the *developed nations*. Moreover, despite the fast growth registered by some of the developing countries, a large proportion of people in these countries still live in extreme poverty. The Indian stance in the climate change negotiations has been guided by the principle of CBDR. India thus believes that the climate change agreement of 2015 should take into consideration a whole gamut of issues including adaptation, finance, technology development and transfer, capacity building, transparency of action and support in a balanced manner, and loss and damage in addition

to mitigation. As per the *Economic Survey 2014–15*, the broad parameters of India's stand on the climate change issue are as given below:

Mitigation: Historical responsibilities of developed countries and equity in access to global atmospheric resources should continue to be the basis of defining mitigation commitments. The 2015 agreement must ensure that the developing countries be given their fair share of carbon and development space. The contribution of developing countries to mitigation efforts is far greater than that of developed countries and could be further enhanced if developed countries effectively implement and significantly increase their commitments of providing finance, technology, and capacity building support to developing countries.

Adaptation: Equal weightage has to be given to adaptation as it is essential for reducing vulnerabilities of communities to climate change. This assumes more importance in view of the fact that the developing countries are the most vulnerable to climate change. However, both global action and finance flows have been biased in favour of mitigation. The developing countries are pushing hard to include adaptation in a comprehensive and balanced manner in the 2015 agreement.

Finance: The responsibility of providing financial assistance to the developing countries lies with the developed countries and this has been clearly articulated in the UNFCCC. India together with other developing countries continue to urge the developed countries to honour their obligation to provide new, additional, and predictable financial support to developing countries in a measurable, reportable, and verifiable manner. In this context ambitious capitalization of the GCF assumes significance. Developed countries have been urged to provide clear timelines and pathways to reach the US$ 100 billion annual commitment made by them in 2010.

Technology transfer: Technology forms a major component of any move towards combating climate change. The important issue in this regard is that while the developed countries are the frontrunners in clean technology, the developing countries do not possess either sufficient technical capability or the financial resources to develop clean technologies. Appropriate mechanisms for smooth transfer of technology from the developed to developing countries have to be agreed upon. The intellectual property rights price-tag should not come in the way of such technology transfer.

IPCC ASSESSMENT REPORT

The Intergovernmental Panel on Climate Change (IPCC) reviews and assesses the most recent scientific, technical, and socio-economic information produced worldwide relevant to climate change. The IPCC in its recent report the *Fifth Assessment Report (AR5),* published in **2014**, has observed that there has been an increasing trend in the anthropogenic emissions of greenhouse gases (GHG) since the advent of the industrial revolution, with about half of the anthropogenic CO2 emissions during this period occurring in the last forty years.The period 1983–2012 is likely to have been the warmest thirty year period of the last 1400 years. CO2 emissions from fossil fuel combustion and industrial processes have contributed a major portion of total GHG emissions during the period 1970–2010. Two major findings of the report are—

(i) Contribution (%) by different countries to cumulative **Global CO_2:** USA (21.2); EU (18.4); China (10.7); Russia (7.4); Brazil (4.4); Jappan (3.3); India (2.8); Canada (2.2); and Rest of the World (28.7).

(ii) Sectoral emissions (percentage) to **Global Green House Gases:** Electricity & Heat production (25); AFOLU, i.e., agriculture, forestry and other land use

(24); Industry (21); Other energy (9.6); and Buildings (6.4).

FINANCING CLIMATE CHANGE

The idea of a global budget for carbon and its corresponding financing stems from the objective of stabilising the GHG concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system. There has already been a 0.8° C increase in global mean temperature. It is widely believed that we are fast approaching the 2° C temperature rise within which the global community is striving to limit itself. This indicates that only a small and fast closing window of opportunity exists for the international community to take actions and ensure that we avoid reaching this point.

Yet the question remains that how to finance actions to achieve this target.[6] A UNFCCC paper (2007) estimated a requirement of US$ 200–210 billion in additional annual investment in 2030 to return GHG emissions to current levels. Further, additional investme nt needed worldwide for adaptation was estimated to be annually US$ 60–182 billion in 2030. However, with the passage of time and inadequate action, these estimates are being revised upwards. Most recent estimates presented at the UNFCCC's workshop on Long-term Finance (July 2012), point to an even more enormous scale of funds, in the range of $600–$1500 billion a year, that would be needed by developing countries for mitigation and adaptation. This amount is at least 5–10 times the prospective financing flows of US$100 billion per year by 2020 agreed upon as the goal under the UNFCCC. Representatives from the International Energy Agency reported at this workshop that annual global investments for power generation alone, in a 2° C temperature rise scenario, would involve $370 billion from 2010 to 2020; $630 billion between 2020 and 2030; and $760 billion between 2030 and 2050.

DOMESTIC RESOURCES AND MECHANISMS

The UNFCCC (The latest available data of actual emissions available is upto 2010 only) notes that Kazakhstan, Cyprus, Malta, and Belarus did not have reduction commitments for 2008-2012 under the KP. Canada, Japan, New Zealand and Russia are not Parties to the second commitment period to the **KP** (Kyoto Protocol): Countries that are undergoing the process of transition to a market economy. For any representative country say for Australia, the table shows that in the first commitment period, Australia could collectively increase emissions by 8 per cent between 2008-2012 (taking the base year as 1990), whereas for the second KP round, Australia would need to reduce its emissions by 0.5 per cent collectively between 2013–2020. The last two columns of the table measure progress towards the first KP target which shows that Australia's actual emissions increased by 30 per cent between 2008–10. This indicates that for the period between 2010–12, Australia's emission should have been reduced by 22 per cent for it to be within the target.

The assessment and quantification of the costs of adaptation and mitigation is a difficult task. However, it is clear that these costs are significant and will likely be higher in the future as initiatives are taken in line with the goals outlined in the NAPCC. The preliminary estimates indicate a sum of Rs. 230,000 crore to fulfill the mission objectives under the NAPCC alone, let alone other lower carbon strategies and environment policies and programmes of the government.

The most obvious source of financing for climate change action is government budgetary support. Most of it would come as sectoral finance

6. ***Economic Survey 2012-13,*** MoF, GoI, N. Delhi, p. 262.

Carbon Taxes and Environmental Subsidies

A recent study 'Preliminary Modeling Studies on Carbon Taxes and GDP Loss' was conducted by the Ministry of Environment and Forest, GoI. The results of the study are given as below—

Undiscounted cumulative GDP loss: Carbon tax is *revenue positive* when it involves no adjustment to other tax rates in the economy. It is *revenue neutral* when other tax rates are adjusted so that the revenue inflow from carbon tax is exactly balanced by an equal reduction in yields from reduced taxes.

GoI Expenditure on Environment Promoting Subsidies

Environment-promoting Subsidies	Exp. in 2008–09 (Rs. crore)
Sewerage & sanitation	1,236.06
Soil & water conservation	26.04
Fisheries	221.52
Forestry & wildlife	696.36
Agricultural research & education	365.11
Special areas development prog.	1,560.29
Flood control & drainage	175.28
Non-conventional energy	477.21
Ecology & environment	473.80
Total	**5,231.67**

Source : A Technical Paper on *'Environmental Subsidies in India: Role and Reforms'* by the Madras School of Economics (January 2012), as quoted by the *Economic Survey 2012–13*, p. 264.

since some of the resources for adaptation and mitigation are built into the ongoing schemes and programmes. Although mitigation is sometimes an important co-benefit, the deployment of resources for such purposes is largely guided by the overall availability of resources. The Finance Bill 2010-11 created a corpus called the National Clean Energy Fund (NCEF) out of a cess at the rate of Rs.50 per tonne of coal to invest in entrepreneurial ventures and research in the field of clean energy technologies. The government expects to collect Rs. 10,000 crore under the NCEF by 2015. Governments have a range of policy instruments and variables at their disposal to use for generating the enormous resource requirements in this field. This includes a set of price signals, direct and indirect taxes, subsidies, and export and import levies. Theoretically, environment- related taxes have an important role to play in funding green initiatives. At the same time, any government must use these policy tools after serious consideration and analysis as they may have serious repercussions on other sectors of the economy. Preliminary modelling studies by the Ministry of Environment and Forests indicate that even a modest revenue-neutral economy-wide Carbon tax of US$10 per ton of GHG emissions in India would result in a GDP loss of around US$ 632 billion at 2005 prices. At the same time, the government continues to use subsidies to promote the environment.

Carbon taxes and *subsidy* may not be relied solely as the most viable policy option. Therefore, India is experimenting with a careful mix of market mechanisms together with fiscal instruments and regulatory interventions. On one hand, where the

cess on coal is a type of carbon tax being levied in India, **PAT** (Perform Achieve and Trade) and **RPO** (Renewable Purchase Obligation) are examples of cap and trade market mechanisms promoting energy efficiency and the use of renewable energy respectively in India.

The Twelfth Plan, in the particular context, lower carbon strategies will require capital finance for improvements in technology and enhanced deployment of renewable and clean energy technologies. Some of these objectives may be met through regulatory interventions and use of market mechanisms, in which case the required budgetary support may be small. In other cases, adequate financial outlays will be needed to implement policies and measures that can achieve specific mitigation outcomes in the individual sectors. So far, three grants of Rs. 5,000 crore each, for forest cover, renewable energy, and the water sector, have been recommended by the 13th Finance Commission for the state governments.

Considering the large resource requirement, arguments in favour of setting up a **National Green Fund** to finance public and private sector projects/ activities aimed at protecting environment in accordance with the Twelfth Plan objectives have found support. The Fund could also be a vehicle for receiving international support through agreed bilateral and multilateral sources and can finance

PAT and RPO

The ***PAT*** (perform - achieve - trade) is a scheme for trading energy-efficiency certificates in large energy-intensive industries under the National Mission for Enhanced Energy Efficiency—

(i) Identified industries are required to improve their specific energy consumption (SEC) within the specified period of three years or face penalty provisions.

(ii) At the same time this mechanism facilitates efficient industries to trade their additional certified energy savings (that go beyond the assigned target) with other designated consumers who could use these certificates to comply with their SEC-reduction targets.

(iii) In the Twelfth Five Year Plan, the PAT scheme is likely to achieve about 15 million tonnes oil equivalent of annual savings in coal, oil, gas, and electricity (including 6.686 million ton of oil-equivalent energy savings of first phase).

Similarly, the ***RPO*** (Renewable Purchase Obligation) is creating domestic markets for renewable energy through regulatory interventions at state level.

(iv) The RPO is the minimum level of renewable energy (out of total consumption) the obligated entities (DISCOMs, Captive Power Plants, and Open Access Consumers) are entitled to purchase in the area of a distribution licensee.

(v) The obligation is mandated by the State Electricity Regulatory Commission (SERC). Since the renewable energy sources are not evenly spread across India, SERCs cannot specify a linear level of RPOs for all states.

(vi) Renewable Energy Certificates (RECs) under the RPO mechanism is an instrument that enables the obligated entities to meet their Renewable Purchase Obligation by trading surplus or deficit RECs among themselves with the owner of the REC being able to claim to have purchased renewable energy.

Source: ***Economic Survey 2012-13,*** MoF, GoI, N. Delhi, p. 265.

actions not only at national level but also at state level for agreed priorities and thrust areas.

Carbon offsetting and its requisite financing require global effort and process. Markets that are operating take signals from international negotiations. Domestic markets and mechanisms alone are neither sufficient for generating resources of the required scale nor efficient enough for reaching the set level of targets and therefore rely heavily on international policy architecture. The second commitment period of the KP has brought some respite and certainty to the carbon markets; however, due to lack of ambition the future of carbon markets could still be in an indeterminate state. India's actions for climate change will, therefore, need to be financed from a pool of resources consisting of domestic resources, international carbon finance, and multilateral funds.

International Sources and Issues

India, primarily out of its own concerns, has chalked out ambitious plans and policies to tackle climate change and environment issues that reflect India's strong will to address this global public good. However, given the *scarcity of resources* and competing demands, finding the matching resources is a challenge. The 'Expert Group on Low Carbon Strategies' has also stated in its Interim Report that aggressive mitigation cannot be achieved without substantial international financial support, both in terms of financial resources and technology transfer. The Indian PM also echoed similar sentiment in his **Rio+20 Summit** speech: *'Many countries could do more if additional finance and technology were available. Unfortunately, there is not enough evidence of support from the industrialised countries in these areas.'*

In the context of making finances available to developing countries, in the recent past, much of the talks under the UNFCCC revolved around two numbers, namely US$ 30 billion between 2010 and 2012 as **FSF** (Fast Start Finance) and US$ 100 billion annually by 2020 as long-term finance. These were the two finance figures that the developed world collectively pledged as climate change finance in 2009. These pledges need to be new and additional. The term *'new and additional'* in the context of provision of finances by developed countries can be traced right from the text of the Convention to various COP decisions. In this sense 'new and additional' refers to provision of financial resources that represent new commitment, rather than those that are diverted from flows that have already been earmarked for some other form of development assistance.

However, in the absence of an agreed definition of additionality in climate finance, the developed and developing countries have diverging views. In the backdrop of these differences, together with great uncertainty in finance flows, complex web of channels, and lack of transparency and reporting practices, the actual additionality on FSF turned out to be a matter of great contention *(given below in the box)*. These differences more recently led to demand from developing countries on the need for a mechanism to **MRV** (*measure, report, and verify*) climate finance flows.

As a part of the ***finance package*** in the Doha Conference, the MRV of finance was an important element of the deal. It is satisfying that elements of MRV will be taken up by the Standing Committee on Finance under the COP. The Committee will consider ways of strengthening methodologies for reporting, measuring, and tracking climate finance. Talking about other finance elements, the Conference did not take ambitious or meaningful decisions especially on the demand for finance for the period between 2013 and 2020. The final decision encourages developed country Parties to increase efforts for at least maintaining the average annual 2010–12 level of finance between 2013 and 2015. On the other hand, it is reassuring that the work programme on long-term finance started

in COP17 in Durban has been extended with a view to continuing discussion on likely sources of finance in the long term. To sum up, finance negotiations and outcomes at Doha were in the nature of small slow steps rather than big strides.

Simultaneously, there have been efforts to build the requisite infrastructure for enabling and facilitating the flows of climate finance under the Convention. This is because only scaling up of finance will not suffice. The money should be put to efficient use and generate results. To this effect, work on operationalising the GCF progressed. The Republic of Korea has been selected as the host country to house its secretariat. The GCF is expected to be instrumental in channelling a significant share of the US$ 100 billion expected annually to be mobilised to developing countries by 2020 for addressing climate change. The vision, structure, and strategy of the Fund to carry out its function are a crucial priority on the agenda of the GCF Board. The Board should not rush with the 'standard' solutions sometimes proposed by outside interests but focus on ultimate goals and results on the ground with accountability and transparency.

Meanwhile, there are other Funds under the UNFCCC which continue to function. Collectively, the climate focal area of Global Environment Facility (GEF), the Special Climate Change Fund, the Least Developed Countries Fund, and the Adaptation Fund disburse around less than US$ 1 billion per year (Report on the workshop of the work programme on long-term finance 2012). The GEF, which is also an operating entity of the financial mechanism of the UNFCCC like the GCF, provides project grants for addressing global environmental issues while supporting national development initiatives. Till date, India has accessed about US$ 438 million of GEF grant of which US$ 269.5 million is for projects under the climate change focal area. At the same time, the **CIF** (Climate Investment Fund)—a collaborative effort among the multilateral development banks is offering its funds to be used for climate action on the basis of agreed terms and conditions. India has agreed 'in principle' to accessing the CIF, provided it is not treated as part of the climate change finance flows under the Convention and no GHG emission reduction related conditionalities are associated with the funds. The Trust Fund Committee in May 2012 has approved the allocation of the first tranche amounting to US$ 263 million for four projects contained in India's Investment Plan.

Carbon Markets and Private Sector

Visible disappointments with the Doha outcomes on finance, many observers warned that we are heading towards a climate fiscal cliff. In this context, the private sector and global carbon markets are being increasingly emphasised. While not sufficient in themselves, the private sector and carbon markets have shown significant potential in mobilising finance for climate change especially for mitigation action.

As per the UNFCCC report on long-term finance, of the estimated current international climate financial flows, US$ 55 billion per year was generated from the private sector. Likewise, carbon markets help developing countries to find financial resources to proceed on their sustainability efforts. The CDM (the KP's market mechanism) as the world's largest carbon market has helped mobilise more than US$ 215 billion collectively so far in investments in developing countries (CDM Policy Dialogue Report). India has been an active player in the CDM, with over 2000 projects having been accorded host country approval, which has the potential of facilitating an overall inflow of approximately US$ 7.07 billion if all the projects get registered.

Both these sources, at the same time, have serious limitations in terms of predictability and adequacy of flows. It is absolutely clear that they

will not deliver on the hardest things: equity, public goods, and adaptation such as climate resiliency in agriculture or offgrid distributed renewables for poor regions. They will instead prove useful for market- led goods and services for the better, such as grid-based solar and wind power, where public subsidies in one form or another will be demanded. Also private sector investment is guided by risk return. This explains the strong inclination of the private sector towards mitigation projects. Adaptation financing continues to be a concern for all developing countries with insignificant private participation as adaptation usually does not yield returns on investment.

Carbon markets on the other hand are volatile, where success is contingent on the level of collective mitigation of ambition of nations. The end of the first phase of the KP saw the CDM market collapsing with carbon prices declining around 70 per cent in the past year alone. Moreover, unilateral restrictions imposed by the authorities in some of the major carbon markets such as EU on carbon credits from major developing countries such as India have not helped matters. The prices of carbon credits are likely to remain in a trap until the global ambition improves and new market mechanisms emerges to take into account the pledge based emissions. Both the carbon markets and private money need clear and targeted signals from public policies to address the institutional and market barriers confronting them.

PROBLEMS & PROSPECTS

Though multilateral efforts on sustainable development and climate change have led to several positive outcomes, there are still areas of concern where further work is needed to safeguard the interests of developing countries in future deliberations. Some of the challenges and deliverables from India's point of view are—

(i) Follow up and action on the Rio+ 20 outcome document, and the four processes/mechanisms that were as part of it, especially on developing SDGs and the processes on the financing strategy and technology transfer.

(ii) Taking forward the climate change discussions at Doha, the key question to be addressed is to articulate equality in the evolving arrangements that will be applicable to all in the post 2020 period. We have to ensure that domestic goals continue to be nationally determined even as we contribute to the global efforts according to the principle of CBDR and respective capabilities.

(iii) Taking concrete decisions on the sectoral framework for such actions closing the possibility of both unilateral measures and actions being initiated in sectors by the respective international organisations like ICAO or IMO on their own.

(iv) Equity, fair burden sharing, and equitable access to global atmospheric resources have to be protected and addressed more adequately under the DP, India will have to fight for its fair share of carbon and development space.

The sources and channels of providing long-term finance by developed countries have not yet been clearly identified. With no certainty on funding in the coming years, it is absolutely necessary to expeditiously mobilise finance and provide initial capital to the GCF for its operations.

Based on historic emissions and responsibilities, developed countries should take the lead. However, according to a June 2011 Study[7], developing countries are pledging greater cuts in their GHG emissions than developed countries.

India is also proactive in this regard with its intentions and ambition firmly in place in its policies and programmes. One may rightly argue that with the Twelfth Plan's focus on 'environmental sustainability', India is on the right track with the right enabling environment and has a number of achievements to its credit. However, the challenge while India is growing is to identify the key drivers and enablers of growth be it—

(i) Infrastructure
(ii) Transportation sector
(iii) Housing, or
(iv) Agriculture

And finally, to make the above-given sectors grow sustainably. This leads us to the next and most **vital issue** of finding and raising new and additional resources for meeting economic well-being needs with greater environmental sustainability. More often, it is the resource crunch which is the stumbling block for developing countries like India. While it makes efforts to efficiently and expeditiously bring price signals and other policy instruments into play, India could do much more if new and additional finance and technology are made available through multilateral processes.

"Be it national or global, environmental decline and global warming occurred gradually over decades and centuries, picking up pace with time. We must remember that the clock is now ticking on the needed global action to combat and contain this decay. This action should be fair, just and equitable for all countries so that our future has ecological and economic space for sustainable development for all".[8]

Moreover, mankind is faced with a situation when, by all means, it develops and selects the kind of 'technologies' which have the minimum or least 'fallouts' on our eoclogy and environment in the process of promoting the cause of mankind's development. Absence of global concensus cannot be cited by the individual nations as a refuge to sit idle and continue in the mode of 'business as usual'. Before it is too late, the conscience of humanity must awaken from its inertia.

EPILOGUE

Hardly anything makes economic sense unless its continuance for a long time can be projected without running into absurdities. Growth and development can happen to a 'limited objective', but it cannot be stretched upto an 'unlimited extent'. How can the 'finite' earth support mankind's 'infinite' physical needs? – long before this was postulated by the 'Club of Rome' in 1972, exactly the same thing Gandhiji had said in late thirties itself, 'Earth provides enough to satisfy every man's need, but not for every man's greed'. Mankind needs to introspect not only about its present needs but the way those needs are being met.

Besides, we also need to 'differentiate' between our 'needs' and 'aspirations'. Our physical needs

7. Stockholm Environment Institute, 'Comparison of Annex 1 and non-Annex 1 pledges under the Cancun Agreements', as cited by the ***Economic Survey 2012-13,*** MoF, GoI, N. Delhi, p. 268.
8. ***Economic Survey 2012-13,*** MoF, GoI, N. Delhi, p. 268.

have a direct 'link' with the resources we have at our disposal to meet them. If mankind is to survive and prosper, we need to be aware of the repercussions of our activities on Mother nature.[9]

9. These virtuous opinions can be seen in a number of contemporary thinkers and writers since 1970s:

E. F. Schumacher, ***'The Economics of Permanence',*** *Resurgence,* Volume 3, No. 1, May/June 1970, (reprinted in Robin Clarke, Editor, ***'Notes for the Future: An Alternative History of the Past Decade',*** Thames & Hudson, London, 1975). Schumacher invoked Gandhi while advocating for the 'economics of permanence'.

Jeffery Sachs, ***'Common Wealth: Economics for a Crowded Earth',*** Penguin Books, Great Britain (GB), London, 2009, pp. 29-35, 55-155.

Jeffery Sachs, ***'The End of Poverty',*** Penguin Books, GB, London, 2005, pp. 280-284.

Tim Harford, ***'The Undercover Economist',*** Abacus, GB, London, 2006, pp. 90-104.

Thomas L. Friedman, ***'The World is Flat',*** Penguin Books, GB, London, 2006, pp. 383-385, 495-504

Ramachandra Guha, ' ***The Ecology of Affluence'*** in ***'The Ramachandra Guha Omnibus',*** Oxford University Press,N. Delhi, 2005, pp. 69-97.

CHAPTER

20

PREPARING FOR THE DEMOGRAPHIC DIVIDEND

- Introduction
- Comparing Growth and Trade
- Reasons Behind Less Creative Jobs
- Informality of Employment in India
- Services Not Creating Enough Jobs
- Need of Formal Apprenticeships
- Way to Evidence-Based Better Policy
- Way to Policy
- Cautions to Preparedness

*India is a glaring example of demographic dilemma–while rate of population growth is a matter of concern at one hand, at the other it also unfolds opportunity because children and youth account for a large share of this growth. It is an advantage for India now because the country is entering the demographic dividend phase while China is exiting it–demographic dividend refers to a period, usually, 20 to 30 years, when a greater proportion of people are young and in the working age-group. This cuts spending on dependants, spurring economic growth. India hopes that by the time this dividend phase ends around 2045, it would have achieved a stable and balanced population.**

** See different reports of the United Nations Population Fund, United Nations Children's Fund together with the Economic Surveys of 2010-11 to 2014-15.*

INTRODUCTION

As the developed world is in the process of greying and are heading for a crunch in the 'working population', nations with growing population in the working age-group see this as an opportunity to employ their surplus manpower in there nations. In case of India, the situation has been considered to be highly favourable by international as well as Indian experts. But these are mere aspirations. To reap real diridends, we need to provide the required 'quality' to the quantity of our population. We need to strengthen our human resource development capabilities keeping in mind the future requirements. Only then the dividend of demography will be in India's favour.

The *Economic Survey 2012–13*, on the India's prospects of garnering demographic dividend, says, "Policymakers are usually focused on short-run economic management issues. But the short run has to be a bridge to the long run. The central long-run question facing India is 'Where will good jobs come from?' Productive jobs are vital for growth. And a good job is the best form of inclusion. More than half our population depends on agriculture, but the experience of other countries suggests that the number of people dependent on agriculture will have to shrink for per capita incomes in agriculture to go up substantially. While industry is creating jobs, too many such jobs are low productivity non-contractual jobs in the unorganized sector, offering low incomes, little protection, and no benefits. Service jobs have relatively high productivity, but employment growth in services has been slow in recent years. India's challenge is to create the conditions for faster growth of productive jobs outside agriculture, especially in organised manufacturing and services, besides improving productivity in agriculture. The benefit of rising to the challenge is decades of strong inclusive growth".

OPTIMISM VS PESSIMISM

Experts with optimistic views are confident in India's demographic dividend because of the fact that India's dependency ratio, as measured by the share of the young and the elderly as a fraction of the population, will come down more sharply in the coming decades. More working age people will mean more workers, especially in the productive age groups, more incomes, more savings, more capital per worker, and more growth. Also, because demographic change is associated with fertility declines, the transition period may be accompanied by greater female participation in the labour force [1].

As per the IMF, every fast-growing Asian economy in recent years has accelerated as it underwent a demographic transition. In India[2] itself, the high growth states (Tamil Nadu, Karnataka, and Gujarat) in the period 1991–2001 had a dependency ratio which was 8.7 percentage points lower than that of the low growth states (Bihar, Madhya Pradesh, and Uttar Pradesh) and an average annual growth rate that was 4.3 percentage points higher. Looking ahead, the low growth states will benefit more from the demographic dividend, as higher incomes and lower fertility alter demographics. Indeed, over the period 2001–11, the hitherto laggard states have grown at an average of around 5 per cent annually. The difference between their growth and that of the leaders in the period 2001–11 is just 1.5 percentage. So demographic transition seems to be correlated with growth, with some

1. Bailey, M.J. (2006*), 'More Power to the Pill: The Impact of Contraceptive Freedom on Women's Life Cycle Labor Supply', Quarterly Journal of Economics,* No. 121, pp. 289–320.
2. S. Aiyar and A. Mody (2011), ***'The Demographic Dividend: Evidence from the Indian States'***, IMF Working Paper 11/38, Feb. 2011.

reasons to believe that causality flows both ways i.e., lower dependency ratios increase growth and higher growth reduces fertility and consequently dependency ratios.

These optimists point to another reason for cheer. Cross-country evidence suggest that productivity is an increasing function of age, with the age group 40–49 being the most productive because of work experience[3]. Nearly half the additions to the Indian labour force over the period 2011–30 will be in the age group 30–49, even while the share of this group in China, Korea, and the United States will be declining. That India will be expanding its most productive cohorts even while most developed countries and some developing countries like China will be contracting theirs in the coming decades can be another source of advantage.

However, the as pessimists are not convinced. A larger workforce translates into more workers only if there are productive jobs for it. Will there be enough productive jobs? One way to make progress in answering this question is to understand the commonalities as well as the differences between India's growth path and that of other populous fast growing Asian economies. By comparing where India is today, with where those countries were at similar stages in their development, as well as by looking at what they did next, we might get a better perspective on what India might need to do. Of course, any such analysis has to be accompanied by two important caveats—

(i) First, countries differ and do not necessarily follow similar trajectories;

(ii) Second, the global environment has changed.

The opportunities India faces now are different from those that previous fast growers faced when they were at a similar stage of development. Thus, blindly replicating their trajectory may be unwise.[4]

COMPARING GROWTH AND TRADE

If we analyse the various economic outcomes for selected Asian countries around their dates of initial 'takeoff' into periods of high growth, we identify the year of takeoff for comparator Asian countries based on IMF (2006)[5] the dates are 1979, 1973, and 1967 for China, Indonesia, and Korea respectively. For India, taking the year of takeoff as 1991, when major economic reforms began, the following narrative is clear as given below:

(i) India was growing at similar rates as other Asian economies before takeoff. After takeoff, it kept pace with Indonesia, but China and Korea grew faster.

(ii) Setting date 0 as the year the country's per capita GDP in 2000 US dollars, crossed $500;

(iii) By the time India's dependency ratio falls below 40 per cent, China's growth is more robust under both these alternatives, while India's matches that of Indonesia.

(iv) Korea's trajectory is similar to India's in the initial years after takeoff, though after 10 years the slope of its trajectory increases steeply.

3. Feyrer, J. (2007), ***'Demographics and Productivity',*** Review of Economics and Statistics, No. 89 (1), pp.100-109.
4. As is suggested by the ***Economic Survey 2012-13,*** MoF, GoI, p. 27
5. IMF (2006) defines the takeoff date for China as the year when major economic reforms began. For Newly Industrialized Economies (which includes Korea) and for ASEAN-4 (which includes Indonesia), the date is defined as the year when the 3-year moving average of constant price export growth first exceeded 10 per cent. Takeoff year 0 is defined as the year the country's per capita income crossed $500. The takeoff years are defined as 1993, 2003, 1988, and 1951 for China, India, Indonesia, and Korea respectively. Per capita income is measured by GDP per capita in 2000 US dollars. Takeoff year 0 is defined as 1979, 1991, 1973, and 1967 for China, India, Indonesia, and Korea respectively. Per capita income is measured by GDP per capita in 2000 US dollars. *Sources* : ***World Bank (2012)*** and calculations of the ***Economic Survey 2012-13.***

(v) By plotting an index of a country's share of world trade, with year 0 based on our first takeoff definition (1979, 1973, 1967, and 1991 for China, Indonesia, Korea, and India respectively). interestingly, India's growth in its share of world trade is similar to China's and greater than Indonesia's at similar periods after takeoff. India's openness is also evidenced by the trade to GDP ratio, which exceeded 55 per cent in 2011. By contrast, this ratio is only 31 per cent for the United States.

(vi) The takeaway from the evidence examined so far is that India's growth performance has been similar to that of some of the fast-growing Asian economies at similar stages after takeoff, but not as spectacular as China's. Interestingly, despite being seen as a trade laggard, India has grown more open to trade at about China's pace.

SOURCES OF GROWTH

For knowing the edge India has in garnering 'demographic dividend', a comaprision with the other Asian economies in the area of ***sources of growth*** will serve the purpose.

(i) Growth in per capita income is driven by growth in labour productivity (what the average worker produces), growth in working age population (fewer the people who are in the dependent age group in the population, greater the output), growth in the fraction of those who can work and that actually look for work (labour force participation rate), and growth in those looking for work who actually find it (employment rate).

(ii) Because accurate employment data are hard to find for developing countries, studies typically ignore the employment rate in decomposing the sources of growth. A decomposition of per capita income growth during the 20 years after takeoff suggests that across countries, much of the increase in per capita income comes from greater labour productivity.

(iii) Interestingly, except for Korea, **LFP**[6] (labour force participation) has fallen on an average annual basis, so it subtracts from growth.

(iv) Finally, the increase in the share of WAP (working age population) seems to add only a little to growth.

(v) Since the increase in working age population is what we call the demographic dividend, the fact that it contributes so little to growth (on average, 0.5 percentage points for India in the 20 years since 1991) may seem a puzzle.

The puzzle can be solved this way – the increase in the fraction of people working is probably not the main consequence of the demographic dividend. Instead, the effects of the demographic dividend are channelled through the increase in labour productivity, which comes from more physical capital employed per worker (in turn resulting from greater saving and investment), more human capital per worker (which comes from more education as smaller families lead to greater spending on education per child), and greater **TFP** (total factor productivity).[7]

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6. LFP is a measure of the active portion of an economy's labor force. It refers to the number of people who are either employed or are actively looking for work. The number of people who are no longer actively searching for work would not be included in the participation rate. During recession many workers often get discouraged and stop looking for employment that is why the participation rate decreases.

7. TFP measures how productive the job intrinsically is, capturing aspects such as the technology used, efficiency with which the work is carried out, and use of hard-to-measure aspects of work such as tacit knowledge, organisational capabilities, and trust.

Therefore, it is useful to see how much each of these factors contributed to labour productivity. Better *human capital* accounts for only a small part of the growth in labour productivity for Asian fast growers. Instead, the two biggest contributors are the growth in capital deployed per worker and growth in TFP. Indonesia and Korea relied much more on capital deepening. India did not have as much growth in capital per worker as these countries but had stronger growth in TFP. Finally, China grew both because of more capital deployed as well as strong increases in TFP.

Quite interestingly, in the years beyond the 20th year after takeoff which India is now entering, capital deepening slowed for both Indonesia and Korea but it increased for China. More interestingly, TFP slipped considerably for Indonesia and was not large for Korea to begin with. However, it increased for China.

Precisely speaking, the underpinnings for continued strong Chinese growth in the years beyond the second decade after takeoff are a robust investment rate as well as substantial increases in the intrinsic productivity of jobs. If India were to follow a similar path, it would need to increase savings and investment, both of which will follow from the demographic transformation. But it will also have to increase the intrinsic productivity of jobs, that is TFP.

IMF *(World Economic Outlook-2006, 'Asia Rising: Patterns of Economic Development and Growth', Chapter 3)* suggests that a significant portion of China's increase in TFP has come as workers migrate from low-productivity sectors like agriculture to high-productivity sectors like manufacturing. What lies ahead for India? A recent **study**[8] says that LFP in agriculture is very low but it employs over half the labour force. In contrast, financial and brokerage services are the most productive sector, in the economy, but employ a tiny share of the labour force.

Labour Productivity & its Reallocation

IMF (2006) suggests that a significant portion of China's increase in TFP has come as workers migrate from low-productivity sectors like agriculture to high-productivity sectors like manufacturing. What lies ahead for India? That so many continue to be dependent on agriculture is one reason that the government has focused on improving productivity in agriculture, even while attempting to support incomes of both farmers and workers through various programmes. Agricultural productivity remains low probably because too many agricultural workers work with relatively fixed and limited amounts of productive assets i.e., land and capital (irrigation, technology, tractors, machinery, and the like). One way to increase labour productivity, therefore, is to increase investment (and thus capital per employee) across all sectors, including agriculture.[9]

An equally effective way of increasing labor productivity might be to increase TFP by moving some of those dependent on low-productivity agriculture to higher-productivity jobs in industry or services. This would also allow those who remain in agriculture to farm larger, more viable plots, employing more mechanised equipment to improve labour productivity. Clearly, more investment in worker-receiving sectors will be needed to keep up the capital per employee, but the typically greater TFP in those sectors will also mean much greater output per capita. Continuing

8. R. Hasan, D. Mitra, and A. Sundaram , 'What Explains the High Capital Intensity of Indian Manufacturing?' ***Indian Growth and Development Review,*** *2012.*
9. R. Hasan, K. Robert, and L. Jandoc, ***Labor Regulations and the Firm Size Distribution in Indian Manufacturing,*** Columbia Program on Indian Economic Policies, Working Paper No. 2012–13, 2012.

reallocation of workers out of low-productivity sectors into higher-productivity sectors is akin to increasing TFP and can therefore be a growth engine.[10]

What has been the situation of **workers' reallocation in India**? By plotting sectoral shares of employment and shares of value added in the years since takeoff the following situation has been shown by the **World Bank** *(World Development Indicators, July 2012)*:

Situation in ***Agriculture*** sector—

(i) India certainly has a bigger share of employment in agriculture today than the other Asian countries, but perhaps only because it has not had as many years since takeoff.

(ii) Employment share and value added share in agriculture in India is coming down at a similar pace as in the other Asian economies (though Korea seems to have a lower share of people in agriculture).

(iii) Extrapolating into the future, if India followed China's or Indonesia's path, about a 10 percentage point share of overall employment would move out of agriculture in the next 10 years, bringing the share of employment in agriculture down to about 40 per cent.

In sector ***Industry***, greater differences are seen—

(i) While the growth in India's share of employment in industry seems to be on par with the growth of other Asian economies at similar stages (with the exception of Korea), the surprising fact is that India's share of value added in industry has not grown to keep pace with its share of employment,basically, it has fallen.

(ii) Contrast this picture with China's where the share of value added in industry has always been very high relative to its share of employment, or Indonesia's and Korea's where the share of value added has kept increasing as the share of employment has increased (e.g., for Indonesia) or even decreased (e.g., for Korea).

(iii) The alarming conclusion is that while workers are being added to industry in India, the productivity of the jobs they are going into has not been high. In part, this is because the data we work with treats low-productivity construction as a part of industry, and the booming construction sector has accounted for a large share of the jobs created in industry.

(iv) However, an additional problem is that few of the jobs in industry are formal or being created by the comparatively more productive large firms.

The ***Services*** sector show another typical trait—

(i) While the share of employment in services has been growing very slowly, the share of value added is significantly higher than in other Asian economies.

(ii) China has a similar share of employment in services at a similar time from takeoff even though its share of value added is much lower.

(iii) A big factor in India's larger services share is that services started out at the time of take-off with a much larger share, but growth has also been strong.

Several finer points suggested by these sectoral pictures across countries:

(i) Unlike the conventional wisdom, India does not have more people in agriculture

10. M. Bosworth and S. M. Collins, ***'The Empirics of Growth: An Update'***, Brookings Papers on Economic Activity, 2003.

than other Asian countries at similar stages of development and the share of workers dependent on agriculture has been shrinking at a similar pace.

(i) However, the pace of shrinkage is set to increase if India is to follow the trajectory of these other countries.

(ii) One problem is that while industry is creating jobs, these have been relatively low-productivity jobs. As a result, per capita income in India has not benefited as much from inter-sectoral migration of workers out of agriculture as other Asian countries have.

(iii) A second problem is that the high-productivity services sector is not able to create employment commensurate with its growth in value added.

Chances of Missing Jobs

There is a clear transition of workers out of agriculture if we follow the path of other Asian countries. In addition, the demographic dividend will ensure more workers joining the labour force. How many workers will industry and services have to absorb in the next decade? How many will they absorb if they continue creating jobs as they have in the past? Could the demographic dividend turn into a demographic curse as some have argued? These questions may be answered taking clues from World Bank's *World Development Indicators-2012* and UN Population Division's *Revision of World Population Prospects-2010:*

(i) Assuming that employment in industry and services will grow during 2010-20 at the same rate as during the previous decade the share of employment in agriculture will fall to 40 per cent by 2020 (the same level as that of China in 2010). Population in the working age group will grow based on projections by the UN Population Division.

(ii) Assuming the labour force participation rate and the unemployment rate to be unchanged at 2010 levels, 2.8 million jobs will be missing by 2020.

(iii) To put this in perspective, this will only be 0.5 per cent of the labour force. While any shortfall in jobs is problematic, there does not seem an immediate cause for alarm.

There are a large number of assumptions which go into this estimate. For instance, labour force participation is pegged at the 56 per cent rate, the same as in 2010. If instead, more women enter the labour force, reversing the declining trend since 2000, the labour force participation rate could plausibly increase to 58 per cent by 2020. This is lower than the 60 per cent rate in 2000, but even with this conservative assumption, the number of missing jobs increases to 16.7 million, roughly six times that in the baseline scenario, and 3.7 per cent of overall employment in 2010. Finally, if the official unemployment is projected to decrease, say by 2 percentage points, over the next decade, again that would imply the need to employ a larger number of workers. The number of *missing jobs* in 2020 under this higher expected employment scenario is estimated at 11.8 million or four times that in the baseline scenario.

The back-of-the-envelope calculations done above should be taken as just starting point for more careful investigation. While a simple extrapolation of existing trends suggests India can absorb the labour exiting agriculture even if exits increase to the level experienced by China, there is no room for complacency. Minor changes in assumptions lead to tens of millions of additional jobs needed. So even while policymakers focus on making jobs more productive, India also needs more jobs than suggested by current trends so as to have a sufficient buffer.

REASONS BEHIND LESS CREATIVE JOBS

India's policies have created such a situation that too many small firms stay small and unproductive and are not allowed graceful close down. Too many large profitable firms/bisinesses prefer relying on temporary contract labour and machines than on training workers for longer-term jobs. We may visit the problem through two routes:

(i) Impediments to Business Growth
(ii) Labour Regulations

I. IMPEDIMENTS TO BUSINESS GROWTH

As a group, it is estimated that micro, small, and medium enterprises (MSMEs)[11] employ 81 million people in 36 million units across the country.[12] Yet, many of these firms are unable to grow and/or even shut down. As per a recent study,[13] as compared to surviving small firms in the United States which grow spectacularly, surviving small firms in Mexico grow moderately, while surviving small firms in India shrink. Productivity is commensurately lower in India. Indeed, within the MSME group, there is a strong concentration of small enterprises and near non-existence of medium enterprises. And that is the real challenge of the MSME sector—to be able to not just start up, but also continue to grow, thereby becoming a source of sustainable jobs and value creation.

Too many firms in India stay small, unregistered, unincorporated, largely informal, or in the unorganised sector because they can avoid regulations and taxes. These firms have little incentive to invest in upgrading skills of largely temporary workers or in investing in capital equipment that could bring them into the tax net, so their productivity stays low. Low productivity gives them little incentive to grow, completing the vicious circle. These firms face some of the key challenges while starting up and at every level of growth.

REGULATORY ENVIRONMENT

The regulatory environment plays an important role in the lifecycle (birth, growth, and death) of MSMEs. We may cite few glaring comparative examples from some sources:

1. As per the **World Bank's** *'Doing Business: Measuring Business Regulations', 2013'*–
   (a) India ranks 132 out of 185 countries in ease of doing business,
   (b) Starting a business where India ranks 173, takes about 12 procedures, 27 days, and a paid up capital of 140 per cent of per capita income.
   (c) By contrast, it takes only 7 procedures, 19 days, and 18 per cent of per capita income on average for our neighbours in South Asia.
   (d) After getting done with the ***initial procedures***, entrepreneurs have to obtain a number of clearances when applying for building/occupancy permits and utility connections. These require separate visits to various authorities whose employees often inspect the site.
   (e) It takes as long as 1.5 months to obtain an electricity connection in 7 out of the 17 benchmarked Indian

11. The criterion of investment in plant and machinery is used to categorize MSMEs—micro enterprises have investment ceiling of 25 lakh, small enterprises of 5 crore, and medium enterprises of 10 crore.
12. These data are from the Ministry of Micro, Small, and Medium Enterprises and include registered and unregistered units across manufacturing and services (including wholesale/retail trade, legal, educational, and social services, hotels and restaurants, transport, and storage and warehousing).
13. C. Hsieh and P. J. Klenow, ***'The Life Cycle of Plants in India and Mexico'***, Chicago Booth Research Working Paper No. 11-38, 2011.

cities. Many processes especially at state level remain complex, forcing companies to hire a consultant, thereby adding to the costs.

(ii) An easier ***process of exit*** is needed for the MSME, which can quicken and simplify the process of resolving the claims of workers and financiers so that the assets of the failed firm can be put to better use. According to *World Bank's 'Doing Business in India, 2009'*—

(a) Across 17 Indian cities, the insolvency process takes on average 7.9 years, costs 8.6 per cent of the estate value (mostly due to attorney fees, newspaper publication costs, liquidator's fees, and preservation costs), and the recovery rate is only 13.7 per cent.

(b) The process is slower even than in other South Asian countries where, in the same year, it took on average five years and creditors could expect to recover on average 19.9 per cent.

(c) Low asset recovery in failed firms feeds into lower levels of financing for Indian MSMEs.

The government has tried to compensate for some of these impediments by offering MSMEs incentives and concessions. But schemes and interventions based on tightly defined classifications create an incentive structure that might prevent firms from growing. Service tax exemptions for firms with less than Rs 10 lakh revenue and exemption from central excise duty for firms with an annual turnover of less than Rs 1.5 crore are examples of these schemes. The jump from 'small' to 'medium' enterprise especially entails loss of several perks.

(iii) However, there are, also many good practices and regulations strewn over different cities of India, which, if standardised and adopted across the country, can improve the business climate enormously. The *World Bank's 'Doing Business in India, 2009'* has shown that if a hypothetical city called 'Indiana' were to adopt best practices found in several benchmarked cities (e.g. lowering number of procedures to start business to Patna levels, days to start a business to Mumbai levels, procedures around construction permits to Ahmedabad levels, days to enforce a contract to Guwahati levels, and recovery rate for closing a business to Hyderabad levels), it would rank a much improved 67 out of the 181 economies measured.

Difficult Funding

Indian banks and financial institutions are wary of lending to MSMEs because they lack adequate credit histories or collateral. A cluster-centric approach is one way of addressing this because it reduces transactions costs for the lender, while repeated interactions for a lender with cluster members increases the scope for building trust. While there have been efforts to facilitate these, their coverage is still small. Schemes such as credit guarantees by the Small Industry Development Board of India (SIDBI) have been useful, but there are gaps.

The presence of *Angel investors*, *venture capital funds*, and *impact investors* are still at a nascent stage and small compared to global peers. Most of these investments are biased towards services, especially technology and e-commerce. Government funds (through grants and seed funding programmes such as Technopreneur Promotion Programme and Technology Development Board) are often

available after extensive paperwork and slow processing. Moreover, the experience from other countries is that new venture finance is often an activity better left to the private sector, with the government facilitating the way or piggy-backing on private funding rather than actually taking the lead.

To the extent large banks are concerned, with remote central offices they tend to have bureaucratic procedures for loan approvals, and limit discretionary authority for branch officers. As a result, small and medium enterprises, which tend to have short and largely informal track records, find it hard to fulfil the norms for obtaining credit.[14] Moreover, conversations with bankers and business people suggest that large banks exert less effort in trying to help a small troubled firm than they would a larger client. As a result, in countries with more varied banking systems, small firms tend to migrate to smaller banks for assistance.[15] Better funding to MSMEs can happen with the presence of more small local banks in India.

A vibrant *corporate bond market* could serve more in this scenario. Even then the MSMEs will not be able to issue bonds, but as large firms will migrate to the 'bond route' (as they are typically cheaper) it will make space on the bank balance sheets for MSME loans.

Lack of Quality Infrastructure

The lack of quality infrastructure (roads, utilities, real estate, logistics) increases transaction costs disproportionately for MSMEs which typically cannot create customised alternatives such as access roads and captive power plants which larger firms can. Absence of this supporting infrastructure causes *greater cash burn* and distraction of management from core business operations. One constraint in creating infrastructure or setting up businesses is **land acquisition**. A number of reforms are needed or are on the anvil (see the next sub-title *'Land Reforms'*) to ensure that land is less of an impediment to growth.

Land Reforms

Land is probably the single most valuable asset in the country today. Not only could greater liquidity for land allow more resources to be redeployed efficiently in agriculture, it could ease the way for land-utilising businesses to set up. Perhaps as important, it could allow land to serve as collateral for credit. Three important steps are needed regarding it[16]:

(i) to map land carefully and assign conclusive title,
(ii) to facilitate land leasing, and
(iii) to create a fair but speedy process of land acquisition for public purposes.

The National Land Records Modernisation Programme (NLRMP), started in 2008, aims at updating and digitising land records by the end of the Twelfth Plan. Eventually, the intent is to move from *presumptive title* (where registration of a title does not imply the owner's title is legally valid) to *conclusive title* (where it does). Important points related to this process may be summarised as follows:

(i) Digitisation will help enormously in lowering the costs of land transactions, while conclusive title will eliminate legal uncertainty and the need to use the government as an intermediary for

14. Allen Berger, Nathan Miller, Mitchell Petersen, Raghuram Rajan, and Jeremy Stein (2005***), 'Does Function Follow Organisational Form? Evidence from the Lending Practices of Large and Small Banks' Journal of Financial Economics***,76: 237–69.

15. Ibid.

16. ***Economic Survey 2012–13,*** MoF, GoI, p. 40

acquiring land so as to 'cleanse' title.

(ii) Given the importance of this programme, its rollout in various states needs to be accelerated. Easier and quicker land transactions will especially help small and medium enterprises that do not have the legal support or the management capacity that large enterprises have.

(iii) Prohibitory *land leasing norms* raises the cost to rural-urban migration as villagers are unable to lease their land, and often have to leave the land untilled or leave a family member behind to work the land. Lifting these restrictions can help the landless (or more efficient landowners) get land from those who migrate, even while it will allow landowners with education and skills to move to industry or services.

(iv) Compulsory registration of leaseholds and of the owner's title would provide tenants and landowners protection.

(v) Of course, for such a leasing market to take off, owners should be confident that longterm tenancy would not lead to their losing ownership. With a vibrant leasing market, and clear title, there should be little reason for not strengthening ownership rights.

(vi) For large projects with a public purpose, such as the proposed National Industrial and Manufacturing Zones, which will facilitate the setting up of small and medium enterprises, large-scale land acquisition may be necessary.

(vii) Given that the people currently living on the identified land will suffer significant costs including the loss of property and livelihoods, a balance has to be drawn between the need for economic growth and the costs imposed on the displaced.

(viii) The Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Bill 2011, currently before Parliament, attempts to draw such a balance. As experience is gained with large-scale land acquisition, the institutions set up by the bill can be fine-tuned to achieve its aims.

(ix) Finally, encouragement needs to be given to land readjustment schemes, where when an area is identified for development, owners participate by giving up some of their land for infrastructure creation, but get back the rest, with the benefit that its value is enhanced by the infrastructure. Small and medium enterprise clusters can benefit especially from such schemes.

(x) Given that large-scale land acquisition is still at a nascent stage, central schemes should allow room for states to experiment and should be modified, the light of the experince of states.

This measure will also create a conducive environment for 'corporate' and 'contract' farming which is not picking up due to absence of a proper 'land-leasing' norm in the agriculture sector. But then the 'labour law' reform will also be needed which will benefit the business and industries, too.

The major **non-labour impediments** for a small business to become formal and grow large, as well as some steps the government is taking have been highlighted here, there is evidence that these constraints affect industrial performance. After classifying industries according to their intensity of use of infrastructure, or dependence on external finance, it has been found out:[17]

17. P. Gupta, R. Hasan, and U. Kumar, ***'Big Reforms but Small Payoffs: Explaining the Weak Record of Growth in Indian Manufacturing',*** in S. Bery, B. Bosworth, and A. Panagariya (eds.), ***India Policy Forum***, Vol. 5, Sage Publications, Delhi, 2008, pp. 59-108

(i) that post delicensing, industries more dependent on infrastructure, grew less as compared to industries which are not as dependent on infrastructure; and

(ii) the gain in manufacturing-sector output in these industries has been especially small in states with inferior infrastructure.

(iii) that industries more dependent on external finance have witnessed slower growth as opposed to those less dependent on external finance, and have fared much worse in terms of new factories, employment generation, as well as new investment.

Therefore, there is need to take steps for improving infrastructure, access to finance, as well as the overall business environment. It is hoped that massive infrastructure projects like the ***DMIC*** (Delhi-Mumbai Industrial Corridor) will provide relatively light regulation, and heavy infrastructure, where businesses have easy access to the land they need and workers can live in a safe healthy township (see the next sub-title '*The DMIC*').

THE DMIC

Conceived by the Ministry of Economy, Trade and Industry (METI) of Japan and the Ministry of Commerce and Industry (MoCI) of India, the DMIC seen as an example of India's 'Integrated Approach to Industrial Growth and Development'. This is being developed by the Government of India with a view to using the high-capacity western Dedicated Freight Corridor as a backbone **for creating** a global manufacturing and investment destination. The project seeks to develop a series of futuristic infrastructure-endowed smart industrial cities that can compete with the best international manufacturing and industrial regions. The *master plan* has a vision for 24 manufacturing cities. Potential production sectors include general manufacturing, IT/ ITES components, electronics, agro and food processing, heavy engineering, pharmaceuticals, biotechnology, and services. Total investment is pegged at $90 billion. ***Special features*** [18] of the the Project are as given below :

Possible Socio-economic Impact: Its Influence Area of 436,486 sq. km is about 13.8 per cent of India's geographical area. It extends over seven states and two union territories, viz., Delhi, Uttar Pradesh, Haryana, Rajasthan, Madhya Pradesh, Gujarat, Maharashtra, Daman and Diu, and Dadra and Nagar Haveli. Around 17 per cent of the country's total population will be affected. The project goals are to double employment potential in 7 years, triple industrial output in sector on a sustained basis over next three years.

Urban Governance: Its innovative urban governance framework corporatises the urbanisation process. The central government will create a corpus fund, the 'DMIC Project Implementation Revolving Fund', as a trust administered by a board of trustees. The fund will contribute debt and equity to the SPVs (Special Purpose Vehicles) on a case-by-case basis. Land will be made available by the state government. The city SPVs will be vested with the responsibilities of planning and development and the power to levy user fees. The SPVs are to be companies under the Companies Act. The valuation increases from urbanisation and development will accrue to the city-level SPVs, and will be reinvested in the cities. The initial construction of the cities will be done through project managers with global experience, who will control, monitor, review, and supervise the detailed engineering.

18. Presented by the ***Economic Survey 2012-13,*** MoF, GoI, p. 41 with inputs coming from Amitabh Kant, CEO & MD and Abhishek Chaudhary, Vice-President, DMIC Development Corporation Limited.

Financing: Its trunk (basic) infrastructure is unlikely to be commercially viable that is why it would require government funding. Such internal infrastructure projects include land improvement, road works, earthworks, sewerage, storm water drainage, flood management, and solid waste management. Once such infrastructure is in place, the subsequent additions to the cities will be commercially viable and can be implemented through public private partnerships (PPPs). For major infrastructure activities such as power plants, integrated townships, and highways, PPP projects are planned. Various sources of funding have been planned as multilateral, bilateral, and domestic government.

Physical Infrastructure: The Multi-modal High Axle Load Dedicated Freight Corridor (DFC), 'a high-capacity railway system', is at the heart of the infrastructure. It will cover 1,483 km and will have nine junction stations along which other railroad networks will connect allowing the system to extend its reach across a wide area. Other infrastructure plans include logistic hubs, feeder roads, power generation facilities, up-gradation of existing ports and airports, developing greenfield ports, environment protection mechanisms, and social infrastructure.

Industrial Infrastructure: It seeks to upgrade existing industrial clusters and also develop new industrial facilities—to be developed on the concept of 'node-based development', based on Investment Regions (IRs) and Industrial Areas (IAs). These are proposed as self-sustaining industrial townships with world-class infrastructure including domestic/international air connectivity, reliable power, and competitive business environment. IRs will have a minimum area of 200 sq. km. and IAs 100 sq. km. In all 24 manufacturing cities (IRs and IAs) are planned. Seven major manufacturing cities are being planned for the first phase. These will serve as the key nodes for overall growth and development.

Power Infrastructure: Power for the industrial and residential zones is an essential requirement. The provision of world class power infrastructure will require 'twenty-four hour' good quality supply. The major power inputs will come from six gas-based projects of around 1000–1200MW each. Other power options include the use of renewable energy sources integrated through a smart grid.

Skill Development: The skill-building strategy underlying the DMIC is based on a 'hub-and-spoke' model in which one Skill Development Centre in every state with subsidiary institutions linked to it. Curricula will be based on the types of industries located in the region and identified regional strengths.

Land Acquisition: Land acquisition appears to be a major challenge. Different state governments are adopting diverse approaches for dealing with the issue. Gujarat has a 'land-pooling' model whereby 50 per cent of the land is acquired while the remaining 50 per cent is left with the original owners giving them a stake in the upsides generated by land monetisation. Maharashtra allows for 'negotiated purchase' involving various stakeholders. In Haryana and Rajasthan, trunk and industrial infrastructure are created by the state governments but private developers directly participate in the other activities. The value increase is captured by the states through development fees. Furthermore, in the initial DMIC master-planning process, the attempt was made to identify large, easy-to-acquire land parcels that were either barren or government owned.

Environmental Clearances: The master-planning process was put forward for a general Terms of Reference clearance, which has already been obtained. This has reduced the compliance load for individual project clearances. The individual projects will now need to get their draft impact assessments cleared by the respective state pollution control authorities.

Water Management: As the corridor passes through relatively arid parts of the country, the industrial hubs are to have integrated water resource management plans drawing upon lessons from countries such as Singapore. It is proposed to make each manufacturing city self-reliant and sustainable in terms of its water requirements. Recycling is a major strategy in all the industrial nodes.

Steps to Improve Business Climate

The business climate of India has not been conducive enough for the arrival, growth and winding-up of the MSMEs. By effecting some regulatory changes, the business climate for MSMEs can be improved in a great way which they may be summarised as follows:[19]

Common policy: There are a vast number of business regulations that often overlap and sometimes contradict each other. A common policy and an institutional architecture overseeing all business regulations will help consolidate and enact changes.

Facilitation: Establishing independent facilitation and coordination agencies as PPP service companies with mandate from the state government, staffed with specialists and responsible for getting work done through various departments for starting up and running of businesses. These agencies will also help arrange services such as financing, finding raw material suppliers, and marketing products. They will charge a fee for some of the services provided, and be financially selfsufficient.

Simplification of Registrations: Creating a one-stop online registration system for time-bound registrations for starting a business. The applicant will need to file a single application on the website, with the required information being picked up by each government department. Over time, this process can be extended to other activities such as trading across borders and paying taxes. This will require detailed mapping exercises and setting up of a 'best practices' framework.

Easier Compliance after Growth: Enabling compliance ratings of MSMEs (through ISO-like common standards) and allow easier compliance norms to firms with higher ratings. Easier norms can take the form of simpler procedures (such as self-certification) across government departments. For instance, a company with a good history of tax compliance should be treated as a good citizen when it deals with the pollution control board. Over time, high compliance ratings could also act as a signal to financiers and enable easier access to credit.

Easy Exit: The arduous process of exit for unsuccessful companies needs to be made simpler, faster, and cheaper.

Transforming Employment Exchanges: Transforming the 1,000-odd employment exchanges across states into career centres offering counselling, assessments, apprenticeships, training, and jobs.

Improving Statutory Pre-emptions: Currently for low wage workers in formal employment, the plethora of statutory pre-emptions, especially

19. Various issues of the ***Economic Survey;*** Employment and Unemployment Situation in India (various years), ***NSSO,*** Ministry of Statistics and Programme Implementation (MOSPI); ***Census of India,*** as has been presented by the ***Economic Survey 2012–13,*** MoF, GoI, p. 42. *Notes* : Industry includes manufacturing, construction, mining, and utilities. Organized-sector employment is obtained from the ***Economic Survey.*** The organized sector consists of non-agricultural establishments in the private sector that have 10 workers or more, and all establishments irrespective of size in the public sector. For the other subsectors within industry, the organized sector essentially refers to all companies and government administrations. Unorganized-sector employment is estimated by deducting estimates of organized employment from total employed workforce. Total employment is generated by multiplying the worker population ratio (from the NSSO Employment-Unemployment Surveys) by the estimated population of India as per ***Census*** sources.

for provident fund and health insurance, can lead to very low net salary and act as disincentive to formal employment. The value and benefits received from these pre-emptions can be improved by encouraging competition between different pension and health schemes.

Reducing Attractiveness of Staying Small: Growing bigger is unattractive in India because some of the benefits targeted at MSMEs are withdrawn while some new regulations and obligations come upon them. Innovative approaches are needed for giving MSMEs the incentive to grow. For instance, new regulations could be kept in abeyance for a period after the MSME crosses the size threshold that would require it to meet the regulation.

II. Labour Regulations

India has a number of labour practices that, economists have argued, further impede the creation of productive jobs in the largescale organised sector. There exists considerable variation in hiring practices across firms of different sizes in India. A recent study [20] finds that the job creation rate is much bigger for small firms than for large ones; on the other hand the job destruction rate is higher in large firms, with the result that the net employment rate in large firms is negative and strikingly smaller than in small firms.

In the same way, organised industry creates few jobs compared to unorganised industry (which is dominated by small firms). Growth in unorganised industry jobs in 2009–10 is primarily explained by a dramatic growth in construction. Based on data from National Sample Survey Organisation (NSSO) surveys, employment in construction increased by 70 per cent between 2004 and 2009. One recent development is the significant pickup in growth of the organised industry sector jobs in 2009–10. However, two points may be of note. First, this growth is characterised by adding mostly to 'informal' jobs within the formal sector with little increase in productivity. Second, despite the recent pickup in organised-sector job growth, unorganised-sector employment still constitutes more than 95 per cent of overall industry employment; specifically within manufacturing, unorganised-sector employment comprises 70 per cent of overall employment.

Why more jobs are not being created by India's large organised manufacturing? There are several possible explanations. First, strict labour laws may have hindered the growth of organised large-scale manufacturing. India, the employment protection legislation (EPL) laws are stricter than in all but two OECD countries. However, very few workers are actually covered by these laws. Indeed, India may suffer the consequences of strong worker protection (low flexibility for employers and strong reluctance to offer workers formal jobs) without giving most workers the benefits. Although the direct impact of India's labour regulations has been a subject of intense debate, there is a substantial body of evidence which suggests that rigid labour regulations have played a significant role in explaining low organised manufacturing output and employment and high informal manufacturing output.

However, some economists dispute the evidence that establishes the importance of labour regulations in determining economic

20. S. Dougherty, V. C. Frisancho Robles, and K. Krishna, ***'Employment Protection Legislation and Plant-Level Productivity in India',*** NBER Working Paper No. 17693, 2011. The study has taken data upto 2004 and has applied the silmilar methodology as applied by the economists Steve Davis, John C. Haltiwanger, and Scott Schuhh, Job Creation and Destruction, MIT Press, Cambridge, 1998.

outcomes. In India's case, one of the first and most frequently cited studies on the topic[21] has come under extensive criticism [22]. While more work has been done that addresses some of these criticisms, the evidence on the effects of labour regulations outside of India is also mixed. As per the World Bank,[23] 'A careful review of the actual effects of labour policies in developing countries yields a mixed picture. Most studies find that impacts are more modest than the intensity of the debate would suggest.' If labour laws really constrain firms, they would respond in predictable ways:

(i) Relying more on capital instead of labour
(ii) Resorting to informal arrangements/ limiting their scale in order to remain outside of the formal sector altogether, and/or
(iii) Hiring contractual labour

The increased use of capital-intensive techniques is reflected in a steeply rising capital/ labour ratio for the organized economy.[24] This raises the obvious question whether it is justifiable for a relatively labour abundant country like India with low wages to be increasingly resorting to more capital-intensive technology. Of course, as we have argued earlier, countries would use more capital per worker as they get richer, but the capital intensity is higher and has increased at a much faster rate for large firms than for small firms in India, even while they have created fewer jobs.[25]

Firms would also resort to informality if labour laws were overly constraining (as has been argued earlier in this chapter). The extent of informality in India stands out relative to countries at similar levels of development (discussed in the next sub-title *'Informality of Employment in India'*). Roughly 85 per cent of the workforce in India is engaged in the informal sector all of which are unincorporated enterprises operated on a proprietary or partnership basis and with less than 10 employees. The prevalence of informal employment – workers in either the informal sector or in the formal sector but lacking employment or social security benefits is even higher; 95 per cent of jobs are informal and 80 per cent of non-agriculture wage workers work without a contract.

There is **advantage of formal employment** via contracts for worker training and learning, especially if contracts have a significant probability of being rolled over into the long term. Experience is important for skill development. With a paucity of technical/vocational training institutions (say like the *German model*) in India, 'on-the-job learning' is one of the easiest and most viable models of human capital accumulation. Employment that is likely to endure provides incentives to the firm for nurturing skill building and to the worker for developing skills. These contracts necessitate *backloading* of pay and incentives (compensation increases with experience) so that workers do not avail of the training and leave. In contrast, informal and temporary contracts are in fact flat and sometimes even *frontloaded*, absolutely the inverse of the desired architecture. Long-lasting employment does not mean tenure for life, which is the other extreme of the contract space commonly

21. T. Besley and R. Burgess, ***'Can Regulation Hinder Economic Performance? Evidence from India.' Quarterly Journal of Economics,*** 119 (1), 2004, pp. 91-134.
22. A. Bhattacharjea, ***'Labour market regulation and industrial performance in India: A critical review of the empirical evidence,' Indian Journal of Labour Economics***, 49 (2), 2006, pp. 211–232.
23. World Bank, ***'Doing Business: Measuring Business Regulations'***, 2013.
24. Prachi Mishra, ***'Has India's Growth Story Withered?', Economic and Political Weekly,*** Vol. XLVIII No. 15, N. Delhi, April 13, 2013.
25. S. Dougherty, ***'Labor Regulation and Employment Dynamics at the State Level in India'***, OECD Economics Department Working Papers No. 624, 2008

found in India. Permanent employment not only limits firm flexibility, it also reduces some workers' incentives to learn or exercise effort. An intermediate structure that exists in most countries is contracts that allow termination in situations of firm distress or for poor worker performance, but with carefully designed and effective redressal mechanisms if the employee is fired without cause, as well as compensation for severance and unemployment benefits.

Whatever be the causes, the fact is that India is not creating enough productive jobs. Moreover, India has the *dubious distinction* of having some of the most comprehensive labour laws in the world, even while having one of the largest fractions of the working population unprotected. Not only do informal workers have lower productivity and earn less, but they are also more vulnerable to violations of basic workers' rights such as reasonable working conditions and safety at work. It may be the stringent protection that is afforded by existing regulations that is responsible for both the 'paucity of good jobs' as well as the inadequate protection that most workers have. In India, reforms are typically implemented only after they have been subject to a lot of debate and after some sort of ***political consensus*** is reached on them. It is therefore imperative that consensus building on **labour market reforms** should start soon. India needs many more firms in the formal sector, especially firms that continue growing and creating productive jobs. India may take some ideas from Mauritius as how did it undertake reforms that improved employment.

It may take time to build political consensus for fundamental reforms. In the meantime, states could be allowed more flexibility to experiment without coming into conflict with central statutes. As best practices evolve, success in job growth will resolve theoretical debates more easily than a thousand papers. If indeed, rigid labour laws are determined to be the key constraining factor in the creation of productive jobs. Win-win reforms are easily available. Existing permanent workers can continue till retirement with their privileges left untouched. The remaining workers could be encouraged to move into contractual employment that can be terminated, but which gives the worker some protections including severance pay, unemployment insurance, and the right to reverse unfair dismissal through appeal.

In the meantime, the government should continue to create a minimum safety net for informal workers (in the informal sector and in informal work arrangements in the formal sector) by, for example, extending the reach of national-level schemes such as the RSBY (Rashtriya Swasthya Bima Yojana) and the NPS (New Pension Scheme) and introducing *unemployment insurance schemes* (e.g. Supplementary Unemployment Benefits Fund to be created by automotive companies).

INFORMALITY OF EMPLOYMENT IN INDIA

The *extent, causes* and *consequences* of informality in India's employment can be seen by the following way:

1. Extent of Informality

India has witnessed impressive economic growth over the past 20 years, but despite of it, the vast majority of Indian workers continue to toil in informal employment.

(i) Roughly 85 per cent of the workforce is engaged in the *informal sector*; even after excluding the agricultural sector, the share of the workforce in the informal sector remains at 70 per cent.[26] The prevalence of *informal employment* workers in either

26. As of 2009-10. The informal sector is defined by the National Commission for Enterprises in the Unorganised Sector (NCEUS) as all *unincorporated* enterprises operated on a proprietary or partnership basis and with less than 10 employees.

the informal or formal sector who lack employment or social security benefits is even higher.

(ii) While precise estimates of the extent of informal work arrangements are hard to come by, a detailed study by the National Statistical Commission reveals that as of 2004–05, 95 per cent of jobs are informal and these are not limited to the informal sector, even in the public sector, 33 per cent of all jobs in India are informal.[27]

(iii) Among wage employees outside of agriculture, more than three-quarters have no written contract, 70 per cent are not eligible for any paid leave, and 74 per cent are not covered by social security benefits. Along all of these measures of informality, India saw an uptick over time.[28]

(iv) "While high levels of informality are not uncommon in South Asia, India (along with the rest of the region) stands out from an international perspective. Using lack of pension coverage as a proxy for informal employment, 91 per cent of the labour force in South Asia is informal, surpassed only by Africa. Compared to countries at a similar level of development, India's very low usage of written contracts for its non-agricultural employees, 80 per cent of whom work without a contract, also stands out. This figure is higher than for, for example, China, Pakistan, Ghana, and South Africa. This is despite the fact that India's share of employment in the informal sector is roughly in line with that of its peers and confirms the significant prevalence of informal arrangements within the formal sector."[29]

2. Causes of Informality

Informal employment results both from workers being excluded from formal jobs and from workers or firms voluntarily opting out of formal employment.

(i) The 'exclusion' view of informality emphasises the *dual nature* of labour markets, in which a highly productive formal sector coexists with a subsistence informal sector, which absorbs excess labour.

(ii) It has been found out through evidence that constraints to the expansion of the formal sector model (such as insufficient capital accumulation and natural resources)[30] or overly burdensome costs of registering[31] lead to persistent informal employment.

(iii) As per the 'voluntary' view, firms and workers decide on whether to become formal by comparing the perceived costs of being formal with its perceived benefits. In this setting, labour institutions, taxation, and regulations primarily explain the prevalence of informal employment, by effectively increasing the

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27. The incidence of informal jobs in the formal sector is highest among the non-informal household sector—95 per cent of jobs are estimated to be informal, as has been studied by R. Kolli, A. Sinharay, ***'Share of Informal Sector and Informal Employment in GDP and Employment', Journal of Income and Wealth,*** 33(2), July-December 2011.
28. National Sample Survey, ***'Informal Sector and Conditions of Employment in India',*** Report No. 539, January 2012.
29. R. Nayar, P. Gottret, P. Mitra, G. Betcherman, Y. Lee, I. Santos, M. Dahal, M. Shrestha, ***'More and Better Jobs in South Asia',*** World Bank, 2012.
30. A. Lewis, ***'Economic Development with Unlimited Supplies of Labour'***, The Manchester School of Economic and Social Studies, May 1954.
31. H. De Soto, ***'The Other Path',*** Harper and Row Publishers, New York, 1989.

costs of formality. At a cross-country level, countries with more burdensome entry regulations have larger informal sectors.[32] The labour laws of India may incline firms to go for informal arrangements, rely more on capital instead of labour, or limit their scale in order to remain outside of the formal sector altogether. This issue has been discussed in the next sub-title '*Labour Laws as Impediments*').

3. Consequences of Informality

The high rate of informality in India is a drag on its economic development and a source of considerable inequity.

(i) Productivity differences between workers in the formal and informal sectors are large, suggesting that moving a worker from an informal to a formal firm would bring about sizeable gains from improved allocation of resources.

(ii) Rough estimates suggest that an informal job in the formal sector has double the value added than an informal job in the informal sector. And importantly, the value added per worker in a formal job within the formal sector is almost ten times that in an informal job in the formal sector. Therefore, loosely speaking, the benefits of moving into contracts within the formal sector are likely to be substantial and significantly higher than the gains from moving an informal-sector worker into an informal job within the formal sector.[33]

(iii) Besides earning less, informal workers are also more vulnerable to violations of basic human rights such as reasonable working conditions and safety at work. With little job security and limited access to safety nets, most of the informally employed remain extremely vulnerable to shocks such as illnesses and loss of income. This is why a strong correlation exists between informality and poverty in India.[34]

(iv) From the point of view of firms, informal work arrangements bring benefits: lower price and greater flexibility in adjusting the quantity of labour in response to fluctuating demand. Yet, these benefits are partly offset by costs, such as low worker loyalty and inadequate incentive to invest in worker skill building. Moreover, any net benefits need to be weighed against the social costs to the workers and the economy as a whole.

(v) Finally, persistently high levels of informality come at a significant fiscal cost in terms of forgone fiscal revenue.[35] In 2004–05, the unorganised sector contributed roughly half of India's GDP[36] implying a significant expansion of the tax base if the informal sector were to join the formal economy. The high

32. S. Djankov, R. La Porta, F. Lopez-de-Silanes, and A. Schleifer, ***'The Regulation of Entry', Quarterly Journal of Economics,*** 117(1): pp. 1-37, 2002.
33. These rough estimates provide an upper bound of the difference in value added across formal and informal jobs, since informal workers may not be as productive as formal-sector workers for reasons unrelated to their employment status, such as lack of education or skills. The causality could also go the other way if firms that are less productive are more likely to employ informal workers.
34. As per the National Commission for Enterprises in the Unorganised Sector (NCEUS), 2011.
35. S. Levy, ***'Good Intentions, Bad Outcomes: Social Policy, Informality and Economic Growth in Mexico',*** Brookings Institution Press, Washington, 2008.
36. National Statistical Commission, ***'Report of the Committee on Unorganised Sector Statistics'***, Ministry of Statistics & Programme Implementation, GoI, N. Delhi, 2012, p. 30.

The Mauritian Miracle

While Mauritius was assuming self-rule from the British, two noted intellectuals (and to be **Nobel laureates**), James Meade (economics) and V.S. Naipaul (literature) prophesied a bleak future for this small island. In the 1960s, Mauritius was heavily dependent on one crop, *sugar*, was prone to 'terms-of-trade' shocks, and was undergoing rapid increase in population. What followed though was counter to their predictions. Between 1977 and 2006, real GDP grew by an average of 5.2 per cent per annum. Per capita GDP growth averaged 4.2 per cent versus 0.7 per cent for the rest of Africa. From 1970 to 2008, life expectancy increased from 62 to 73 and infant mortality dropped from 64 per 1000 births to 15.

What explains this performance? A leading factor in the first two decades of turn around is the creation and efficient management of the EPZs (Export Processing Zones). Some major characteristics of the 'Mauritius EPZ' were:

(i) It was not a geographical zone – any firm could opt into the regulatory scheme.

(ii) The main policies were – ease of inputs and materials imports, no restriction on repatriation of profits, a 10-year income tax holiday for foreign investors, a policy of centralised wage setting, and an implicit assurance that labour unrest would be minimized and wage increases moderate.[37]

(iii) Firms were allowed to constantly adjust labour force through layoffs and realistic compensation packages and allowed greater flexibility in work hours.

(iv) It had relaxed laws so that women could participate to a greater extent.

These structural transition had a very positive and quicker impact on the economy. The first stage was motivated by a productive structural shift and ensuring full employment. By 1990, about one-third of the labour force on the island, 90,000 people, was employed in the EPZs. Jobs added in the EPZs accounted for two-thirds of the total increase in employment between 1970 and 1990. Increased per capita incomes from this transition eventually fuelled more human capital build-up, allowing further diversification into services.

prevalence of informality also hampers the ability of economic policies to have direct and quick impact on the economy.

Labour Laws as Impediment

A rapid expansion of the manufacturing sector has been a key element of the growth experience of successful developing countries, especially labour-abundant ones. In this context, the Indian manufacturing sector exhibits many peculiarities:

(i) It contributes (also documented earlier in the chapter) a rather small and stagnant share to GDP;

(ii) Its composition is more skewed towards skill and capital intensive activities compared to countries at similar levels of development;[38]

(iii) Only a small share of employment in manufacturing is in organised manufacturing. The unorganised

37. P. Romer, ***'Two Strategies for Economic Development: Using Ideas and Producing Ideas'***, Proceedings of the World Bank Annual Conference on Development Economics, 1992.
38. A. Panagariya, ***'India: The Emerging Giant'***, Oxford University Press, New York, 2008.

manufacturing sector accounted for almost 70 per cent of total manufacturing employment in 2009–10; [39]

(iv) Employment is heavily concentrated in small firms. The degree of concentration is much higher than in other Asian countries. For example, the share of micro and small enterprises in manufacturing employment is 84 per cent for India versus 27.5 per cent for Malaysia and 24.8 per cent for China.

These characteristics of Indian manufacturing are quite puzzling in that product market reforms since the early 1990s, including dramatic trade liberalisation and virtual abolishment of the industrial licensing regime, have been primarily focused on removing various constraints on the manufacturing sector. How then does one explain the peculiarities of the Indian manufacturing sector? Several theories have been put forward to explain this puzzle, ranging from strict labour laws that have hindered growth, especially of labour-intensive industries, infrastructure bottlenecks that have prevented industries from taking advantage of reforms, and credit constraints due to weaknesses in the financial sector which may be holding back small and medium sized firms from expanding. India's labour regulations have been criticised on many grounds including sheer size and scope , their complexity, and inconsistencies across regulations:

(i) There are 45 different national and state level labour legislations in India.[40] The labour laws apply only to the organised sector.

(ii) As the size of a factory grows, it increasingly becomes subject to more legislation. A few specific pieces of the legislation are particularly constraining.

(iii) According to Chapter VB of the **IDA** (Industrial Disputes Act), it is necessary for firms employing more than 100 workers to obtain the permission of state governments in order to retrench or lay off workers.

(iv) While the IDA does not prohibit retrenchment, states have often been unwilling to grant permission. Section 9A of the IDA lays out the procedures that must be followed by employers before changing the terms and conditions of work, which introduces additional rigidities for firms in using their existing workers effectively.[41] In particular, worker consent is required in order to modify job descriptions or move workers from one plant to another in response to changing market conditions.

How do these regulations affect the manufacturing sector quantitatively?

Evidences[42] show that industrial performance has been weaker in states with pro-worker labour laws. There have also been several recent studies that establish the importance of labour regulations.[43] Estimates using plant-level data suggest that firms in labour intensive industries and

39. ***'Report of the Working Group on Employment, Planning and Policy for Twelfth Five Year Plan'***, Planning Commission, N. Delhi, 2012.
40. A. Panagariya, ***'India: The Emerging Giant'***, 2008, op. cit.
41. An employer must give a notice of three weeks in writing to the workers of any change in the working conditions including change in shift work, grade classification, rules of discipline, technological change that may affect the demand for labour, and changes in process or department. See Datta-Chaudhuri (1996) and Debroy (2010) for details.
42. T. Besley and R. Burgess, 2004, op. cit.
43. Studies such as – (a) S. Dougherty, V. C. Frisancho Robles, and K. Krishna, ***'Employment Protection Legislation and Plant-Level Productivity in India'***, NBER Working Paper No. 17693., 2011; (b) P. Gupta, R. Hasan, and U. Kumar, ***'Big Reforms but Small Payoffs: Explaining the Weak Record of Growth in Indian Manufacturing'***, In S. Bery, B. Bosworth, and A. Panagariya (eds.), India Policy Forum, Vol. 5, Sage Publications, N. Delhi, 2008, pp. 59-108.

in states with flexible labour laws have 14 per cent higher TFP than their counterparts in states with more stringent labour laws. Moreover, the impact of delicensing has been highly uneven across industries within India's organised manufacturing sector. In particular, labour-intensive industries have experienced smaller gains from reforms. In addition, states with relatively inflexible labour regulations have experienced slower growth of labour-intensive industries and employment. Further, the difference in the performance of labour-intensive industries in states with flexible labour laws and states with inflexible labour laws has increased over time. Labour laws may also be an important factor responsible for the skewed distribution of size in Indian industries. Firms in states with more inflexible labour regulations tend to be smaller, especially in the labour-intensive sub sectors of manufacturing.

A contrarian view is that Indian businesses have learnt to get around the laws by hiring contractual labour, outsourcing non-core activities, etc; it is thus argued that labour regulations are not a binding constraint to industrial performance and employment growth. Indeed, in surveys of firms, businesses do not list labour laws among the top constraining factors. One way of reconciling this response with the systematic empirical evidence discussed here is that firms have learned to adapt to the labour laws by either not hiring permanent workers or by staying below the threshold of these laws and therefore, they do not see them as a constraint. A study[44] points out that the counterfactual of whether labour laws would constrain firms that would emerge in the absence of strict labour laws cannot be captured in the surveys. Moreover, the adverse consequences of the labour laws can be inferred from the low rate of job creation in the formal sector, low productivity in the informal sector, and small firm size, especially in labour-intensive industries and states with more inflexible labour laws.

SERVICES NOT CREATING ENOUGH JOBS

While the share of employment in services in India was relatively high at take-off, its growth has since then been slow (as have been discussed earlier in this chapter). At the same time, the share in value added, which was high at take-off, has continued to rise quickly. This implies that *while productivity in the sector has been high, the services sector is not creating many jobs* this is the opposite of the problem with the industry.

In the process of business creation, there may some common impediments to services and industry both, for example, regulatory hurdles and access to funding and infrastructure. Labour regulations are also likely to constrain creation of jobs in services. For example, 27 per cent of retail stores in India report labour regulations as a problem for their businesses.[45]

But what stands out for the services sector is the importance of **education** and **skilling**. Suitable higher education is important for high-end services such as IT, software development, and finance. Mid-level services such as retail trade, hotels, and restaurant services also require adequate skilling of the labour force. The 'formal apprenticeship' programme of the government, which places ***employers at the heart of education,*** can play a powerful role in imparting job-relevant skills and also retraining, preparing, and upgrading the labour force. In its current form, the Act and

44. Krueger, A. O. (2007), ***'The Missing Middle',*** Stanford Center for International Development Working Paper No. 343.
45. Labour regulations for India's retail sector are contained in the Shops and Establishment Act (SEA), which includes minimum wages, regulation of hours of work, and rules for employment and termination of service. See Mohammad Amin, ***'Labor Regulation and Employment in India's Retail Stores'***, Social Protection and Labor Discussion Paper No. 0816, World Bank, 2008.

the Rules governing apprenticeships are outdated and rigid from both the perspective of employers and employees and they need to be amended (discussed in the next sub-title *'Need of Formal Apprenticeship'*).

Addressing both quality and quantity issues are the twin challenges in skill development and training so as to correct the mismatch between employers who do not get people with requisite skills and millions of job seekers who do not get employment. The National Skill Development Mission (NSDM) aims to impart employment-oriented vocational training to ***8 crore people over the next 5 years*** by working with state governments (through the State Skill Missions) and incorporating the private sector (through PPPs and for-profit vocational training) and NGOs. Basic education is also an important input for enhancing human capital. Recent government initiatives to expand access to quality primary education are important; however, more needs to be done (discussed under the forthcoming sub-title 'Improving Primary Education'), see Box 2.8).

NEED OF FORMAL APPRENTICESHIPS

In the process of achieving a quality manpower, experts have always emphasised the schemes which impart formal apprenticeships to the working population of a country. Though India has already such schemes put in place, but due to several reasons could not bring in the desired effects in the economy. As India aspires for higher demographic dividend, it is high time that India re-oriented and restructured the existing set of Acts and Rules governing the apprenticeships to bring in rational points, we may have a **three part** discussion on the issue.

1. The Importance of Apprenticeship

Equipping the labur force with productive skills lies at the heart of tapping the demographic dividend. Apprenticeships are an effective way of ensuring that entry-level workers have the skills required to join the formal workforce by 'learning on the job' and even 'earning while learning'. It has been amongst the oldest social institutions in India. However, it needs to be formalised and scaled up. In the current environment, India's educational system is overburdened by sheer demand for quality education. According to a recent study[46] by India's first vocational university, 80 per cent of India's higher education system of 2030 is yet to be built and is grappling with the *threefold problem* of cost, quality, and scale. This is compounded by the inability of much of the current education system to produce 'work-ready' labour. In fact, the **disconnect** between the formal educational system and requirements of the employers becomes even more acute in times of rapid structural and technological change. In such an environment, company-led apprenticeship programmes, that place employers at the heart of education, can play a powerful role in imparting job-relevant skills and also repairing, preparing, and upgrading the labour force. They can aid five important transitions that the labour force is currently making

(i) from agriculture to non-agriculture,
(ii) from rural to urban,
(iii) from the unorganised sector to the organised,
(iv) from school to work, and
(v) from subsistence self-employment to wage employment.

Several countries have benefited greatly from focused programmes on skilling the workforce on

46. TeamLease, ***'India Labor Report (2012), Massifying Indian Higher Education: The Access and Employability Case for Community Colleges'***, TeamLease and Indian Institute of Job Training, Ahmedabad, 2012.

the job, including Japan, US, UK, and Germany. Germany, in particular, has a well-known dual education system that combines classroom/online courses at a vocational school with workplace experience at a company. School authorities are responsible for the former while the company is responsible for the latter. More than 75 per cent of Germans below the age of 22 have attended an apprenticeship programme. Training apprentices also benefits corporates. The UK Task Force Report on Apprentices in 2005, demonstrated that the benefits of apprenticeships were numerous, including – i).increased productivity, ii). lower net costs of training (versus training non-apprentices), iii). greater staff retention, and iv). a more highly motivated workforce.

2. Things India Have

The apprenticeship programmes in India are governed by The Apprentice Act 1961 and the Apprenticeship Rules 1992. The organisational structure and rules and regulations overseeing it are complex and burdensome. The Ministry of Labour and Employment oversees 'trade apprentices' through six regional offices. The Ministry of Human Resource Development oversees 'graduate, technician, and technician (vocational) apprentices' through four boards located in different cities. There are strict norms on permissions, trades permitted, training duration, stipend levels, apprentice/employee ratio, and training facilities. It is onerous to create new apprenticeship positions, and there are several vacancies even in positions that have already been created. As a consequence, India only has under 3,00,000 formal apprentices.

To ensure that comparier do not hire cheap labour in guise of an apprenticeship programme, the regulatory norms were kept tighter. The need of the time is to develop set of provisions streamlining regulation and incentivise corporates, while protecting the interest and well-being of apprentices.

3. Making it Work

The present rules and regulations overseeing apprenticeships need to be changed such that employers and prospective apprentices can choose each other freely by just requiring information on what will be learnt on the job and a minimum wage. Some recommendations including those from the 2009 **Planning Commission** taskforce are described below:

(i) *Simpler Regulation:* A single window mechanism is needed to clear company applications for pan-India apprenticeship programmes. Currently, companies need to approach each state apprenticeship adviser separately. Partnerships between companies and industry federations should be facilitated by giving timely permissions.

(ii) *Wider Reach:* Presently apprentices are only allowed in specified trades. Majority of graduates are not currently covered under 'Formal Apprenticeships'. In addition, the procedure to include new trades especially services, which are largely excluded, is complex and can take many months. A fully deregulated list is needed for apprenticeships to remain dynamic and in line with the changing needs of the workplace.

(iii) *Flexibility to Companies:* At present many schemes are required to be unnecessarily long (up to four years), and have rigid requirements on 'worker to apprentice ratio'. Moreover, the penal provisions for companies, even for small violations of the rules, are very severe. Certain relaxation of rules can help give flexibility to companies. For example, the duration

of apprenticeship training can be allowed to vary across trades and companies. Short-duration programmes (less than 12 months) can be freed from much of the oversight provided they pay minimum wages. Relaxing the rigid requirements on the ratio of apprentices to workers could also accelerate capacity creation.

(iv) *Dual System of Training:* Partnerships between companies and educational institutions should be encouraged. Like the 'German model', corporates can be allowed to outsource theoretical training, and educational institutions can be allowed to outsource practical training.

(v) *Active Exchanges:* There should be active exchanges and portals, matching prospective apprentices to employers.

WAY TO EVIDENCE-BASED BETTER POLICY

Educational investments contribute to aggregate economic growth. More than this, they enable citizens to broadly participate in the growth process through improved productivity, employment, and wages, and are therefore a critical component of the 'inclusive growth' agenda of the Government of India. The past decade has seen substantial increases in education investments under the Sarva Shiksha Abhiyan (SSA), and this additional spending has led to considerable progress in improving primary school access, infrastructure, pupil-teacher ratios, teacher salaries, and student enrollment. Nevertheless, student learning levels and trajectories are disturbingly low, with nationally representative studies showing that over 60 per cent of children aged 6-14 are unable to read at second-grade level. Further, these figures have shown no sign of improving over time (and may even be deteriorating).[47]

The decade also saw a number of high-quality empirical studies on the causes and correlates of better learning outcomes based on large samples of data and careful attention paid to identification of causal relationships. This research has identified interventions/inputs that do not appear to contribute meaningfully to improved education outcomes, as well as interventions that are highly effective. In particular, the research over the past decade suggests that increasing inputs to primary education in a 'business-as-usual' way is unlikely to improve student learning meaningfully unless accompanied by significant changes in pedagogy and/or improvements in school governance. It is, therefore, imperative that *education policy shifts* its emphasis from simply providing more school inputs in a 'business-as-usual' way and focuses on improving 'education outcomes'.

SCHOOL INPUTS

Both administrative and survey data show considerable improvements in most input-based measures of schooling quality. But there is very little impact of these improvements in school facilities on learning outcomes. This is not to suggest that school infrastructure does not matter for improving learning outcomes (they may be necessary but not sufficient), but the results highlight that infrastructure by itself is unlikely to have a significant impact on improving learning levels and trajectories. Similarly, while there may be good social and humanitarian reasons for 'mid-day meal' programmes (including nutrition and child welfare), there is no evidence to suggest that they improve learning outcomes. Even more striking is the fact that no credible study on education in India has found any significant positive relationship between teachers possessing formal teacher training credentials and their effectiveness for improving student learning.

47. ***ASER-2012,*** as cited by the ***Economic Survey 2012–13,*** MoF, GoI, N. Delhi, p. 286.

In the same way, there is no correlation between teacher salary and its effectiveness for improving student learning, and at best there are very modest positive effects of reducing pupil-teacher ratios on learning outcomes. As discussed further, these very stark findings most likely reflect *weaknesses in pedagogy* and *governance* which are key barriers in translating increased spending into better outcomes.

The results summarised so far can be quite discouraging. Fortunately, the news is not all bad, because the evidence of the past decade also points consistently to interventions that have been highly effective for improving learning outcomes, and are able to do so in much more cost-effective ways than the status-quo patterns of spending.

PEDAGOGY

The science of education, teaching and classroom instruction (pedagogy) is a key determinant which decides how schooling inputs translate into learning outcomes. Today, following the right kind of pedagogy has become particularly challenging in India as several millions of first-generation learners have joined a rapidly expanding national schooling system. In particular, standard curricula, textbooks, and teaching practices that may have been designed for a time when access to education was more limited, may not serve the purpose in the new circumstances prevailing today. The default pedagogy of 'completing the textbook', does not reflect the learning levels of children in the classroom, as they always remain behind the textbook expects them to be. Evidences suggest that the 'business-as-usual' pedagogy – simply following the textbooks – can be improved with large positive impacts in early grades that target the child's current level of learning:

(i) These positive results have been found consistently in programmes run by non-profit organisations in several locations (including UP, Bihar, Uttaranchal, Gujarat, Maharashtra, and Andhra Pradesh).

(ii) The estimated impact of these interventions have been considerably high often exceeding the learning gains from a full year of schooling (their instructional time period is typically only a small fraction of the duration of the scheduled school year).

(iii) These interventions are typically delivered by modestly paid community teachers, who mostly do not have formal teacher training.

(iv) The supplemental remedial instruction programmes are highly cost effective and deliver significant learning gains at much lower costs than the large investments in standard schooling system.

GOVERNANCE

Another explanation for the 'low correlation between increases in spending on educational inputs and improved learning outcomes' may be the *weak governance* of the education system and limited effort on the part of teachers and administrators to improve student learning levels:

(i) The most striking symptom of weak governance is the high rate of teacher absence in government-run schools. While teacher absence rates were over 25 per cent across India in 2003, an all-India panel survey in 2010 that covered the same villages found that teacher absence in rural India was still around 24 per cent.

(ii) The fiscal cost of teacher absence was estimated at around Rs. 7,500 crore per year suggesting that governance challenges remain paramount.

(iii) There is evidence that even modest improvements in governance can yield significant returns. Improving

monitoring and supervision of schools is significantly correlated with reductions in teacher absence, and investing in improved governance by increasing the frequency of monitoring could yield an eight-to-tenfold return on investment in terms of reducing the fiscal cost of teacher absence.

(iv) The importance of motivating teachers by rewarding good performance has also been pointed out by the evidences. Rigorous evaluations of carefully designed systems of teacher performance pay in Andhra Pradesh show substantial improvements in student learning in response to even very modest amounts of 'performance-linked pay' for teachers, that was typically not more than 3 per cent of annual pay.

(v) Evidence from a long-term follow up shows that teacher performance pay was 15 to 20 times more effective for raising student learning than reductions in pupil-teacher ratios.

(vi) More broadly, these results suggest that the performance of front-line government employees depends less on the level of pay and more on its structure.

WAY TO POLICY

Putting the lessons taken from the evidences discussed above, following three immediate policy measures are desired at the moment for right kind of 'human resource preparedness'.[48]

(i) Make learning outcomes an explicit goal of primary education policy and invest in regular and independent high-quality measurement of learning outcomes. While independently measuring and administratively focusing on learning outcomes will not by itself lead to improvement, it will serve to focus the energies of the education system on the outcome that actually matters to millions of first-generation learners, which is functional literacy and numeracy.

(ii) Launch a national campaign of supplemental instruction targeted to the current level of learning of children (as opposed to teaching to the 'textbook') delivered by locally hired teacher assistants, with a goal of reaching minimum absolute standards of learning for all children. There is urgent need for a *mission-like* focus on delivering "universal functional literacy and numeracy" that allow children to *'read to learn'*. The evidence strongly supports scaling up supplemental instruction programmes using locally hired short-term teaching assistants that are targeted to the level of learning of the child, and the cost-effectiveness of this intervention also makes it easily scalable.

(iii) Pay urgent attention to issues of teacher governance including better monitoring and supervision as well as teacher performance measurement and management. A basic principle of effective management of organisations is to have clear goals and to reward employees for contributing towards meeting those goals. The extent to which the status quo does not do this effectively is highlighted in the large positive impacts found from even very modest improvements in the alignment of employee rewards with organisational goals. There can be

48. K. Muralidharan, ***'Priorities for Primary Education Policy in India's 12th Five-year Plan', in*** NCAER-Brookings India Policy Forum 2012–2013, NCAER, New Delhi, 2012.

potentially large returns of implementing these ideas in education and beyond.

The next decade will see the largest ever number of citizens in the school system at any point in Indian history (or future), and it is critical that this generation that represents the *demographic dividend* be equipped with the literacy and skills needed to participate fully in a rapidly modernising world. In a fiscally constrained environment, it is also imperative to use evidence to implement cost-effective policies that maximise the social returns on any given level of public investment. The growing body of high-quality research on primary education in the past decade provides opportunity for putting this principle into practice.

CAUTIONS TO PREPAREDNESS

The economic history of recent times is replete with examples of economies that were supposed to have great potential but ultimately did not achieve rapid economic growth and improvements in standards of living. We also have, at the same time, instances of economies classified as *basket cases* that achieved rapid turnarounds. India's achievement in the post-reform period and South Korea's rapid transformation surely fall in this latter category. But India's continuing on a rapid growth path is not preordained. Besides favourable circumstances, it requires deft policy making and a broad vision of the future, possible risks, and opportunities. We stand at a crossroads where we need to develop a clear strategy for continued inclusive growth. Let us consider what might happen under different hypothetical scenarios based on informed estimates, which reflect the forces that will be at play:[49]

(I) Business as Usual

Big aspirations of the 'demographic dividend' are not bad provided India goes for the timely and right kind of preparations for it. But if the 'business as usual' style of functioning continues, fallouts may be highly ugly.

(a) Some improvement in infrastructure but only slow improvement in education, and no change in institutional structure such as business regulation and labour laws.
(b) Some movement from agriculture to low skill services such as construction and household work, as well as to informal manufacturing, but too few quality jobs.
(c) GDP growth settles into a comfortable 6–7 per cent, the new 'normal'.
(d) There is growing presence of unprotected workers in manufacturing and the possibility of rising labour frictions.
(e) There is immense pressure on education to make students job-worthy, but with organised manufacturing playing little role in training workers and imparting skills on the job, there is a continuing mismatch between employer needs and worker capabilities.
(f) Growth is slower than it could be and inequality higher than it ought to be.

(II) Reforms

In the times of globalising world being in sync with the time and contemporary world will be necessary. There will be requirement of speedier concensus on the fronts of 'economic reforms'. If the required kind of 'reforms' are effected at the 'right' times, outcomes may be glorious and historic—

(a) Vast improvements in infrastructure, education, as well as in business regulation and labour laws.
(b) As fewer workers depend on agriculture, larger holdings and more investment

49. This part is based on the ***'Consequences & Conclusion'*** discussed by the ***Economic Survey 2012–13***, in Chapter-2: Seizing Demographic Dividend, MoF, GoI, N. Delhi, pp. 53-54.

in capital and technology create a much healthier agricultural sector, with significant rural entrepreneurship surrounding activities like horticulture, dairy products, and meat.

(c) The manufacturing sector becomes a training ground for workers, absorbing more students with a middle or high school education.

(d) India moves into niches vacated by China such as semi-skilled manufacturing, even while enhancing its advantage in skilled manufacturing and services.

(e) India experiences faster and more equitable growth.

(f) Social frictions are minimized as both agriculture and manufacturing create better livelihoods.

(III) Decline

Suppose India fails or lags in the process of putting the 'required set of things' in place, so that it can strengthen its position to garner higher demographic dividend, i.e., no improvement in infrastructure, education, or institutions . Just visualise the resulting ugly scenarios –

(a) As fewer jobs are created outside of agriculture, more people stay in agriculture, increasing the pressure on land and lowering incomes. Small agricultural plots do not provide enough income, nor can they be leased out.

(b) More families break up, with males seeking work elsewhere, and labour participation increases.

(c) There is large-scale migration to overburdened cities.

(d) More supports are given to agriculture and transfers are made to rural areas so as to prevent further migration.

(e) The strain on government finances increases.

(f) Income inequality between good service jobs in cities and marginal agricultural jobs in rural areas increases tremendously.

(g) Social strains/tensions grow.

The above-given scenarios are *clear possibilities* and should be seen as 'indicative' rather than conclusive in any way. The key policy message from this chapter is that India has to focus on an agenda to create productive jobs outside of agriculture, which will help it reap the *demographic dividend* and also improve livelihoods in agriculture.India needs to examine carefully whether regulations constrain businesses excessively and, if so, stripping the excess regulation while ensuring adequate protection and minimum safety nets for workers, will be the need of the time. Building infrastructure and expanding access to finance will also help. The government looks clearly engaged in this process, further steps need greater debate and action. Future governments will also be required to follow them. Continuity will be playing a very crucial role in this phase thus it will be advisable that not only the government in the seat of power but the opposition in the Parliament also accepts the delicacy of the moment and tries to build a concensus coming above the petty politics of the past. This becomes even more important when Indian politics is crossing through the phase of coalition governments in the Centre. Together with the Union Government the active support from the State Governments will be the need of the time and the process of planning may be used here tuned with the idea of 'monitorable targets', to attain this end.

CHAPTER

21

HUMAN DEVELOPMENT IN INDIA

- Introduction
- Human & Gender Development
- Population Policy, Women & Child Sex Ratio
- Poverty Estimates
- Promoting Inclusive Growth
- Demographics
- Socio-Economic and Caste Census
- Educational Issues
- Employment Issues
- Employment Growth
- Labour Reforms
- Health Sector
- Social Sector Expenditure
- Restructuring of the CSSs
- Future Policy Actions

*The basic purpose of development is to enlarge 'people's choices'. In principle, these choices can be infinite and can change over time. People often value achievements that do not show up at all, or not immediately, in income or growth figures–greater access to knowledge, better nutrition and health services, more secure livelihoods, security against crime and physical violence, satisfying leisure hours, political and cultural freedoms and sense of participation in community activities. The objective of development is to create an enabling environment for people to enjoy long, healthy and creative lives.**

* *Mahbub ul Haq* (1934-1998), founding editor of the ***Human Development Report***, UNDP, 1990.

INTRODUCTION

Economic growth still remains the immediate focus of the world economies. But, income enhancement can only bring the desired development in the country once it is supported by a conscious public policy aimed at it. Again, the presence of 'good governance' in the policy framework can hardly be missed. After the increased acceptance to welfare economics, the standard of life of the masses has emerged as the most popular tool to measure developmental achievemnets of the economies—the idea is much similar to the concept[1] of 'human development' articulated by the UNDP· In recent times, the world has started accepting the role of people's *attitudinal* and *behavioural* dimensions, too in the gamut of devlopment promotion.[2] Further, we see an increased and consensual acceptance among the nations on the issue of delivering 'happiness' and 'life satisfaction' to the citizens.[3] It means, over the last few decades the whole idea about the 'ultimate' aim of the economies has gone for a kind of metamorphosis. Human development, increased social welfare and well-being of the people have been the ultimate objective of development planning in India. Increased social welfare of the people requires a more equitable distribution of development benefits along with better living environment. Development process, therefore, needs to continuously strive for broad-based improvement in the standard of living and quality of life of the people through an inclusive development strategy that focuses on both income and non-income dimensions. Making growth and develeopment percolate to the *'marginaliged and disadvantaged sections'* of society (i.e., the SCs, STs, OBCs, Minorities and Women) remains the offical policy of 'inclusive growth' for the country.[4]

The challenge is to formulate *inclusive* plans to bridge regional, social and economic disparities. The Approach Paper to the 12th Plan (2012–17) rightly stresses the need for more infrastructural investment with the aim of fostering a faster, sustainable and more inclusive growth. The GoI has been conscious about the development of the social sector which includes areas like, health, education, shelter, social welfare, social security, etc. Once the economy commenced the process of economic reforms we see an increased attention on the strengthening of social sector—enhancing the social infrastructre and situation.[5] But India is faced with a variety of interconnected and interdpendent issues and challenges in the areas, such as, inclusion, expansion, implementation, accountability, governance, decentralisation, etc.[6]

Changing times[7]**:** Equitable growth has been the focus of Indian economic policy since the 1960s. By 2020, India is projected to be the youngest nation in the world in terms of size. While this 'youth bulge' provides India *great opportunities*, it also *poses challenges*. These young people need to be healthy, suitably educated, and appropriately skilled to contribute optimally to the economy.

1. Amartya Sen, ***Development as Freedom,*** Oxford University Press, N. Delhi, 2000, pp. 3-11.
2. ***World Development Report 2015: Mind, Society, and Behaviour***, world Bank, Washigton DC, 2015.
3. ***World Happiness Report-2012 & 2013***, Sponsored by the UNO, N. York, 2013 & 2014.
4. ***Eleventh Five Year Plan (2007–12)***, Planning Commission, GoI, N. Delhi.
5. Increased allocations of fund as well as enhanced performance is reported by the ***Economic Surveys of 1991–92 to 2014–15***, MoF, GoI, N. Delhi.
6. Amartya Sen and Jean Dreze, ***An Uncertain Glory: India and its Contradictions***, Allen Lane, Penguin Books, London, 2013, pp. vii-xiii.
7. ***Economic Survey 2014–15***, MoF, GoI, N. Delhi, pp. 131–146.

Despite global shocks, India has not compromised on expenditures on welfare activities, especially for the vulnerable population. The success of programmes and policies of the government lies in the strength of institutional structures with strong public delivery systems as well as in the attitudes and mindset of the people. To ensure conversion of outlays into outcomes the role of the *PRIs* is crucial. Though significant outcomes have been achieved in the areas of poverty reduction, health, and education, more remains to be done. Government, along with *civil society*, *media*, and *other stakeholders*, must work towards changing the *patriarchal mindset* of society and empowering women to realize their untapped potential and fulfil their aspirations. New windows of opprotunities are waiting to tapped by India and the its human resource.

HUMAN & GENDER DEVELOPMENT

In the *Human Development Report-2014 (HDR-2014)*, India is at **135th** rank (out of 187 countires) with a value of 0.586 in the Human Development Index (HDI), the lowest among the BRICS countries, with Russia at 57, Brazil at 79, China at 91, and South Africa at 118, and slightly ahead of Bangladesh and Pakistan. Significantly, while China improved its ranking by ten places between 2008 and 2013, India's position improved by just one rank. Thus a lot remains to be done to bridge the gap. Major highlights of the HDR-2014 are as given below:

- India's HDI is also below the average of countries in both the medium human development group (0.614) and in South Asia (0.588).
- Between 1980 and 2013, India's life expectancy at birth (LEB) increased by 11.0 years,
- mean years of schooling increased by 2.5 years, and expected years of schooling increased by 5.3 years
- while gross national income (GNI) per capita increased by about 306.2 per cent.
- As compared to BRICS nations and some neighbouring countries, India reports theleast mean years of schooling and an LEB that is just above that of South Africa.Bangladesh, with less GNI per capita than India, has a much higher LEB and meanyears of schooling.
- China, which recorded a slightly higher HDI than India in 1980, has widened the margin in 2013. The existing gap in health and education indicators between India and developed countries and also many developing countries highlights the need for much faster and wider spread of basic health and education, as reflected by China and Sri Lanka.
- In terms of gender equality, the HDR ranks India **127** out of 152 countries with a **Gender Inequality Index** (GII) of 0.563. The GII for 149 countries reveals the extent to which gender inequality erodes national achievements in reproductive health, empowerment and labour market participation. A comparison with India's developing country peers in the G-20 grouping also shows India in poor light on gender equality issues. Unlike the HDI, a higher GII value indicates poor performance.
- The **Gender Development Index** (GDI), defined as a ratio of the female to male HDI measures gender inequality according to three basic parameters of human development:

(i) Health (Life Expectancy at Birth),

(ii) Education (expected years of schooling for children and mean years for adults
aged 25 years and older); and

(iii) command over economic resources (estimated GNI per capita).

Country rankings are based on absolute deviation from gender parity in HDI. The GDI is calculated for 148 countries. The female HDI value for India is 0.52 as compared to 0.63 for males, resulting in a GDI value of 0.828. In comparison, Bangladesh and China are ranked higher with values of 0.908 and 0.939 respectively. India is in the bottom 25 per cent of all countries on the HDI, it ranks in the bottom 20 per cent on the GII (Gender Inequality Index). These statistics reflect the high levels of gender inequality in India and the poor status of women and girls in Indian society.

- India is a signatory to the Convention on the Elimination of All Forms of Discrimination against Women *(CEDAW)*, which is often described as an international bill of rights for women. It defines discrimination against women and sets the agenda for national action to end violations of women's rights. An important element of CEDAW is its affirmation of:
  (i) Women's reproductive rights,
  (ii) Right to determine the number,
  (iii) Spacing of children, and
  (iv) Equal access to family planning.
- In India, unfortunately, there is an increasingly disproportionate emphasis on *women's sterilization*; thus tubectomies account for a whooping 97.5 per cent of all sterilisation operations in 2013–14 (a massive jump from 78.6 per cent in the 1980s). This runs counter to ourgoals of achieving gender equality and women's empowerment. Sterilisation constitutes 75 per cent of India's contraceptive use. It is unparalleled in any country in the world today. The closest is Latin America where it forms 40 per cent of all contraceptive methods.
- Another concern is the **secular decline** in the child sex ratio (CSR– girls per 1000 boys aged 0–4 or 0–6) in India from 976 in 1961 to 918 in 2011; the SRS (2013) reports a figure of 909 for 2011–13. Globally CSR is calculated as boys per 100 girls. Comparatively, in Asia and the Pacific, the CSR (boys per 100 girls aged 0–14) was 110 in 2012, much higher than the sex ratio under natural conditions (105). While China's CSR declied from 121 in 2010 to 117 in 2012, India's CSR increased from 109 to 111 over the same period.
- **Violence against women** was defined by the UN General Assembly in 1993 defined as 'any act of genderbased violence that results in, or is likely to result in, physical, sexual or psychological harm or suffering to women.' Consequently, apart from violence against married/adult women, excess female child mortality, female infanticide, and child marriage are also considered violence against the female gender.
- The implementation of the Protection of Women from Domestic Violence Act 2005 (PWDVA) is weak, as nineteen states have no planned schemes. Appropriately a new scheme, *Beti Bachao Beti Padhao Programme (BBBP)*, for promoting survival, protection, and education of the girl child was launched in January 2015 at Panipat, Haryana, a state that is noted for the lowest CSR – 835 (SRS 2013). The BBBP has the following ***objectives***—

(i) To celebrate the girl child,

(ii) Facilitate her education with the objectives of preventing gender-biased sex-selective elimination, ensuring survival and protection, and

(iii) Education of the girl child.

The BBBP ***aims*** to address—

(i) declining CSR through a mass campaign targeted at changing social mind set, and

(ii) creating awareness about the criticality of the issue.

POPULATION POLICY, WOMEN & CHILD SEX RATIO

The data from the 'Ministry of Health & Familly Welfare, GoI' and the '*Statstical Yearbook UNESCAP*' (as referred by the *Economic Survey 2014–15*) conclude shows a renewed focus on *controlling the rise in population*, directed in particular at women, and through means that blur the lines between persuasion and coercion. Persuasion takes the form of incentives offered not just to poor couples for sterilisation but rewards to local bodies for their performance, euphemistically described as 'promotional and motivational' measures, resulting in the organization of mass camps for female sterilization. India's population policy seems *focused* on extending family planning measures, mainly contraceptives for women, leaving them with little reproductive choice or autonomy. The data from the official sources paint a very grim picture in this regard:

(i) The November 2014 tragedy in Bilaspur, Chhattisgarh in which 13 young women with very young children lost their lives, and forty-five more were taken critically ill, highlights a specific and serious problem that needs urgent attention, female sterilisation.

(ii) The 3rd Round of the *National Family Health Survey* (NFHS-3, 2005–06) reports that even in developed states like Tamil Nadu and Maharashtra female sterilisation accounts for 90 per cent and 76 percent of all contraceptive use, respectively; the median age at sterilisation for women was reported at 24.9 years in both Tamil Nadu and Maharashtra.

(iii) Of the total *sterilisation* operations performed in 2012–13, tubectomy/laproscopic sterilisations account for 97.4 percent, while male vasectomy operations, considered less complicated risky, account for only 2.5 percent.

(iv) Government *expenditures* are also skewed toward female sterilization. Out of the budget of Rs 397 crores for family planning for 2013–14, 85 percent (Rs. 338 crore) is spent on female sterilization. By contrast 1.5 percent of the total budget is spent on spacing methods and 13 percent on infrastructure and communications.

The Fallouts of Population Policy: The negative fallouts of pursuing a population policy that largely focuses on birth control also contributes to declining ***child sex ratios***—if every family is to have fewer children, there is a greater anxiety that at least one of them should be ***male***. In this instance, there may be a case for the government to undo as much as to do for example, by not setting targets expected levels of achievement (ELA), withdrawing incentives for female sterilization and for mass camps. In addition, the *Economic Survey 2014–15* suggested the following actions to the government:

(i) Review the family planning program and re-orient it in such a way that it is

aligned with reproductive health rights of women, and needs of India's population.

(ii) Increase budgets for quality services, static family planning clinics and quality monitoring and supervision.

(iii) Address youth needs, induct more counsellors for sexual health, more youth-friendly services, and adequate supply of spacing methods.

POVERTY ESTIMATES

Since India commenced the process of economic reforms, a major shift has taken place in the country's poliy-orientation towards poverty alleviation and employment generation—in place of *wage employment*, the focus has shifted to *self-employment* – so that 'gainful employment' could be created and poverty could be alleviated permanently [8].

The Planning Commission used to estimate poverty using data from the large sample surveys on household consumer expenditure carried out by the National Sample Survey Office (NSSO) *every five years*. It ***defines*** poverty line on the basis of monthly per capita consumption expenditure (MPCE). The methodology for estimation of poverty followed by the Planning Commission has been based on the recommendations made by experts in the field from time to time—the recent estimates based on the recommendations of the Expert Group headed by *Prof. Suresh D. Tendulkar* which submitted its report in December 2009. The *Economic Survey 2014–15* has released the latest estimates of poverty in the country (for the year 2011–12). These estimates have been prepared following the *Tendulkar Committee* methodology (2009) using household consumption expenditure survey data collected by the NSSO in its 68th Round (2011–12). Over a span of seven years, between 2004–05 and 2011–12:

(i) The total poverty declined from 37.2 to 21.9 per cent.

(ii) Rural poverty declined sharper from 41.8 to 25.7 per cent.

(iii) Urban poverty declined from 25.7 to 13.7 per cent.

PROMOTING INCLUSIVE GROWTH

The focus of the Indian development planning has been on formulation of programmes and policies aimed at bringing the 'marginalized and poor sections' of society into the mainstream. The government has been implementing many such programmes for social and financial inclusion. The disbursement of benefits needs a systematic channel which will provide for financial empowerment and make monitoring easier and the local bodies more accountable. The *Pradhan Mantri Jan Dhan Yojna (PMJDY)* launched in August 2014 and the *RuPay Card* (a payment solution), are important schemes in this regard. These two schemes are complementary and will enable achievement of multiple objectives such as financial inclusion, insurance penetration, and digitalization.

Given the multiple schemes implemented to foster **inclusive growth**, the role of Panchayati Raj institutions is critical. India needs to strenghten this as an enabling tool to realise enhance inclusion in the development process.

STRENGTHENING THE PRIs

The 73rd and 74th Constitutional Amendments marked a watershed in the history of decentralized governance, planning, and development in India as these made panchayat bodies the third tier of government with reasonable power and

8. ***Economic Survey 1999–2000***, MoF, GoI, N. Delhi.

authority in addition to creating space for women and marginalized groups in the federal set-up. Decentralized democracy was also extended to Fifth Schedule areas through the provisions of another Panchayat (Extension to the Scheduled Areas) Act 1996 known as the Extension Act which not only made the gram sabha a strong body, but also put '*jal, jungle, and jamin*' (water, forest, and land) under its control.

These central acts, however, instead of clearly specifying the powers and functions of panchayats and municipalities, have left it to the discretion of state governments. Articles 243 G and 243 W of these acts decree that the legislature of a state may, by law, endow the panchayats/municipalities with such powers and authority as may be necessary to enable them to function as institutions of self-government. Such law may also contain provisions for devolution of powers and responsibilities upon panchayats/municipalities, subject to such conditions as may be specified therein, with respect to the preparation of plans and implementation of such schemes for economic development and social justice as may be entrusted to them. These may include inter alia *schemes* and *plans* in relation to socio-economic development and providing basic services as listed in the Eleventh and Twelfth Schedules of the Constitution.

Article 243 ZD of the 74th Amendment Act providing for constitution of district planning committees (DPC) by the state government in every district is a milestone in decentralized planning with people's participation. These committees are expected to consolidate the plans prepared by the panchayats and municipalities in the district and prepare a draft development plan for the district as a whole. DPCs have been set up in most of the states. Much of implementation of these panchayat acts, i.e., power-sharing with panchayat bodies, is left to the states. Over the years, the panchayat bodies have not been strengthened in terms of *functions, finances* and *functionaries* ***(triple Fs)*** with regard to preparation of plans and the listed subjects. The ***Economic Survey 2014–15*** suggests the following steps dowards strengthening the PRIs:

(i) The panchayat bodies have the potential to become true vehicles for carrying out the government's slogan of "less government–more governance" if states show consensus.

(ii) In order to convert outlays of the local-centric programmes into outcomes, these institutions need greater *awareness, responsibility,* and *accountability*, which will also enable better connect of these programmes with the common man.

(iii) *Greater devolution* of powers to the panchayats and municipalities is need of the hour, in respect of the 'triple Fs' in a phased manner.

(iv) Majority of panchayat/municipality-centric programmes do have earmarked funds for awareness generation and capacity building. These funds across ministries need to be *pooled together* under the Panchayati Raj Ministry and Ministry of Urban development to make infrastructure and capacity building of panchayats and municipalities a continuous and regular process.

These ***steps*** will create the following possibilities in the local bodies:

(a) Enable them to understand not only their role and rights but also their responsibilities and will make them accountable, bringing about qualitative improvement in governance at decentralised level.

(b) Transform them into *vibrant institutions* and enable them to perform their envisaged role in participatory planning, implementation, execution,

monitoring, and supervision and also carry out social audit of all panchayat/ municipality-centric programmes.

DEMOGRAPHICS

The population of India has gone for some major changes in the recent decades. These changes have not only restructured the contours of Indian demographics but have brought new openings and challenges regarding it:

1. As per provisional results of *Census 2011,* the following facts regarding the Indian population dynamics are of high importance. The 2001–11 is the *first* decade in independent India wherein, the population momentum coupled with declining fertility has dampened the pace of net additions to population. Thus, the net addition in this decade is less than that of the pervious decade by 0.86 million. At present, a little more than *one out of every six* persons in the world is an Indian.
2. As per *Sample Registration System-2013* (SRS) data—
   (a) There has been a gradual decline in the share of population in the age group 0-14 from 41.2 to 38.1 per cent during 1971 to 1981 and from 36.3 to 28.4 per cent during 1991 to 2013.
   (b) On the other hand, the proportion of economically active population (15-59 years) or, India's 'demographic dividend', has increased from 53.4 to 56.3 per cent during 1971 to 1981 and from 57.7 to 63.3 per cent during 1991 to 2013.
   (c) On account of better education, health facilities, and increase in life expectancy, the percentage of *elderly* (60+) has gone up from 5.3 to 5.7 per cent and 6.0 to 8.3 per cent respectively in the same two periods.
   (d) The growth rate of the *labour force* will continue to be higher than that of the population until 2021.
3. According to an *Indian Labour Report* (Time Lease, 2007)—
   (a) 300 million youth will enter the labour force by 2025, and 25 per cent of the world's workers in the next three years will be Indians.
   (b) Population projections indicate that in 2020 the average age of India's population will be the lowest in the world—around 29 years compared to 37 years in China and the United States of America, 45 years in West Europe, and 48 years in Japan.
   (c) Consequently, while the global economy is expected to witness a shortage of young population of around 56 million by 2020, India will be the only country with a youth surplus of 47 million *(Report on Education, Skill Development and Labour Force (2013–14) Volume III, Labour Bureau, 2014).*

As per the *Economic Survey 2014–15*, the main issue to address then is not just providing employment but increasing the employability of the labour force in India. Employability is contingent upon knowledge and skills developed through quality education and training. Thus, any solution to the problem lies in a well-designed education and training regime that sets out to meet these objectives. The problem of low employability levels owing to poor quality of education is accentuated by the fact that fewer students opt for higher education in country. To

garner the 'demographic dividend', the Survey suggested the following ***policy initiatives*** in this regard:

(i) A declining 0–14 population will impact both elementary (5–14 age group) and higher education (15–29 age group). Elementary education can be further subdivided into primary (5–9 age group) and middle/upper primary (10–14 age group). The first stage of impact will be felt in declining enrolment in primary schools. As stated earlier, total enrolment in primary schools has fallen in 2013-14 while upper primary enrolment has grown. The dependency ratio for India is expected to fall from 54 per cent in 2010 to 49 per cent in 2020. In this scenario, given interstate disparities, states that are already facing this situation need to adopt specific policy measures in the field of education, wherein, instead of expanding the number of primary schools, focus should be on—

   (a) Improving access to education considering the high dropout rates among senior students;

   (b) Removing gender disparity especially in the higher age group and in rural areas;

   (c) Improving quality of education, including pupil-teacher ratios and provision of amenities in schools, especially in view of the declining learning levels.

(ii) The *lag in demographic transition* between different states that necessitates state-specific policies to optimally garner the benefits of the demographic dividend. Owing to substantial fertility decline in the south during the last two decades, the south is ahead in the demographic transition compared to the north, thereby the window is already wide open in the south compared to the north. For instance, the projected average age of 29 years in 2020 has already been surpassed in some states like Kerala (33 years), Goa (32.3), Tamil Nadu (31.3), Himachal Pradesh (30.4), Punjab (29.9), Andhra Pradesh (29.3), and West Bengal (29.1). This lag in demographic transition among states in India could turn out to be a *great blessing* from the point of view of coping with the problem of declining population. India is better placed in this respect than most other countries. Thus, two set of policy initiatives emerge for the states—

   (a) The states which are already well into the demographic window should actively pursue policies for employment generation to the already bulging labour force.

   (b) The states just entering the window period have some time to plan and must pursue policies simultaneously in several areas like education, health (including reproductive health), gender issues, and employment generation from now on so that they can fully utilise the opportunity.

SOCIO-ECONOMIC AND CASTE CENSUS

The identification of the real beneficiaries is of paramount importance, for the success of any targeted approach. In line with this approach the *Dr. N. C. Saxena Committee* was constituted to advise on the 'methodology for a BPL census in rural areas'. Since June 2011, for the first time, a Socio-Economic and Caste Census (SECC) is being conducted through a comprehensive 'door-to-door' enumeration in both rural and urban India, authentic information is being made

available on the socio-economic condition and educational status of various castes and sections through the SECC.

This exercise will help better target government schemes to the right beneficiaries and ensure that all eligible beneficiaries are covered, while all ineligible beneficiaries are excluded. Households identified as highly deprived will have the highest inclusion priority under government welfare schemes. Use of the *Aadhar* number in various beneficiary-oriented social sector programmes will also check duplications.

The *SECC 2011* is being conducted simultaneously for rural and urban areas by the respective states, with technical and financial support from the GoI. Enumeration is to be done with the help of about 6 lakh enumerators, who are accompanied by an equal number of technically qualified and computer literate Data Entry Operators (DEO) selected by the country's premier IT majors. The Ministry of Rural Development in association with the Ministry of Housing and Urban Poverty Alleviation, Office of the Registrar General of India (RGI) and the states have shouldered the responsibility of training the enumerators, supervisors, verifiers, and state officials engaged in the census operation. The SECC process ensured transparency and people's participation.

Before finalizing the outcomes, the household data, except caste data, will be placed in the public domain for scrutiny and go through a two-stage appeal procedure in the 'claims and objections' stage. In rural areas, the Gram Sabha will also mandatorily scrutinize the data in a specially convened meeting.

An Expert Committee was also set up to examine the SECC indicators and the data analysis and recommend appropriate methodologies for determining classes of beneficiaries for different rural development programmes. It will consult states, experts, and civil society organizations while arriving at these methodologies.

EDUCATIONAL ISSUES

The educational challenges of India needs immediate attention. This becomes even more essential to enable the economy to garner the situation of demographic dividend. The following areas are of high **concern**:

- With a 73 per cent literacy (Census 2011), there has been marked improvement in female literacy. Male literacy at 80.9 per cent is still higher than female literacy at 64.6 per cent but the latter has increased by 10.9 percentage points compared to 5.6 percentage points for the former.
- The Right of Children to Free and Compulsory Education (RTE) Act 2009 was enacted by the centre to increase the quality as well as accessibility of elementary education in India in April 2010. *Sarva Shiksha Abhiyan (SSA)* is the designated scheme for implementation of the RTE Act. The framework of the SSA has been ***revised*** to include reimbursement for expenditure incurred for at least 25 per cent admissions of children belonging to disadvantaged and weaker sections in private unaided schools from the academic year 2014–15.
- Between 2007–08 and 2013–14, according to the DISE (District Information System for Education), total enrolment in primary schools increased from 134 million to 137 million in 2011–12 and then declined to 132 million in 2013–14 while upper primary enrolment grew from 51 million to about 67 million. This is in line with the changing demographic age structure. India has achieved near

universal enrolment and enhanced *hard and soft infrastructure* (schools, teachers, and academic support staff).

- The overall ***standard of education*** is well below global standards. The findings of the **PISA** (Programme for International Student Assessment)-2009 *(India did not participate in PISA 2012).* The assessment which measures the knowledge and skills of 15-year-olds with questions designed to assess their problem-solving capabilities. Its findings are quite alarming—
  (a) Tamil Nadu and Himachal Pradesh has been ranked at 72nd and 73rd out of 74 participants, higher only than Kyrgyzstan. This exposes the gaps in our education system. These two states at the bottom, with the scores in mathematics and science falls way behind the OECD (Organisation for Economic Cooperation and Development) average.
  (b) Shanghai-China *tops* the rankings followed by Singapore, while the Russian Federation is ranked at 38th position.
  (c) PISA adds, "Countries where students near the end of compulsory schooling perform at high levels tend to maintain their lead after these students transition from school into young adulthood.... There is considerable scope for postsecondary education and training systems, as well as workplaces, to intervene to improve the proficiency of young people who leave school with poor literacy and numeracy skills."

Clearly, the policy prescription lies in shifting attention away from *inputs to outcomes* and focusing on building quality education and skill development infrastructure.

- **ASER** (Annual Status of Education Report) findings have been reporting low levels of learning amongst the 5 to 16 age group in rural India since 2005. The findings of the latest *ASER-2014* are no different. The worrying fact is that these are floorlevel tests (basic 2-digit carry-forward subtraction and division skills), without which one cannot progress in the school system.
- The changing demography and declining child population, the inadequacy of human capital at the base of the pyramid leading to a huge backlog in basic skills could become a big impediment in India's growth. The *Padhe Bharat Badhe Bharat* initiative to create a base for reading, writing, and math fluency is a good step. However, for it to be fruitful, it is critical that the local administration is fully involved and sensitized.
- While the *RTE Act* and the *Juvenile Justice Act 2000* were promulgated to bring children into education rather than employment, they have allowed youth in the 15–18 age-group to slip through the cracks. India has about 100 million young people who fall in this category. Since there are educational and age requirements for entry into most vocational skilling programmes, and job placements are not possible before age 18, the vast majority of this population could land up in the unorganised sector. There is need for research into the type of knowledge or skills required to address the opportunity gaps and to improve productive capacity in the unorganised sector.
- To build capacity in *secondary schools* on par with expanded primary enrolments, several schemes like the Mid-Day Meal

(MDM) scheme, Rashtriya Madhyamik Shiksha Abhiyan (RMSA), Model School Scheme (MSS), and Saakshar Bharat (SB)/Adult Education have also been implemented. The focus of SB is *female literacy*. But the *lack of trained teachers* compounds the problem. To strengthen the cadre of teacher educators by providing early career choice to prospective teachers and to fill the vacancies in teacher education institutions, a new four-year integrated programme, i.e., BA/BEd. and BSc./BEd. has been introduced.

- The Indian *higher education* system is one of the largest in the world in terms of the number of colleges and universities. It is faced with several issues –
  (a) From 350 universities and 16,982 colleges in 2005–06, the numbers have gone up to 713 universities, 36,739 colleges, and 11,343 diploma-level institutions in 2013–14.
  (b) There is need to match the supply with demand and to dovetail education policy to employment opportunities. Therefore, higher education needs to be futuristic and envision areas that will generate future employment opportunities and accordingly offer suitable courses for students.
  (c) The gross enrolment ratio (GER) in higher education has nearly doubled from around 11.6 per cent in 2005–06 to 21.1 per cent in 2012–13, with 29.6 million students enrolled in 2012–13 as compared to 14.3 million in 2005–06.
  (d) The lower penetration into higher levels of education leads to higher dropouts, especially among the secondary and upper primary students, consequently to accumulation of less educated and less skilled job seekers at the bottom of the pyramid. The percentage educated also falls progressively with higher levels of education.

EMPLOYMENT ISSUES

Skilling the Youth: India is face with the dual challenge—developing skills on the one hand and using skills on the other (since skills that are not used are lost). As per the *Labour Bureau Report 2014,* the current size of India's formally *skilled workforce* is small—approximately 2 per cent. This number contrasts poorly with smaller countries like South Korea and Japan that report figures of 96 and 80 per cent, respectively. At all-India level around 6.8 per cent persons aged 15 years and above are reported to have received/be receiving vocational training. As per studies conducted by *National Skill Development Corporation (NSDC)* for the period between 2013 and 2022, there is an incremental requirement of 120 million skilled people in the non-farm sector. The current capacity for skilling is grossly inadequate and needs to be speedily scaled up to meet immediate skill needs of the country. The poor skill levels among India's workforce are attributed to dearth of a formal vocational education framework, with wide variation in quality, high school dropout rates, inadequate skills training capacity, negative perception towards skilling, and lack of 'industryready' skills even in professional courses, as per the *Labour Bureau Report-2014*.

Some recent initiatives that aim to enhance access, equality, quality, innovation, etc. in the area of higher and vocational education are:

(i) Rashtriya Uchchatar Shiksha Abhiyan (RUSA)
(ii) Technical Education Quality Improvement Programme (TEQIP)
(iii) National Skill Qualification Framework (NSQF)

To accord focused attention on skill development, a dedicated Department of Skill Development and Entrepreneurship has been created. In addition, the skilling programme for rural youth has been refocused and reprioritized to build the capacity of poor rural youth to address domestic and global skill requirements. The Deen Dayal Upadhyaya Grameen Koushalya Yojana (DDU-GKY) is a placement-linked skill development scheme for poor rural youth.

Other *new* programmes that aim at bringing *minorities* into mainstream development include:

(i) Nai Manzil (for education and skill development of dropouts).

(ii) USTTAD (Upgrading Skills and Training in Traditional Arts/Crafts for Development)—to conserve traditional arts/crafts and build capacity of traditional artisans and craftsmen belonging to minority communities.

(iii) Nai Roshni (a leadership training programme for women; and MANAS for upgrading entrepreneurial skills of minority youths).

EMPLOYMENT GROWTH

A cause for concern is the deceleration in the *compound annual growth rate* (CAGR) of employment during 2004–05 to 2011–12 to 0.5 per cent from 2.8 per cent during 1999–2000 to 2004–05 as against CAGRs of 2.9 per cent and 0.4 per cent, respectively in the labour force for the same periods. The employment data from the NSSO highlights the following ***major trends*** and ***concerns*** regarding it:

(i) During 1999–2000 to 2004–05, employment on usual status (US) basis increased by 59.9 million persons from 398.0 million to 457.9 million as against the increase in labour force by 62.0 million persons from 407.0 million to 469.0 million.

(ii) After a period of slow progress during 2004–05 to 2009–10, employment generation picked up during 2009–10 to 2011–12, adding 13.9 million persons to the workforce, but not keeping pace with the increase in labour force (14.9 million persons).

(iii) Based on current daily status (CDS), CAGR in employment was 1.2 per cent and 2.6 per cent against 2.8 per cent and 0.8 per cent in the labour force respectively for the same periods.

India has been going through a process of ***structural changes*** in employment percentage

(i) For the first time, the share of the *primary sector* in total employment has dipped below the halfway mark (declined from 58.5 per cent in 2004–05 to 48.9 per cent in 2011–12),

(ii) Employment in the *secondary* and *tertiary* sectors increased to 24.3 per cent and 26.8 per cent, respectively in 2011–12 (from 18.1 per cent and 23.4 per cent respectively in 2004–05).

(iii) *Self-employment* continues to dominate, with a 52.2 per cent share in total employment.

(iv) What is critical is the significant share of workers engaged in low-income generating activities.

(v) There are other issues of concern like poor employment growth in rural areas, particularly among females. Though employment of rural males is slightly better than that of females, long-term trends indicate a low and stagnant growth. Such trends call for diversification of livelihood in rural areas from agriculture to non-agriculture activities.

In order to improve generation of productive employment under the MGNREGA, the IPPE (Intensive and Participatory Planning Exercise) has been initiated to prepare the labour budget for financial year 2015-16 in selected 2500 backward blocks using participatory rural appraisal technique. Emphasis has been laid on agriculture and allied activities to ensure that at least 60 per cent of the works in a district in terms of cost is for creation of productive assets linked to agriculture and allied activities through development of land, water, and trees.

(vi) A major impediment to the pace of quality employment generation in India is the *small share of manufacturing* in total employment. However, data from the 68th Round of the NSSO (2011-12) indicates a ***revival*** in employment growth in manufacturing from 11 per cent in 2009–10 to 12.6 per cent. This is significant given that the National Manufacturing Policy 2011 has set a target of creating 100 million jobs by 2022. Promoting growth of micro, small, and medium enterprises (MSME) is critical from the perspective of job creation which has been recognized as a prime mover of the development agenda in India.

(vii) Although total informal employment increased by 9.5 million to 435.7 million between 2004–05 and 2011–12, it is significant that informal unorganized sector employment declined by 5.8 million to 390.9 million, leading to an increase in informal organized sector employment by 15.2 million. Consequently the *share of unorganized labour* has declined from **87** per cent to **82.7** per cent.

NSSO Rounds are quinquennial thus, information on the employment/unemployment situation in the country is available only after a *gap of five years*. To make available data in the interregnum, the Labour Bureau on annual basis and has also been bringing out Quarterly Survey Reports on the effects of the economic slowdown on employment in select sectors in India since 2009. The results of the latest quarterly summary on employment, July 2014, indicate an increase in employment by 3.5 million since the first survey. The US unemployment rate is generally regarded as the measure of chronic open unemployment during the reference year; while the CDS (Current Daily Status) is considered a comprehensive measure of unemployment, including both *chronic* and *invisible* unemployment. Thus, while chronic open unemployment rate in India hovers around a low of 2 per cent, it is significant in absolute terms.

LABOUR REFORMS

We see a significant improvement in industrial harmony in India is evident from the fact that mandays lost on account of *strikes* and *lockout* have been steadily declining, from 17.6 million in 2009 to 1.79 million (Provisional) to December 2014. The multiplicity of labour laws and difficulty in complying with them has always been cited as an impediment to industrial development in India. This is why labour reforms has been made and active part of the ongoing economic reform process in the country. In a major initiative for *ensuring compliance* and promoting *ease of doing business*, the government has initiated a number of labour reform measures. Thus, amendments have been proposed to labour laws to align them with the demands of a changing labour market. Individually, states like Rajasthan have also introduced major reforms in three labour legislations—the Industrial Disputes Act, Factories Act, and Contract Labour Act. The major

initiatives in this direction are as given below (the informations from the Central Ministry of Labour and Employment, quoted by the *Economic Survey 2014–15*):

1. The *Apprentice Act 1961* was amended in December 2014 to make it more responsive to industry and youth. The 'Apprentice Protsahan Yojana' was also launched to support MSMEs in the manufacturing sector in engaging apprentices. Government is also working affirmatively to bring a *single uniform law* for the MSME sector to ensure operational efficiency and improve productivity while ensuring job creation on a large scale.
2. A unified labour portal scheme called *Shram Suvidha Portal* has been launched for timely redressal of grievances and for creating a conducive environment for industrial development. Its main features are—
   (i) Unique Labour Identification Number (LIN) allotted to around 0.7 million units facilitating online registration;
   (ii) Filing of selfcertified, simplified single online return instead of 16 separate returns by industry;
   (iii) Transparent labour inspection scheme via computerized system as per risk-based criteria and uploading of inspection reports within 72 hours by labour inspectors.
3. *Under Employees' State Insurance Corporation (ESIC)* ***Project Panchdeep***: Digitization of internal and external processes to ensure efficiency in operations, especially services to employers and insured persons. The portal enables employers to file monthly contributions, generate temporary identity cards and create monthly contribution challans online, issue of pehchan card for insured persons for fast and convenient delivery of services. Through the IP Portal, insured persons can check contributions paid/ payable by employers, family details, entitlement to various benefits, and status of claims. Integration of its services will promote ease of business and curb transaction costs.
4. *Under Employees Provident Fund (EPF):* Digitization of complete database of 42.3 million EPF subscribers and allotment of universal account number (UAN) to each member, which facilitates portability of member accounts. UAN is being seeded with bank account, Aadhar Card and other KYC details to promote financial inclusion. Direct access to EPF accounts will enable members to access and consolidate previous accounts.

   Online pensioners can view their account and disbursement details online. The statutory wage ceiling under the Employees Provident Fund and Miscellaneous Provisions (EPF&MP) Act was enhanced to Rs. 15,000 per month and a minimum pension of Rs.1,000 has been introduced for pensioners under the Employees' Pension Scheme-1995 from September 2014.
5. *For Unorganized Workers:* The Rashtriya Swasthya Bima Yojana (RSBY) is a scheme under the Unorganized Workers' Social Security Act 2008. It is a smart card-based cashless health insurance scheme, including maternity benefit, which provides a cover of Rs 30,000 per family per annum on a family floater basis to below poverty line (BPL) families in the unorganized sector. It is proposed to extend the RSBY to all ***unorganized*** workers in a phased manner.

6. *National Council for Vocational Training-Management Information System (NCVT-MIS)* portal has been developed for streamlining the functioning of Industrial Training Institutes (ITIs), Apprenticeship Scheme, and assessment/certification of all NCVT training courses.
7. The *National Career Service(NCS)* is being implemented as a *mission mode project* to transform the National Employment Service and provide various job-related services such as online registration of job seekers and job vacancies, career counselling, vocational guidance, and information on skills development courses, internships, and apprenticeship.

HEALTH SECTOR

The Approach Paper to the 12th Plan has propsed the idea of 'Universal Healthcare', for the first time in the country. It has earmarked a fund equal to 2.5 per cent of the GDP. But the stressed economic situation could not allow the government to go in for it. Though, the government promised a fund for the health sector equivalent to upto 1.5 per cent of the GDP. Meanwhile, the health indicators show improving traits:

- Total fertility rate (TFR) has been steadily declining and is now at 2.3. While state-wise disparities exist, a declining trend is recorded across states, explaining the declining growth rate of population. India is set to reach the UN Millennium Development Goals (MDG) with respect to maternal and child survival—
  (i) The MDG for maternal mortality ratio (MMR) is 140 per 100,000 live births, while India had achieved 178 by 2010–12 and is estimated to reach 141 by 2015.
  (ii) The under-5 mortality rate (U5MR) MDG is 42, while India has an U5MR of 52 and is expected to reach 42 by 2015.

  This is particularly creditable as in 1990 India's MMR and U5MR were 47 per cent and 40 per cent above the international average, respectively. However, significant effort is required to improve the rate of decline of *still-births* and *neonatal mortality*, which have been lower/stagnant in some states.
- While overall death rates have been declining, owing to improvement in health accessibility and facilities, *Sample Registration System-2013* (SRS-2013) reports that a significant 30 per cent of all deaths occur in the age group 0–4 years; the percentages are higher for *girl children* in both rural and urban areas.

There exits a direct relationship between water, sanitation, health, nutrition, and human well-being. Consumption of contaminated drinking water, improper disposal of human excreta, lack of personal and food hygiene, and improper disposal of solid and liquid waste are major causes of diseases in developing countries like India. The Swachh Bharat Mission (Gramin) launched on 2 October 2014 aims at attaining an open defecation free (ODF) India by 2 October 2019, by providing access to toilet facilities to all rural households and initiating Solid and Liquid Waste Management activities in all gram panchayats to promote cleanliness.

To bring the point home the *Economic Survey 2014–15* has quoted two Indian examples (picking from the Ministry of Drinking Water and Sanitation sources) of good practices in the areas of health and hygiene which can be replicated across the country –

(i) *Mundla Village of Icchawar Block in Sehore district—100 per cent sanitized village:* Before the launch of the Global Water, Sanitation and Hygiene for All (WASH) campaign in Mundla village on in February 2014, there were four functional toilets in the village. As of 2 October 2014, the village has been declared an ODF (Open Defecation Free) village. The efforts of villagers have converted it into a hygienic and *100 per cent sanitized* village.

(ii) *Asia's Cleanest Village:* Mawlynnong in Meghalaya is a model that showcases how collective effort can help a village find a place on the tourism map. The village has 80 households, of which 29 are below poverty line (BPL). Being awarded the *Asia's Cleanest Village* award has resulted in an increase in the number of tourists to this village. The villagers have also constructed two tree houses with eco-friendly materials such as bamboo, which provide a magnificent bird's-eye view of the beautiful and clean village and a panoramic view of Bangladesh villages, a few miles away.

Coordinated Policy Actions: Together with capacity building efforts by multiple agencies including Panchayati Raj institutions (PRIs), field level implementers, organizations of high repute identified as key resource centres (KRCs), selfhelp groups, women's groups, convergence with other state departments like Health, Women & Child Development, and Panchayati Raj, provision has been made for incentivizing accredited social health activists (ASHAs) and anganwadi workers to promote sanitation. Guidelines are also in place to involve corporates in the sanitation sector through corporate social responsibility. Some recent initiatives in this direction are –

(i) In order to improve the availability of *drinking water in rural areas*, 20,000 solar power based water supply schemes have been approved under the National Rural Drinking Water Programme (NRDWP) across all the states for their habitations located in far-flung / hilly areas or where availability of electricity is a constraint.

(ii) *Mission Indradhanush* was launched in December 2014 with the *aim* of covering all those children who are either unvaccinated or are partially vaccinated against seven vaccine-preventable diseases which include diphtheria, whooping cough, tetanus, polio, tuberculosis, measles, and Hepatitis B by 2020. The intensification of immunisation activities will be carried out in 201 high focus districts in the *first phase* and 297 districts will be targeted for the *second phase* in 2015.

(iii) With the goal of providing *holistic health solutions*, the erstwhile Department of AYUSH (Ayurveda, Yoga and Naturopathy, Unani, Siddha and Homeopathy) has been elevated to a fullfledged *Ministry* in November 2014. The basic objective of the National AYUSH Mission (NAM) is to promote AYUSH medical systems through cost-effective AYUSH services and strengthening of educational systems.

(iv) Steps are also underway for including *Yoga* in the regular medical system. On the appeal of the India's PM during his UN General Assembly in September 2014, the UN has declared 21 June *International Yoga Day* (the UN Resolution for the same emerged as the most ever supported resolution on the UN platform—getting support from

cutting across the continents, ethnicities and religious allegiances!).

There are multiple determinants of health. Given this situation, it is clear that a prevention agenda that addresses the social and economic environment requires a coordinated action which is (as the *Economic Survey 2014–15* suggests)—

(i) Cross-sectoral, multi-level involinge sectors such as food and nutrition, education, drinking water and sanitation, housing, employment,
(ii) Industrial and occupational safety,
(iii) Welfare including social protection,
(iv) Family and community services, tribal affairs, and
(v) Communications.

SOCIAL SECTOR EXPENDITURE

The RBI data on expenditure on social services by the ***General Government*** (centre and states) as a proportion of total expenditure has also been showing a mixed trend, compared to the Budget Estimates for 2014–15:

- It had declined to **22.3** per cent in 2014–15 (was 24.7 per cent for 2013–14).
- As a percentage of the GDP, expenditure on social services has declined from 6.9 per cent in 2009–10 to **6.7** per cent in 2014–15.
- Expenditure on education increased from 3.0 per cent to **3.1** per cent and on health declining from 1.4 per cent to **1.2** per cent.
- Consistent rise in absolute social-sector expenditure by the general government (centre+state) even during the *global crisis* of 2008–09 and *Euro area crisis* of 2011–12

Public & Private co-operation in healthcare: Government spending on healthcare in India is only **1.2** per cent of GDP which is about **4** per cent of total government expenditure, less than 30 per cent of total health spending. The failure to reach minimum levels of public health expenditure remains the single most important constraint to attaining desired health outcomes.

While it is important to recognize the growth and potential of a rapidly expanding private sector, international experience shows that health outcomes and financial protection are closely related to absolute and relative levels of public health expenditure. India should try to expand the role of the private sector in the healthcare sector with an effort to attend the *following capabilities and needs*—

(a) A Medical Regulatory Authority to regulate the public as well as private sector
(b) Proper Universal Health Insurance penetration
(c) Cecking corruption in the public healthcare system
(d) Rationalising drug subsidies
(e) Expanding the base of public healthcare system

Attending the above-given areas will enable India to move towards the goal of *'Universal Healthcare'* in the coming times. The government should also think of putting in place a working and effective model of *Public Private Partnership* model in the health sector, too.

RESTRUCTURING OF THE CSSs

The need of restructuring the Centrally Sponsored Schemes (CSSs), in the reform period, was taken at an *ideological level* by the GoI in 1999–2000 *(Economic Survey 1999–2000),* for the first time. Several of them were restructured – with the declared goal of going for synchronised and co-ordinated attempts at improving the 'living standard' of the people. Before launching the 12th Plan, we see a major restructuring – the existing

137 CSSs being restructured into **66** (including the **17** Flagship Programmes).

By early 2015, the new government at Centre, again restructured and finetuned a number of ongoing programmes/schemes based on the ***field experience*** to make them ***need based.*** The new list of the programmes/schemes, released by the GoI is as given below (classified areawise):

1. Education Related

Education through broadband facilities: Under this mission more than 700 courses in various disciplines in engineering and science are available *online* under National Programme on Technology Enhanced Learning (NPTEL). E-content for 8 undergraduate subjects has also been generated by the Consortium of Education Communication (CEC) in collaboration with its media centers.

Pandit Madan Mohan Malviya National Mission on Teachers and Teaching: The Mission envisages to address comprehensively all issue related to teachers, teaching, teacher preparation, professional development of curriculum design, designing and development assessment. It is also envisaged that the mission would pursue long term goals of building a strong *professional cadre of teachers* by setting performance standards and creating top class institutional facilities for innovative teaching and professional development of teachers.

Higher Education for persons with special needs (HEPSN): The University Grant Commission (UGC) implemented scheme is, basically, meant for creating an environment at the *higher education* institutions to enrich higher education learning experiences for differently abled persons. Creating awareness about the capabilities of differently abled persons, constructions aimed at improving accessibility, purchase of equipments to enrich learning etc. are the broad categories of assistance under the scheme.

Enhancing Access to Higher Education in unreserved or underserved areas: Rashtriya Uchchatar Shiksha Abhiyan (RUSA) is enhancing access to higher education in unserved or underserved areas by setting up new institutions, and improving infrastructure and facilities in existing institutions. However, specific locations of these institutions are identified by the State Government based on their need assessment and requirements.

Unnat Bharat Abhiyan: UBA has been launched for connecting higher education and society to enable technology and its use for development of rural areas.

GIAN: Global Initiative for Academics Network (GIAN) has been launched to attract the best foreign academics to Indian Universities of Excellence.

Sarva Shiksha Abhiyan (SSA): Launched to implement TRE, the scheme has been restructured on the following lines—

(i) The framework has been revised and reimbursement towards expenditure incurred for at least 25 percent admissions of children belonging to disadvantaged group and weaker section in private unaided schools would be supported from the academic year 2014–15.

(ii) The Government in association with corporate sector has taken up for construction of toilets in all schools with a separate girls toilets before 15th August, 2015.

(iii) *Padhe Bharat Badhe Bharat* has been planned to improve language development by creating an enduring interest in reading and writing with comprehension.

Rashtriya Madhyamik Shiksha Abhiyan (RMSA): The RMSA aims at enhancing access to

secondary education and improving its quality to ensure Gross Enrolment Ratio (GER) more than 90 per cent by 2017 and universal retention by 2020. Certain norms of the scheme have been revised—

(i) To permit State/UT Governments to use State Schedule of Rates(SSOR) or CPWD Rate, (whichever is lower) for construction of civil works permissible under the RMSA.

(ii) To increase the Management, Monitoring Evaluation and Research (MMER) from 2.2 percent to 4 percent of the total outlay under the programme, with 0.5 percent of the 4 percent earmarked for national level and the rest of the 3.5 percent as part of the State allocation.

(iii) To authorize the RMSA Project Approval Board (PAB) of the Ministry of Human Resource Development to consider for approval Integrated Plan of the umbrella scheme of RMSA,

(iv) To authorize the release of funds to the RMSA State Implementation Society directly for all components of the RMSA umbrella scheme

Teacher Education (TE): The Centrally Sponsored Scheme for TE has been revised for the 12th Plan with an approved outlay of Rs. 6308.45 crore to be shared between the Centre and the States in the ratio of 75:25 (90:10 for North Easter Region) to strengthen SCERTs, establish DIETs, Institutes of Advanced Studies in Education (IASEs) and strengthen the existing Colleges of Teacher Education (CTEs) and up-grade existing Government secondary teacher education institutions into CTEs and Departments of Education in Universities as IASEs; and establish Block Institutes of Teacher Education (BITE) in identified 196 SC/ST/Minority Concentration Districts.

Saakshar Bharat (SB)/Adult Education: The focus of SB is female literacy. By the end of November 2014, about 3.13 million learners, of which around three-fourths are women, have successfully passed the assessment tests for basic literacy conducted by the National Institute of Open Schooling (NIOS).

Schemes to encourage education among SC and other schemes: These include—

(i) Pre-Matric Scholarship Scheme for SC Students studying in Classes IX and X

(ii) Pre-Matric scholarships to students, whose parents are engaged in 'unclean' occupations

(iii) Rajiv Gandhi National Fellowship Scheme aims at providing financial assistance to SC students pursuing M.Phil and Ph.D. courses.

(iv) National Overseas Scholarship Scheme: A financial support to students pursuing Master's level courses and PhD/Post-Doctoral courses abroad, maximum 60 awards are to be given from the year 2013–14 onwards.

(v) Scheme of Top Class Education: Eligible students who secure admission in notified premier institutions like the IITs, IIMs, and NITs, are provided full financial support for meeting the requirements of tuition fees, living expenses, books, and computers.

Educational schemes for OBCs: The Pre-Matric scholarship scheme aims to motivate children of OBCs studying at Pre-Matric stage and Post-Matric scholarship intends to promote higher education by providing financial support leading to their earning Ph.D. Degrees.

Scheme for Economic Development: Under Assistance to Voluntary Organizations Working for Welfare of OBCs, grants-in-aid is provided

to voluntary organizations to involve the non-Government sector by providing *skill up-gradation* amongst OBCs in various trades – through various vocational trainings to OBCs.

2. Employment/Training Related

Deen Dayal Upadhyaya Grameen Koushalya Yojana (DDU-GKY): This is a *placement linked* skill development scheme for *rural poor youth*. This initiative is part of National Rural Livlihood Mission (NRLM).

The skilling program for rural youth has now been *refocused* and *reprioritised* to build the capacity of rural poor youth to address the needs of the *domestic* and *global skill* requirements.

Mahatma Gandhi NREGA: The revised provisions are –

(i) Intensive and Participatory Planning Exercise (IPPE) to prepare the labour budget for financial year 2015–16 in selected 2500 backward Blocks has been initiated.

(ii) Emphasis on Agriculture and Allied Activities to ensure that at least 60 percent of the works in a district in terms of cost shall be for creation of productive *assets linked* to agriculture and allied activities through development of land, water and trees.

(iii) Provision for Payment of Technical Assistants/Barefoot Engineers from the Material Component of the Work

(iv) Special Financial Assistance for Staffing of Social Audit Units.

(v) Use of *Machines* for works where speed of execution is most critical (like the works in a flood prone area).

National Livelihoods Mission (NRLM): This was launched after restructuring Swarnajayanti Gram Swarozgar Yojana (SGSY). It aims at organizing all rural poor households and continuously nurturing and supporting them till they come out of abject poverty, by organizing one woman member from each household into affinity-based.

National Urban Livelihood Mission (NULM): Swarna Jayanti Shahari Rozgar Yojana (SJSRY) which has been restructured into NULM, aims at organizing urban poor in self help groups, imparting skill training to urban poor for self and wage employment and helping them to set up self-employment venture by providing credit on subsidized rate of interest. In addition, shelters for urban homeless and infrastructure for street vendors can also be taken up under this Mission.

Support to Training and Employment Programme (STEP): The Scheme is intended to benefit *women* who are in the age group of 16 years and above by providing skills to them for their employability. The Scheme covers any sector for imparting skills related to employability and entrepreneurship, including but not limited to Agriculture, Horticulture, Food Processing, Handlooms etc. and skills for the work place such as spoken English, Gems & Jewellery, Travel & Tourism and Hospitality.

Special Central Assistance (SCA) to the SCs Sub Plan (SCSP): This is a major initiative for *uplifting the SCs* above the poverty line through self-employment or training. The amount of subsidy admissible is 50 per cent of the project cost.

Nai Manzil: Aims at skill development among *drop outs*.

USTTAD (Upgrading the Skills and Training in Traditional Arts/Crafts for Development): This aims to conserve *traditional arts/crafts* of minorities and for building capacity of traditional artisans and craftsmen belonging to minority communities.

MANAS: This for upgrading entrepreneurial skills of *minority youth*. and ***Cyber Gram*** to impart training for *Digital Literacy*.

3. Finance, Insurance and Social Welfare Related

Pradhan Mantri Jan Dhan Yojna (PMJDY) was launched in August, 2014 with a target of 10 crore bank accounts by January 24, 2015. The scheme has yielded deposits of Rs. 8,36,905.5 lakh with 1063.9 lakh new bank accounts as by March 3, 2015—

(i) Payment solutions are an important part of financial inclusion for which a new card payment scheme known as *RuPay Card* has been in operation since May 2014.

(ii) Banks have further been asked to provide universal coverage across all the six lakh villages of the country by providing at least one Basic Banking Account, per household, with indigenous RuPay Debit Card having inbuilt accident insurance of Rs. 1.00 lakh and life insurance cover of Rs. 30,000.

(iii) The RuPay Card is on par with other debit cards.

These two schemes are complementary and will enable achievement of multiple objectives such as financial inclusion, insurance penetration and digitalisation.

Credit Risk Guarantee Fund (CRGF): This Fund has been created to guarantee the lending agencies for loans to new Economically Weaker Section (EWC)/Low Income Group (LIG) borrowers in *urban areas* seeking individual housing loans not exceeding a sum of Rs. 8 lakh (earlier Rs.5 Lakh) for a housing unit of size upto 430 sqft (40 sqm) carpet areas without any third party guarantee or collateral security.

Rajiv Rinn Yojana (RRY): RRY is a Central Sector Scheme applicable in all the *urban* areas of the Country and provides for interest subsidy of 5 per cent on loans granted to EWS and LIG to construct their houses or extend the existing ones.

Aam Aadmi Bima Yojana (AABY): The AABY extends life and disability cover to persons between the age of 18 years to 59 years, living below and marginally above the poverty line in 47 identified vocational/occupational groups, including rural landless households. The Scheme is also available to all RSBY (Rashtriye Swasthya Bima Yojajna) beneficiaries.

The AABY provides insurance cover on natural death, death due to accident, permanent and total permanent disability due to accident. It also provides an add-on-benefit of Scholarship of Rs 100 per month per child to a maximum of two children.

National Social Assistance Programme (NSAP): Schemes under NSAP are social security/welfare scheme for the persons living Below Poverty Line (BPL) and pension/assistance is provided to the BPL household in both *rural* as well as *urban* areas.

Venture Capital Fund for Scheduled Castes: Announced in 2014–15 Interim Budget 2014–15, this scheme has ctreated a venture capital fund of Rs. 200 crore dedicated to promote the entrepreneurial initiatives by the SCs.

Scheme of Equity Support to the National Safai Karamcharis Finance and Development Corporation (NSKFDC) and National Scheduled Castes Finance and Development Corporation (NSFDC): These corporations implement various loan Schemes and skill development programmes for the development of the target group.

Tribal Sub Plan and Special Area Programmes: There are two special area programmes—

(i) Special Central Assistance to States to supplement their TSP (SCA to TSP) for income generating schemes, creation of incidental infrastructure, community

based activities and development of forest villages, and

(ii) Grants under Article 275(I) of the Constitution for development and upgradation of administration in tribal areas. The latter is also used for setting up of *Eklavya Model Residential Schools (EMRS)* in States for providing quality education in remote areas.

National Scheduled Tribes Finance and Development Corporation (NSTFDC): The scheme provides loans and micro-credit at concessional rates of interest for income-generating activities.

4. *Health Related*

Swachh Bharat Mission (Gramin): This was launched on October 2, 2014, which aims at attaining an *Open Defecation Free India* by October 2, 2019, by providing access to toilet facilities to all rural households and initiating Solid and Liquid Waste Management activities in all Gram Panchayats to promote cleanliness –

(i) Under SBM(G), the incentives for Individual Household latrines (IHHLs) have been enhanced from Rs.10,000 to Rs. 12,000 to provide for water availability.

(ii) Part funding from MGNREGA for the payment of incentives for the construction of Individual House Hold Latrines (IHHLs) is now paid from the SBM (G).

(iii) Initiatives to include:

- (a) media campaigns,
- (b) provisioning for incentivizing ASHAs and Anganwadi workers for promoting sanitation,
- (c) guidelines to involve Corporates in Sanitation sector through *Corporate Social Responsibilities*,
- (d) strengthening online monitoring system for entering households level data gathered from the Baseline Survey.

National Health Mission (NHM): The NHM came into being in 2013 to enable universal access to equitable, affordable, and quality health care services. It *subsumes* the NRHM and National Urban Health Mission (NUHM) as sub-missions. The NUHM was initiated in 2013 to cover all cities/towns with a population of more than 50,000 and all district headquarters with a population above 30,000. Other towns would continue to be covered under the NRHM.

National Rural Drinking Water Programme (NRDWP): The provisions are—

(i) 20,000 number of Solar Power Based Water Supply Schemes have been approved across all the States for their habitations located in far flung / hilly areas or where availability of electricity is a constraint.

(ii) During the massive floods in Jammu & Kashmir , mobile water treatment plant and drinking water bottles / pouches were airlifted for the flood affected inhabitants.

(iii) Guidelines with regard to Community Water Purification Plants

(iv) For identifying ground water sources, the Ministry prepared Hydro Geo Morphological Maps and gave them to the States.

(v) Move for Certification of ISO-9001 for the Ministry - The Ministry of Drinking Water and Sanitation is working towards obtaining ISO–9001 Certification

Pradhan Mantri Swasthya Suraksha Yojana (PMSSY): Under it, six All India Institute for Medical Sciences (AIIMS) have become functional,

besides upgradation of medical colleges.Under *fourth phase*, four AIIMS like institutes each at Andhra Pradesh, Vidarbha region (Maharashtra), West Bengal and Poorvanchal are proposed to be established.

Human Resources, Infrastructure Development/Upgradation in Tertiary Health Care: With a view to strengthening the *medical education* infrastructure in the country, the Government has initiated *two new* (CSSs) Centrally Sponsored Schemes—

(i) 'Establishment of New Medical Colleges attached with District/Referral hospitals'

(ii) 'Upgradation of existing State Government/Central Government medical colleges to increase MBBS seats in the country'.

Scheme of Assistance for the Prevention of Alcoholism and Substance (Drugs) Abuse: The Ministry of Social Justice and Empowerment coordinates and monitors all aspects of drug abuse prevention which include assessment of the extent of the problem, preventive action, treatment and rehabilitation of addicts and public awareness. Under this scheme, financial assistance up to 90 per cent of the approved expenditure is given to the voluntary organizations and other eligible agencies for setting up or running Integrated Rehabilitation Centre for Addicts (IRCAs).

5. Housing/Infrastructure Related

Indira Awaas Yojana (IAY): Priority is to be given to families of the manual scavengers, including those rehabilitated and rehabilitated bonded labourers—now it has included the *transgenders*, too. Priority is given to households with single girl child, households where a member is suffering from Leprosy/cancer and people living with HIV. Apart from NER, Uttarakhand, Himachal Pradesh and J&K, the hilly States, other State Governments can also identify difficult areas, keeping the unit as Gram Panchayat.

Rajiv Awas Yojana (RAY): 10 per cent of the RAY allocation is kept for the *innovative projects* and the projects for *slum development/relocation* for the slums on Central Government land or land owned by its agencies, autonomous bodies, etc. To increase *affordable housing* stock, as part of the preventive strategy, the Affordable Housing in Partnership (AHP) Scheme is in place under RAY. External Commercial Borrowings (ECB) has been allowed for affordable housing projects from 2012. It has been extended for Slum Rehabilitation Projects from 2013–14.

Pradhan Mantri Gram Sadak Yojana (PMGSY): This is a *fully funded* centrally sponsored scheme with the objective of providing all-weather road connectivity and also permits upgradation of existing *rural roads*.

Jawaharlal Nehru National Urban Renewal Mission (JNNURM): This was launched to implement reform-driven, planned development of cities in a Mission mode. It has *four components*—two of it are implemented in 65 select cities

(i) Sub-Mission for Urban Infrastructure and Governanc

(ii) Sub-Mission for Basic Services to the Urban Poor

The other two components are implemented in other cities/towns –

(iii) Urban Infrastructure Development Scheme for Small and Medium Towns iv) Integrated Housing and Slum Development Programme

6. Women And Children Related

Beti Bachao Beti Padhao (BBBP) Programme: The programme was launched on in January 2015 at Panipat, Haryana for promoting survival, protection and education of girl child.

It aims to address the issue of declining Child Sex Ratio (CSR) through a mass campaign targeted at changing social mind set and creating awareness about the criticality of the issue. The overall goal of the BBBP programme is to prevent *gender biased sex selective* elimination, ensure survival and protection of the girl child and to ensure education and participation of the girl child.

Nai Roshni: This leadership development training programme for women was *extended* to 24 States 2014-15. It includes – Government Mechanisms, Involvement in decision making process, Health & Hygiene, Sanitation, Violence against women and their rights, Banking Systems, etc., to generate awareness and develop confidence among women.

Reproductive and Child Health (RCH): Two RCH programmes aim to bring about a change in three critical health indicators, maternal mortality rate (MMR), infant mortality rate (IMR), and total fertility rate (TFR)—

(i) Janani Suraksha Yojna (JSY)

(ii) Janani Shishu Suraksha Karyakram (JSSK)

Mid-Day Meal (MDM): Under this, *hot cooked mid-day meals* are provided to all children attending elementary classes (I-VIII) in Government, Government aided, Local body, Special Training Centers as well as Madrasas/Maqtabs supported under SSA across the country.

At present, it provides an energy content of 450 calories and protein content of 12 grams at primary stage and an energy content of 700 calories and protein content of 20 grams at upper primary stage. Adequate quantity of micro-nutrients like Iron, Folic acid, and Vitamin A are also provided in convergence with the National Rural Health Mission (NHRM).

Integrated Child Development Services (ICDS) Scheme: It represents one of the world's largest and most unique programmes for early childhood (below 6 years) development. It aims to reduce the incidence of mortality, morbidity, malnutrition and school dropout; to enhance the capability of the mother to look after the health and nutritional needs of the child through proper nutrition and health education.

Integrated Child Protection Scheme (ICPS): It provides preventive, statutory care and rehabilitation services to children who are in need of care and protection and children in conflict with law as defined under the Juvenile Justice (Care and Protection of Children) Act, 2000 and its Amendment Act, 2006 and any other vulnerable child.

Rajiv Gandhi Scheme for empowerment of adolescent girls (SABLA): The scheme is operational in 205 selected districts across the country since 2010. It aims at all-round development of adolescent girls of 11-18 years (with a focus on all out-of-school age groups). The scheme has two major components:

(a) Nutrition and

(b) Non-Nutrition Component. While the former aims at improving the health and nutrition status of the adolescent girls, the latter addresses their developmental needs.

Indira Gandhi Matritva Sahyog Yojana (IGMSY): The CSS is a Conditional Cash Transfer scheme covered under Direct Benefit Transfer (DBT) programme for *pregnant* and *lactating* women aged 19 years and above for first two live births in 53 districts.

The scheme has been *renamed* as **Matritva Sahyog Yojana (MSY), 2014**. As per the provision of the National Food Security Act (NFSA), 2013, the Ministry has reviewed the entitlement of maternity benefits of IGMSY beneficiaries in 53 districts from Rs. 4,000 to Rs. 6,000.

Rajiv Gandhi National Creche Scheme for Children of Working Mothers : This aims to provide *day care services to children* (in the age group of 0–6 years) of working and other

deserving women belonging to families whose monthly income is not more than Rs. 12,000. The Scheme provides supplementary nutrition, health care inputs like immunisation, polio drops, basic health monitoring, pre–school education (03–06), recreation, emergency medicine and contingencies.

Rajya Mahila Samman and Zila Mahila Samman: These awards to be given to one woman from each State/UT and one women from each District respectively, for advocacy and awareness creation, motivation, community mobilisation, women's empowerment, skill development training and capacity building and enterprise promotion in conjunction with tangible activities.

7. Scheme of Integrated Programme for Older Persons

Under the Scheme, financial assistance is given to implementing agencies for the following major activities provided for the welfare of Senior Citizens:

(a) Maintenance of Old Age homes, Respite Care Homes and Continuous Care Homes
(b) Running of Multi Service Centres for Older Persons
(c) Maintenance of Mobile Medicare Units
(d) Running of Day Care Centres for Alzheimer's Disease/Dementia Patients
(e) Physiotherapy clinics for older persons
(f) Disability and hearing aids for older persons

8. Sansad Aadarsh Gram Yojana (Sagy)

This was launched and its guidelines released in October 2014, for bringing convergence in the implementation of existing Government schemes and programmes without allocating additional funds or starting new infrastructure or construction schemes.

9. UIDAI

The Unique Identification Development Authority of India (UIDAI) is providing—Aadhaar Payment Bridge (APB)—a hassle free mechanism for, amongst other uses, *transfer of direct benefits* under government schemes including Modified Direct Benefits Transfer for LPG (MDBTL).

Aadhaar based verification is being utilized for opening new bank accounts under PMJDY, Biometric Attendance System for Central Government departments, Jeewan Pramaan scheme for central government pensioners, passport application system of Ministry of External Affairs, subscriber management system of Employee Provident Fund Scheme etc.

10. Vanbandhu Kalyan Yojana (VKY)

This new CSS for the STs was introduced in 2014–15. This is a *strategic process* which envisages to ensure that all intended benefits of goods and services under various rogrammes and schemes of Central as well as State Governments actually *reach* the target groups by convergence of resources through appropriate institutional mechanism.

11. Hamari Dharohar

This unique CSS aims to preserve *rich heritage of minority communities* of India under the overall concept of Indian culture. The newly launched NITI Aayog has given a serious call for an Indian Model of Development.

FUTURE POLICY ACTIONS

The *Economic Survey 2014-15* has tried to attract the attention of the governments by advising some future policy actions, which may be seen as given below:

(i) With women accounting for nearly 48 per cent of India's population (Census 2011), there is need to ensure

and safeguard their place in the socio-economic milieu. Since this requires a change in the *patriarchal mindset* of the larger population, government has to continue to be a *proactive facilitator* of this change through consistent policies.

(ii) India aims to be in the top 50 countries of the *Doing Business* ranking. Together with it India must try to be in the top 50 countries in HDI and GII rankings.

(iii) Low levels of *education* and *skill* deficit are responsible for low income levels of a large majority of the labour force, thereby, perpetuating inequality. Consequently, the government's thrust on skill development as well as 'Make in India' aim at improving *employability* and *generating employment avenues*.

(iv) Since demographic predictions warn that the promise of the *demographic dividend* will not last long, in any case not beyond 2050, India needs to take advantage of this demographic window in the next couple of decades.

(v) The challenge for the country now is in planning and acting towards converting its demographic 'burden' into enhanced opportunities for growth by dovetailing the quality of manpower to the requirements of employers (off-farm, industry, and services sectors), both domestic and international. For this intention to translate into reality, a 'bottom-up' approach using Panchayati Raj institutions and Urban Local Bodies as agents of change is the need of the hour.

India needs to include the potential and energy of its vibrant civil society, cultural capacity, youth power and the masses at large to initiate a process of reformatory moves on several fronts – social, economic and political. A new vibrancy was seen during recent years in India, particularily among the common people – it is time to tap this potential.

Note: Analyses and comments articulated in this chapter are based on the notes and suggestions provided by two categories of sources:

(i) *Some of the acclaimed academacians and policy makers* – Amartya Sen, ***Development as Freedom,*** Oxford University Press (OUP), N. Delhi, 2000; Amartya Sen & Jean Dreze, ***Indian Development,*** OUP, N. Delhi, 1996; Amartya Sen & Jean Dreze, ***An Uncertain Glory: Indian and its Contradictions***, Allen Lane, Penguin Books, London, 2013; Jeffrey D. Sachs, A. Varshney and Nirupam Bajpai, ***India in the Era of Economic Reforms,*** OUP, N. Delhi, 1999, pp. 74–80; Kaushik Basu ed., ***India's Emerging Economy,*** OUP, N. Delhi, 2004. & I.J. Ahluwalia and I.M.D. Little (eds), ***India's Economic Reforms and Development,*** OUP, N. Delhi, 1998; Suresh D. Tendulkar & T.A. Bhavani, ***Understanding Reforms: Post 1991 India,*** OUP, N. Delhi, 2007; and Kaushik Basu and Annemie Maertens (eds.) ***The New Oxford Companion to Economics in India, Vol. I & II,*** OUP, N. Delhi, 2012.

(ii) *Official documents and reports of the GoI and its organs* – Several volumes of the ***Economic Survey upto 2014-15,*** MoF, GoI, N. Delhi; India 2014 & 2015; ***The Twelfth Five Year Plan (2012-17): A Draft Outline,*** Planning Commission, GoI, N. Delhi, 2011; and the ***India Development Report 2004–05 & 2012-13,*** OUP, N. Delhi.

CHAPTER

22

ECONOMIC CONCEPTS AND TERMINOLOGIES

(Reference to Selected Terms Related to Economic and Indian Economy)

*Concepts are the constituents of thoughts—consequently, they are crucial to such psychological processes as categorization, inference, memory, learning, and decision-making.**

* *See Eric Margolis and Stephen Laurence, 'Concepts', in the Edward N. Zalta* ***The Stanford Encyclopedia of Philosophy,*** Metaphysics Research Lab, Centre for the Study of Language and Information (CSLI), *Stanford, USA, 2012.*

ACCRUAL BASIS

An accounting method which considers revenues and expenses as they accrue, even though cash would not have been received or paid during the period of accrual.

ACTIVITY RATE

The labour force of a country is known as the activity rate or *participation rate*. It is in per cent and always a proportion of the total population of the country—the economically active population. This rate varies from one country to another depending upon several factors such as school leaving age, retirement age, popularity of higher education, social customs, opportunities, etc.

ADRS

ADR stands for American Depository Receipt, which enables investors based in the USA to invest in stocks of non—US companies trading on a non the US stock exchange. ADRs are denominated in dollars. Simply put, US brokers purchase shares of a foreign company, say Infosys (on behalf of their clients). ADRs are subsequently listed on US stock exchanges.

ADRs can be sponsored or unsponsored. Sponsored ADRs are those in which the company actively participates in the process. Sponsored ADRs can be Level I, Level II or Level III. There are also what are called Rule 144A. The ADRs were first offered in the US in the 1920s. A number of Indian companies have issued ADRs. Infosys Technologies was the *first* Indian company to use the ADR route.

The terms *ADR* and *ADS* are often used interchangeably. The individual shares representeted by an ADR are called American Depositary Shares (ADS).

To the company issuing ADRs, it provides access to the American market. A company can, therefore, raise additional resources. To an American investor, it provides the opportunity to invest in stock of companies not listed in the US. Huge operational, custodial, and currency conversion issues can come into play if the ADR route is not used.

ADS CONVERSION OFFER

Conversion of local shares into American Depository Shares (ADS) of a company is called an ADS conversion offer. It is managed by investment bankers, mainly large investment banks familiar with Indian and global markets The offer allows local investors to convert their shares into ADS and then sell it in US markets. The proceeds of the sale in the US markets is distributed to Indian investors in rupees after deduction of expenses incurred in the process. The company does not issue any new shares. Existing shares are converted into ADS. The scheme obviously can only be offered by companies listed on the Indian and US markets which is the case for many large Indian corporates.

American Depository Shares are usually traded at a premium to the underlying (Indian) share price.

If the share conversion offer takes place through the stock market in India, investors pay no long-term capital gains tax. A 10 per cent short-term capital gains tax is applicable. Investors, however, have to pay the securities transaction tax in the process. However, if the offer is not through the stock market system, then investors have to pay 30 per cent short-term capital gains tax with surcharge or 10 per cent long-term capital gains tax as applicable. Investors do not have to pay any securities transaction tax.

Companies do not issue new shares. Thus, the offer does not lead to any dilution of equity and earnings per share. They are making this offer to satisfy the demand for ADS traded in US markets. This allows companies to have new investors and

creates visibility on the US stock exchanges. They also satisfy the local investor by offering an opportunity to sell their shares at a higher price than available locally on the Indian bourses.

ADVERSE SELECTION

One among the two kinds of the market failure often associated with insurance business which means doing business with the people one would have better avoided.

Adverse selection can be a problem when there is an asymmetry in information between the seller and the buyer of an insurance policy—as insurance will not be profitable when buyers have better information about their risk of claiming than does the seller of the insurance policy. In the ideal case, insurance premiums are set in accordance to the risk of a randomly selected person in the insured bracket (such as 40-year-old male smokers) of the population.

The other kind of market failure is *moral hazards* associated with the insurance sector.

AGRICULTURAL EXTENSION

Agricultural extension is a proper approach to motivate people to help themselves by applying agricultural research and development in their daily lives in farming, home making, and community living. It plays a vital role in community development. It is a two-way channel that brings scientific information to rural people and takes their problems to scientific institutes (for further research and development) for their solution.

In India, like many other developing countries, the role of agricultural extension is more than educational and it needs to deal with the human resource development of the agrarian population too, making it a comparatively tougher task than in the developed countries. The spread of information technology will serve a great purpose in this area.

AGRICULTURAL LABOURER

A person who works on another person's land for *wages* in money or kind or share is regarded as an agricultural labourer. He or she has no risk in the cultivation, but merely works on another person's land for wages. An agricultural labourer has no right of lease or contract on land on which he/she works.

AGRICULTURAL MARKETS

Agricultural Markets are regulated and managed under the Agricultural Produce Market Act (APMC Act) enacted by the respective state governments. The Central government provides guidance and assistance in regulation and development of agricultural-produce markets. 7,521 markets have been brought under regulation upto March this year. To handle increasing quantity, more and more markets have been brought under regulation over the years. There were only 286 regulated markets in 1950 on an average. a regulated market serves 459 sq. km. but the National Commission on Agriculture recommended that a regulated market should serve farmers within a 5 km radius and a command area of 80 sq. km.

ALPINE CONVERTIBLE BOND

An ACB (Alpine Convertible Bond) is a Foreign Currency Convertible Bond (FCCB) issued by an Indian company exclusively to the Swiss investors.

AMMORTISATION

Payment of a loan in installments by the borrower. It is usually done in an agreed period and every installment includes a part of the total loan plus the interest.

ANDEAN PACT

A regional pact to establish a common market link, started originally in 1969. At present it has peru, Equador, Columbia, Bolivia, and Venezuela. The pact had almost collapsed by the mid-1980s due to regional, economic, and political instabilities and was re-launched in 1990 (the original member Chile was dropped and the new member venezuela was added to it).

ANIMAL SPIRIT

'Confidence', considered as one of the essential ingredients of economic prosperity was called by J. M. Keynes as animal spirit. For keynes, this is a 'naive optimism' by which an entrepreneur puts aside the fact of loss as a healthy man puts aside the expectation of death.

But from where does this animal spirit come has been a mystery—can it be created artificially from outside or whether it is an innate thing some are born with, etc.

ANTITRUST

A category of the government policy which deals with monopoly. Such laws intend to stop abuses of 'market power' by big companies and at times to prevent corporate mergers and acquisitions that would strengthen monopoly. The US has such laws and recently it was in news when Microsoft was its target.

APPRECIATION

It shows increase in value and is used in economics in the following two senses:

(i) It is an increase in the price of an asset over time, such as price rises in land, factory building, houses, offices, etc. It is also known as *capital appreciation.*

(ii) It is an increase in the value of currency against any foreign currency or currencies. It is market-based if the economy follows the floating-currency exchange-rate system.

ARBITRAGE

Earning profits out of the price differences of the same product in different markets at the same time. For example, buying and selling any product, financial securities (as bonds) or foreign currencies in different markets/economies. As globalisation is promoting liberalised cross-border movement of goods and services around the world, arbitrage is prevalent today. To avoid arbitrage the WTO member countries (i.e.) the official countries in the process of globalisation) are under compulsion to chalk out homogenous economic policies–and a level-playing field at the international level is emerging.

ARCS

Assets Reconstruction Companies (ARCs) acquire non-performing assets (NPAs) from banks or financial institutions along with the underlying securities mortgaged and/or hypothecated by the borrowers to the lenders. The ARCs then try and manage or resolve these NPAs acquired from banks. It can even infuse more funds in order to reconstruct the asset. If reconstruction is not possible and the borrower is unwilling to repay the loan, the ARCs *even sell* the secured assets.

While the basic principle of ARCs is the same everywhere—to acquire bad loans to resolve them—the essential difference is in the ownership of ARCs, public or private. After the Asian Crisis, countries like Indonesia, Korea, Malaysia, and Thailand have adopted government-owned and funded ARCs. The Philippines, on the other hand, has opted for private ARCs. India, too, has adopted

the private sector model of asset resolution. Here, ARCs are set up as non-governmental vehicles mostly with support from the banking sector and other investors. Also, India has opted for multiple ARCs, which helps in better pricing of bad loans, as opposed to the single ARC model followed in many countries. The RBI has already allowed licenses to three ARCs and some banks are also planning to float ARCs.

ARCs acquire NPAs by way of 'true sale', i.e., once an NPA has been sold, the seller has no further interest in that asset.

ARCs are a product of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (**SARFAESI Act**). And they derive their asset resolution powers from this Act. The act provides full right to the lenders acting in majority (75 per cent of the total debt by value) to enforce the security in tersest (terms of the loan) without judicial intervention. Through buying out major lenders in a loan gone bad (to the extent of 75 per cent of value), through the mechanism mentioned earlier, an ARC is able to have recourse to SARFAESI Act and, thereby, acquire legal muscle to force settlement.

It is true that if a bank itself has 75 per cent of the total value of debt in an NPA or is able to buy out other and accumulate the same, then it also gets recourse to SARFAESI. In that sense, banks are at par with ARCs. That is why we now find that some banks are getting interest and acquiring bad assets, just like an ARC does. However, a bank's business is not to deal bad assets or try and reconstruct them. An ARC, on the other hand, is in the business of reconstructing bad assets, and has acquired skill and experience in asset resolution. It is able to do the same job better. Moreover, selling an NPA helps a bank to clean its balance sheet, too.

ASSET

Anything which has a 'money value' owned by an individual or a firm is an asset. It is of *three* types:

(i) *Tangible Asset:* All physical assets such as land, machinery, building, consumer durables (refrigerator, car, TV, Radio, etc.), etc. (*the assets which are in the material form*).

(ii) *Intangible Assets:* All non-physical/ immaterial assets such as brand names, good-will, credit-worthiness, knowledge, know-how, etc.

(iii) *Financial Assets:* All financially valid valuables other than tangibles and intangibles such as currencies, bank deposits, bonds, securities, shares, etc.

ASSIGNED REVENUE

The term is used to refer to various tax/duty/ cess/surcharge/levy etc., proceeds of which are (traditionally) collected by state government (on behalf of) local bodies (the PRIs), and subsequently adjusted with / assigned to the PRIs. Collection of such revenue is governed by relevant Acts of the local bodies.

Some examples of assigned revenue in India, include, entertainment tax, surcharge on stamp duty, local cess/surcharge on land revenue, lease amount of mines and minerals, sale proceeds of social forestry plantations, etc. State Finance Commissions recommend *devolution* of assigned revenue to local bodies on objective criteria, which may be specified by them in specific context.

AUTARKY

The idea of self-sufficiency and 'no' international trade by a country. None of the countries of the world has been able to produce all the goods and

services required by its population at competitive prices, however, some tried to live it up at the cost of inefficiency and comparative poverty.

BACKWARDATION

A term of future trading which means a commodity is valued higher today (i.e., spots market) than in the futures (i.e., future market). When the situation is opposite, it is known as *contango*.

BACK-TO-BACK LOAN

A term of international banking, is an arrangement under which two firms (i.e., companies) in different economies (i.e., countries) borrow each other's currency and agree to repay (such loans) at a specified future date. Each company gets full amount of the loan on the repayment date in their domestic currency without any risk of losses due to exchange rate fluctuations. It has developed as a popular tool of minimising the exchange-rate exposure risk among the multi-national companies. This is also known as the *parallel loan*.

BAD DEBT

An accounting term to show the loans which are unlikely to be paid back by the borrower as the borrower has become insolvent/bankrupt. Banks might write off such bad debts against the profits of the trading as a business cost.

BADLA

An Indian term for 'contango' associated with the trading system in the stock market which is a postponement of either payments by the share buyer, or the person who needs to deliver the shares against the payment.

BALANCED BUDGET

The annual financial statement (i.e., the budget) of a government which has the total expenditures equal to the taxes and other receipts.

Most governments, in practice run unbalanced budgets, i.e., deficit budgets or surplus budgets– either the expenditures being higher or lower than the taxes and the other receipts, respectively. It is done to regulate the economic activities.

BALANCE OF PAYMENTS

A balance sheet of an economy showing its total external transactions with the world– calculated on the principles of accounting–is an annual concept.

BALLOON PAYMENT

When the final payment of a debt is more than the previous payments, it is balloon payment.

BASING POINT PRICE SYSTEM

A method of pricing in which a differential (i.e., varying) price is fixed for the same product for the customers of the different locations—nearer the customer, cheaper the product. This is done usually to neutralise the transportation cost of the bulky products such as cement, iron and steel, petroleum, etc.

BELLWETHER STOCK

A share which often reflects the state of the whole stock market. The technical analysts, associated with the stock market, usually keep a track-record of such shares and go on to forecast the future stock movements.

BFS

For the purpose of supervision and surveillance of the Indian financial system, a Board for Financial Supervision (BFS) was set up by the RBI in November 1994. The board supervises commercial banks, non-banking financial companies

(NBFCs), financial institutions, primary dealers, and the clearing corporation of India (CCI).

BLACK-SCHOLES

A formula devised for the pricing of financial derivatives or options—made explosive growth possible in them by the early 1970s in the US.

Myron Scholes and Robert Merton were awarded Nobel Prize for Economics for their part in devising this formula—the co-inventor fischer Black had died (1995) by then.

BOND

An instrument of raising long-term debt on which the bond-issuer pays a periodic interest (known as *'coupon'*). In theory, bonds could be issued by governments as well as private companies.

Bonds generally have a maturity period, however, some bonds might not have any definite maturity period (which are known as *'Perpetual Bonds'*).

Bonds are supported/secured by collateral in the form of immovable property (i.e., fixed assets) while *debentures,* also used to raise long-term debt, are not supported by any collateral.

BOOK BUILDING

This is a public offer of equity shares of a company. In this process, bids are collected from the investors, in a certain price range fixed by the company. The issue price is fixed after the bid closing date depending on the number of bids received at various price levels. A company that is planning an initial public offer (IPO) appoints a merchant banker as a 'book runner'. The company issues a prospectus which does not mention the price, but gives other details about the company with regard to issue size, the business the company is in, promotes and future plans among other disclosures. A particular period is fixed as the bid period. The book runner builds an order book, that is, collates the bids from various investors, which shows the demand for the shares. Prospective investors can revise their bid at any time during the bid period. On closure of the book, the quantum of shares ordered and the perspective prices offered are known. The price discovery is a function of demand at various prices, and involves negotiations between those involved in the issue. The book runner and the company conclude the pricing and decide the allocation to each member.

BRACKET CREEP

Increasing incomes due to inflation (via increased dearness allowances, individual income goes for an increase) pushes individuals into higher tax *brackets* and leaves them worse off (as their real income has not increased and their disposable income i.e. income after tax payments, falls) – this phenomenon is known as the bracket creep.

BROAD BASED FUND

This is a fund established or incorporated *outside* India, which has at least 20 investors with no single individual investor holding more than 49 per cent of the shares or units of the fund. If the broad based fund has institutional investor (s), then it is not necessary for the fund to have 20 investors. Further, if the broad based fund has an institutional investor who holds more than 49 per cent of the shares or units in the fund, then the institutional investor must itself be a *broad based fund.*

In India, the entities, proposing to invest *on behalf of broad based funds*, are eligible to be registered as FIIs are: (i) Asset Management Companies, (ii) Investment Manager/Advisor, (iii) Institutional Portfolio Managers, (iv) Trustee of a Trust, and (v) Bank

BROWNFIELD LOCATION

A derelict industrial area that has been demolished to accommodate new industries. This is opposite to the *greenfield location* where a new industry is set up in a new area.

BUBBLE

The price rise of an asset unexplained by the fundamentals and still people interested in holding the assets. After the bursting of the bubble, assets cool down to their real prices.

BUDGET LINE

A line on the dual axis graph showing the alternate combinations of goods that can be purchased by a consumer with a given income at given prices.

BULLET REPAYMENT

'Bullet repayment' means a lump-sum payment for the *entire loan amount* paid at the time of maturity. Such arrangements may be put in place by the banking regulator (RBI in case of India) to fasten the process of recovery of the non-performings assets (NPAs) process of the banks. The distressed assests, in this way come back to bank, may be with a lower profit element to them.

Such an announcement was made by the RBI in 2014–15 allowing *bullet repayment* of loans extended against pledge of gold ornaments and jewellery for other than agricultural purposes.

BULLION

Precious metals such as gold, silver, and platinum that are traded in the form of *bars* and *coins* for investment purposes and are used for jewellery as base metals.

BUSINESS CYCLE

See the chapter with the same title.

BUSY & SLACK SEASONS

The monetary authorities face the challenge of keeping the growth rate as high as possible, at the same time putting burden of adjustment on luxury and unproductive consumption. Monetary policy is an instrument in this respect. However, the right policies may not be palatable to the political and fiscal authorities, which is a serious problem for the economy.

From May beginning to end-September is the *slack season* and from October beginning to end-April is the *busy season* of the ***Indian economy***. During the slack season, crops are generally sown. Agriculture and related businesses are slack and loans taken during the previous busy season tend to be returned. Consequently, the growth rate of money is low or negative. Governments usually borrow heavily during the slack season, since the demand for credit from the commercial sector is not very strong. Since there are no fresh crop arrivals in the market and the demand for crops is steady, the prices are expected to be generally upward in the slack season.

From October, the busy season commences and both agricultural and related industrial productions are high. Since crops arrive in the market during the busy season, prices generally are on the downward drift. It is the seasonal variation in the arrival of crops in the market, in the context of steady demand, that causes prices to fluctuate during the year.

The above pattern has been severely modified in recent years. The government borrows both during the slack and the busy seasons. Industry too is active in both the seasons. Because of greater

storage and stocking facilities, the variations in the flows o f agricultural products have been reduced. Money supply expands continuously and prices are generally up throughout.

BUYER'S MARKET

A short period of market situation in which there is excess supply of goods/services forcing price fall to the advantage of the buyers.

BUYOUTS

Private equity (PE) investors participate in two types of buyouts of firms (a PE-backed buyout simply means that the PE investor takes a controlling stake i.e. between 50–100 per cent in a company):

(i) *Management Buyout (MBO):* In such buyouts, the PE investor usually helps the existing management of the company to buy out the promoters of the company. In return, the PE investor takes a majority stake.

(ii) *Leveraged Buyout (LBO):* In such buyouts, a large portion of fund in acquiring the company is financed by debt–the normal ratio being 70 per cent debt and 30 per cent equity.

CAMELS

An acronym derived from the terms capital adequacy (C), asset quality (A), management (M), earnings (E), liquidity (L) and systems for control (S). The acronym is used as a technique for evaluating and rating the operations and performance of banks all over the world.

CAPITAL

Capital is one of the three main factors of production (*labour* and *natural resources* are the other two), classified into *physical capital* (i.e., factories, machines, office, etc.) and *human capital* (i.e., training, skill, etc.).

In a joint stock company, the capital has various specific terms showing different forms of the *share capital:*

(i) *Authorised Capital:* This is the amount of share capital fixed in the Memorandum of Association (MoA) and the article of association of a company as required by the Companies Act. This is also known as the *Nominal* or *Registered Capital.*

This is the limit (i.e., nominal value) upto which a company can issue shares. Companies often extend their authorised capital (via an amendment in the MoA) in advance of actual issue of new shares. This allows the timing of capital issue to be fixed in light of the company's need for new capital and the state of the capital market and allows share options to be excercised accordingly.

(ii) *Paid-up Capital:* The part of the authorised capital of a company that has actually been paid up by the shareholders. A difference may arise because all shares authorised may not have been issued or the issued shares have been only partly paid-up by then.

(iii) *Subscribed Capital:* The capital that has actually been paid by the shareholders (as they might have committed more than this to contribute). It means, the subscribed capital is the actually realised paid-up capital (paid-up capital is subscribed capital plus credit/due on the shareholders).

(iv) *Issued Capital:* The amount of the capital which has been sought by a company to be raised by the issue of shares (it should be kept in mind that this cannot exceed the authorised capital).

(v) *Called-up Capital:* The amount of share capital the shareholders have been *called* to pay to date under the phased payment terms. It is usually equal to the 'paid-up capital' of the company except where some shareholders have failed to pay their due installments (known as *calls in arrears*).

CAPITAL ADEQUACY RATIO

A regulation on commercial banks, co-operative banks and the non-banking financial companies to maintain a certain amount of capital in relation to their assets (i.e., loans and investments) as a cushion (shock-absorber) against probable losses in their investments and loans.

A concept devised by the Bank for International Settlements (BIS), Basel, the provision was implemented in India in 1992 by the RBI (for more detailed discussion see the chapter on 'Banking').

CAPITAL CONSUMPTION

The capital that is consumed by an economy or a firm in the production process. Also known as *depreciation*.

CAPITAL-OUTPUT RATIO

A measure of how much additional capital is needed to produce each extra unit of the output. Put the other way round, it is the amount of extra output produced by each unit of added capital. The ratio indicates how efficient new investment is in contributing to the growth of an economy.

A capital-output ratio of 3:1 is better to the 4:1 as the former needs only three units extra capital to produce one extra output in comparison to the latter which needs four units for each extra unit output.

CARBON CREDIT

Amidst growing concern and increasing awareness on the need for pollution control, the concept of carbon credit came into vogue as part of an international agreement, known popularly as the Kyoto Protocol. Carbon credits are certificates issued to countries that reduce their emission of GHG (greenhouse gases) which leads to global warming. It is estimated that 60–70 per cent of the GHG emission is through fuel combustion in industries like cement, steel, textiles, and fertilisers. Some GHGs like hydro fluorocarbons, methane, and nitrous oxide are released as byproducts of certain industrial process which adversely affect the ozone layer, leading to global warming.

Kyoto Protocol is a voluntary treaty signed by 141 countries including the European Union, Japan, and Canada for reducing GHG emission by 5.2 per cent below 1990 levels by 2012. However, the US, which accounts for one-third of the total GHG emission is yet to sign this treaty. The preliminary phase of Kyoto Protocol started in 2007 while the second phase starts from 2008. The penalty for non-compliance in the first phase is 40 euro per tonne of Co_2 equivalent and in the second phase the penalty will be hiked to 100 euros per tonne of Co_2.

The Kyoto Protocol provides for *three* mechanisms that enable developed countries with quantified emission limitation and reduction commitments to acquire greenhouse gas reduction credits. These mechanisms are Joint Implementation (JI), Clean Development Mechanism (CDM) and International Emission Trading (IET). Under *JI,* a developed country with a relatively higher costs of domestic greenhouse reduction sets up a project in another developed country which has a relatively low cost. Under *CDM,* a developed country can take up a greenhouse gas reduction project activity

in a developing country where the cost of GHG reduction project activities is usually much lower. The developed country would be given credits for meetings its emission reduction target, while the developing country would receive the capital and clean technology to implement the project. Under *IET* mechanisms, countries can trade in the international carbon credit market. Countries with surplus credits can sell the same to those with quantified emission limitation and reduction commitments under the Kyoto Protocol.

The concept of carbon credit trading seeks to encourage countries to reduce their GHG emissions, as it rewards those countries which meet their targets and provides financial incentives to the others to do so as quickly as possible. Surplus credits (collected by overshooting the emission reducing target) can be sold in the global market. One credit is equivalent to one tonne of Co_2 emission reduced. Carbon Credit (CC) is available for companies engaged in developing renewable energy projects that offset the use of fossil fields. Developed countries have to spend nearly $25 billion which will be ultimately spent by developing countries. In countries like *India,* GHG emission is much below the target fixed by Kyoto Protocol and so, they are excluded from reduction of GHG emission. On the contrary, they are entitled to sell surplus credits to developed countries. It is here that trading takes place. Foreign companies, who cannot fulfill the protocol norms, can buy the surplus credit from companies in other countries through trading. Thus, the stage is set for Credit Emission Reduction (CER) trade to flourish. India is considered as the *largest* beneficiary claming about 31 per cent of the total world carbon trade through the Clean Development Mechanism (CDM).

The trading takes place on two stock exchanges, the Chicago Climate Exchange and the European Climate Exchange. CC trading can also take place in the open market as well. European countries and Japan are the major buyers of carbon credit. Under the Kyoto Protocol, global warming potential (GWP) is an *index* that allows for the comparison of greenhouse gases with each other in the context of the relative potential to contribute to global warming. For trading purposes, one credit is considered equivalent to one tonne of Co_2 emission reduced.

Getting carbon credits certified for Kyoto is a rather lengthy and complex process. There are four stages of CDM approval. First stage is at the domestic level where the project gets approved by National CDM Authority (NCM). After NCM's approval the project is sent to the United Nations Framework Convention on Climate Changes. After this the executive board of UNFCCC reviews the project. The project gets evaluated on every front and is then registered under UN FCCC only if it meets all the norms. Thereafter, certification is done for the reduction in emission and credits are issued.

CARRY TRADE

Borrowing in one currency and investing in another is termed as carry trade. In recent times (upto November 2007) trillions of dollars have been borrowed in low-cost 'yen' for deployment across money markets, stock markets, and even real estate markets across the globe and a part of the money flowed into India, too.

In recent months, Japan has been the best market for 'carry trades' because of a weak Yen and a cost of borrowing that is almost 'zero'; in seven years since 1999, and after two hikes by the Bank of Japan, the interest rate is 0.5 per cent. The money thus borrowed is usually invested in the respective currencies in markets where the interest rate is higher, or in equities. Preferred destinations include the USA, N. Zealand, and Australia for debt investments, and emerging markets such as India for equity investment.

CASH COW

A profitable business or firm (may belong to either public or private sector) which gives regular cash flow to the owner (this happens either due to regular demand of the popular goods produced by the firm or the compulsions of the consumer to buy the products). As for example, the antiseptic lotion 'Dettol' is a cash cow for Reckitt and Colman in the private sector and LPG is a cash cow for the manufacturing and marketing government companies (provided there is no subsidy on LPG).

CAVEAT EMPTOR

A Latin phrase which means *'let the buyer beware'*. Simply put, it means that the supplier has no legal obligation to inform buyers about any defects in his goods or services; the onus is on the buyer to himself determine the level of satisfaction out of the products.

CETERIS PARIBUS

A Latin phrase which means *'other things being equal'*. The phrase is used by economists to cover their forecastings.

CHINESE WALL

The segregation of the different activities of a financial institution (such as, jobbing, stockbroking, fund management, etc.) in order to protect clients' interest.

CIRCUIT LIMIT

A limit of regular fall in share indices of Stock Exchanges around the world after which the exchange are closed for further trading. For example, circuit limit decided for the BSE (Bombay Stock Exchange) has been fixed at 10 per cent. The time there is a continuous fall in the BSE Sensex and it reaches 10 per cent, the exchange is closed to further trading.

Such a limit/provision prevents the share market from crashing down.

CLASSICAL ECONOMICS

A school of thought in economics based on the ideas of Smith, Ricardo, Mill, etc. The school dominated the economic thinking of the world until about 1870, when the *'marginalist revolution'* took place.

CLEAN COAL

Underground coal gasification and liquefaction which converts coal into liquid and gaseous fuel alternatives is a recognised 'clean coal' technology—handy in extraction of energy from coal seams which connot be mined through conventional methods.

CLOSED SHOP

The requirement that all employees of a given firm be members of a specified trade union. It is a method of restricting labour supply and maintaining high wages applied by a powerful trade union.

COLLECTIVE PRODUCTS

A product which can only be supplied to a group. Many goods and services provided by the governments fall in this category, such as, national defence, police administration, etc.

COMMODITIES TRANSACTION TAX

[See Chapter 17, *Tax Structure in India*]

COMMODITY MONEY

Products being used as the means of payment as in the traditional barter system. Such practices take place generally when the confidence in money has fell down (as for example in the situations of high inflation and high depreciation).

COMMUNITISATION

A method of privatising public service delivery without going for the tendering process. It is done by transfering powers including financial powers to the user community who will take up the job of revenue collection along with an effective and more practical governance of the service delivery. This model is bereft of profit motive and so, more transparent.

Service delivery in communitised elementary schools and health service institutions has improved considerably and power tariff collection has risen by 100 per cent since the reform began in 2002 in Nagaland—Secretary, Union Ministry of Steel, Raghaw Sharan Pandey who did it in Nagaland as its chief secretary.

COMPARATIVE ADVANTAGE

It is about identifying activities that an individual, a firm or a country can do most efficiently, being together.

The idea, usually credited to David Ricardo, underpins the case of free trade. It suggests that countries can gain from trading with each other even if one among them is more efficient (i.e., it has an *absolute advantage*) in every kind of economic activity.

CONSOLS

This is the abbreviated form of *consolidated stock.* The government bonds which have no maturity and thus have an indefinite life–are tradable on the floors of the stock exchanges.

CONSORTIUM

An *ad hoc* grouping of firms, governments, etc. brought together to undertake a particular project by pooling their resources and skills for major construction projects, loans, etc.

CONSUMER DURABLES

Consumer goods that are consumed over relatively long periods of time rather than immediately (opposite to the *consumer non-durables*) such as cars, houses, refrigerators, etc.

CONSUMER NON-DURABLES

Consumer goods which yield up all their satisfaction/utility at the time of consumption (Opposite to the *consumer durables*), examples are cheese, pickles, jam, etc.

CONSPICUOUS CONSUMPTION

Consumption for the purpose of showing off ostentatiousness but not for the utility aspect – for example, the use of diamond-studded sandals, watches, pens, etc.

CONTAGION

A situation or an effect of economic problems in one economy spreading to another also known as the *domino effect.*

CONTRARIAN

A person following an investment strategy (specially in share market) just opposite to the general investors in a given period. For example, when a share is generally being sold by the investors, a contrarion keeps on buying them—

the logic is that due to selling pressure the price will fall below the intrinsic value of the share and there is a prospect of future profit out of the share.

CORE INVESTMENT COMPANIES (CICS)

A NBFC carrying on the business of acquisition of shares and securities which satisfied the conditions: it holds not less than 90 per cent of its total assets in this form; its investments in the equity shares in group companies constitutes not less than 60 per cent of its total assets; it does not trade in its investments in shares, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment; and it does not carry on any other financial activity except investment in bank deposits, money market instruments, government securities, loans to and investments in group companies.

CORPORATE SUSTAINIBILITY INDEX

The Bombay stock Exchange (BSE) has proposed to come out with a corporate sustainability index (CSI)—a possible new stock exchange which will be created for developing *trust marks* to denote a corporate's sustainability achievements. This will be the first such index in Asia.

CORRECTION

A term usually used in stock market which shows a reversals of share prices in reaction to an excessive rise or fall of the past.

CREATIVE DESTRUCTION

The process by which an innovative entrepreneur takes risks and introduces new technologies to stimulate economic activity, replacing old technologies is known as 'creative destruction'. As per *Schumpeter, Joseph A.* (1883–1950), creative destruction is the key to economic growth. But due to irregularity in such innovations, business cycle is followed by both collapse and crisis (J. A. Schumpeter, *capitalism, Socialism and Democracy,* 1942).

CRONY CAPITALISM

An approach of doing business when the firms look after themselves by looking after their own people (i.e., families and friends). Used in negative sense.

CROSS SUBSIDY

The process of giving subsidy to one sub-area and fulfilling it through the profits from the other sub-area. As for example, in India kerosene oil is cross-subsidised against petrol and aviation fuel.

CROWDING-OUT EFFECT

A concept of public finance which means an increase in the government expenditure which has an effect of reducing the private sector expenditure.

CSR

The concept of corporate social responsibility (CSR) is fast gaining popularity among the corporate sector of the world. As per the experts, the CSR is qualitatively different from the traditional concept of passive philanthropy by the corporate houses. Basically, the CSR acknowledges the *debt* that the corporates owe to the community within which they operate. It defines the corporates' partnership with social action groups (i.e., the NGOs) in providing financial and other resources to support development plans, especially among disadvantaged communities. There is stress on long-term sustainability of business and environment and the distribution of well-being.

DEBENTURE

An instrument of raising long-term loan by companies, having a maturity period bearing an

interest (*coupon rate*). Theoretically they may be secured or unsecured by assets such as land and buildings of the issuing company (known as *collateral*).

Debenture holders are provided with a prior claim on the earnings (by interest) and assets of the company in the situation of liquidation of the company over the *preference* and *equity shareholders* of the company.

DEBT RECOVERY TRIBUNAL (DRT)

Banks and financial institutions have often faced a tough time in recovering loans, on which the borrowers have defaulted. To expedite the recovery process, the Committee on the Financial System, headed by *Mr. Narasimham* considered the setting up of special tribunals, with special adjudicator powers. This was felt to be necessary to carry through financial sector reforms. Since there is an immense overload on the Indian legal system at present, recovery of many unpaid debts, due to banks or financial institutions, are held up, indefinitely. This affects the balance sheets of the banks as the amounts involved are very large.

It was thought that an independent forum was needed to deal with debts of these types. Thus, in *1993* the *Recovery of Debts Due to Banks and Financial Institutions Act'* was passed. The Act, however, imposes a limitation and states that only those debts which are in excess of Rs. 10 lakhs (or upto Rs. 1 lakh, where the Central government specified certain types of debts) would come under its purview.

The tribunals are set up by the Central government. The government also specified the areas within which such tribunals will have jurisdiction. A DRT consists of the Presiding Officer to be appointed by notification by the Central government. The government may also specify that the presiding officer of one tribunal may takeover the functions of the presiding officer of another tribunal. A person has to be at least a district judge to become a presiding officer of a Tribunal.

The very first step involved in the recovery process is to make an application to the Tribunal under Section 19 of the Recovery of Debts due to Banks and Financial Institutions Act, 1993. Every bank and financial institution, which stands to recover loans and other debts, shall initiate the procedure by first forwarding an application to the Tribunal within the local limits of whose jurisdiction the defaulter company is located. After the financial institution has filled an application before the Tribunal, and if there are other banks whose loan to the same company has become bad, the latter can join the recovery suit.

DEBT SWAP SCHEME

In 2003, the Government of India announced a scheme to replace the relatively high cost debt of states with lower cost borrowings, taking advantage of falling interest rates. The scheme envisages states pre-paying that portion of their outstanding debt to the Centre on which the interest rate is 13 per cent and more, contracted during the mid-1990s when general interest rates were high.

Of a total stock of Rs. 2,44,000 crore of outstanding Plan loans, Rs. 1,00,000 crore worth of loans bear a coupon rate of 13 per cent and above. Servicing these loans is a major burden for states, many of which are undergoing fiscal stress. These loans from the Centre would be pre-paid using fresh, lower cost debt, which consists of both the small savings lent to the states by the National Small Savings Fund and additional market borrowings. As a result, while the total debt of the states would remain unchanged, the cost of servicing the loans would come down. This is the fiscal benefit to the states.

All collections from small savings, which include post office deposits, Kisan Vikas Patras, National Savings Certificates, and the Public Provident Fund (PPF), flow to the public account.

After adjusting for repayments to the depositors of these small savings instruments, the entire net collections are lent to the states. Of the amount apportioned to each state based on the collection in the respective states, 70 per cent is made available as cash transfer, while the remaining 30 per cent is used for repaying the high cost loans of 13 per cent and above.

Apart from this, states are also now allowed to use additional market borrowings at an average interest rate of less than 6.5 per cent to retire high cost debt.

In simple language, what this means is that while the small savings deposits except for the PPF have a maturity of five to six years, the repayment of loans given to states against small savings is over a period of 25 years. If interest rates were to rise over the medium to long term, this could obviously create a problem for the centre, since the cost of its borrowings would be going up, while the return on its existing loans to the states would remain locked. It is to take care of this risk that the higher spreads is needed.

DECOUPLING THEORY

Decoupling theory holds that Asian economies, especially emerging ones, no longer depend on the United States economy for growth, leaving them *insulated* from a severe slowdown there, even recession—looked true for some time as Asian stocks rose while socks in the US fell - however, as fears of recession mounted in the US, stocks declined heavily. Looking this happen in late 2008 the decoupling theory regarding the Asian as well as the EU economies have now lost ground. But still the emerging economies are able to have higher growth rates and exports in comparision to the US – that is why the theory is still debated by the experts.

DEINDUSTRIALISATION

Sustained decrease in the share of the secondary sector in the total output (GDP) of an economy.

DEMAT ACCOUNT

It is a way of holding securities in electronic or dematerialised form. Demat form of shares can be traded online. As such, the transactions are concluded much faster, which prevents theft, misuse, forging of original shares certificates or other documents, and allows an investor to buy or sell shares in any quantity. Demat account allows for faster refund of money in case application is not accepted. Demat accounts are offered by banks, and the dematerialised stock is held by the depository (National Securities Depository Ltd.–[NSDL] or Central Securities Depository Ltd.–[CSDL]). The investor needs to fill up the requisite forms, submit the documents and pay the applicable charges in order to have the demat account opened.

DEMERGER

The breaking-up of a company into more separate companies. Such companies are usually formed through mergers.

DERIVATIVES

The financial assets that 'derive' their value from other assets, such as shares, debentures, bonds, securities, etc.

DIIS

Domestic Investment Institution (DIIs) are the financial institutions of Indian origin investing in India is different derivatives such as share, securities, corporate bounds, etc. They may

be public/govt. owned or privately owned—mutual funds, pension funds and insurance (life) companies are the major ones in India.

DIRECT COST

The direct material and labour cost of a product–proportionally varies with the total output.

DIRECT INVESTMENT

The expenditure on physical assets (i.e., plant, machinery, etc.).

DIRTY FLOAT

A term of foreign exchange managment when a country manipulates its exchange rate under the floating currency system to take leverage in its external transactions.

DISCOUNT HOUSE

A financial institution specialising in buying and selling of short-term (i.e., less than one year) instruments of the money market.

DISGORGEMENT

Disgorgement is a common term in developed markets across the world, though for most market participants in India it is a new thing. Disgorgement means repayment of illegal gains by wrongdoers. Funds that were received through illegal or unethical business transactions are 'disgorged', or paid back, with interest to those affected by the action. It is for the first time in India that the capital markets regulator, SEBI has passed this order of disgorgement; internationally it is the civil courts that have this mandate along with the markets regulator.

Disgorgement is a 'remedial' civil action, rather than a 'punitive' civil action. In the US, individuals or companies that violate Securities and Exchange Commission regulations are typically required to pay both civil money penalties and disgorgement. Civil money penalties are punitive, while disgo-rgement is about paying back profits made from those actions that violated securities regulations.

Interestingly, disgorgement payments are not only demanded of those who violate securities regulations. In the US, anyone profiting from illegal or unethical activities may be required to disgorge their profits. The money disgorged from the violating parties is used to create a 'Fair Fund'–fund for the benefit of investors who were harmed by the violation.

DISMANTLING OF TEXTILE QUOTA

Until December 31, 2004, global textile trade was largely regulated by the quota system. A textile exporting country (for example, India) could not export a particular textile item to an importing country (say, the Us) beyond a fixed quantity, determined bilaterally. The phase-out of textile quota has removed the non-tariff barrier. The move is expected to drive outsourcing of textiles and apparel manufacturing to low-cost destinations. India is considered the *second largest* beneficiary of quota dismantling after China. It has advantages of having an integrated textile industry right from fibre to fashion. According to government projections, India's textile exports is expected to touch $50 billion mark by 2010.

DISSAVING

The situation of higher current consumption over current disposable income by the households–the difference is met by withdrawals from the past savings (*i.e., decrease in saving*).

DOMINO EFFECT

An economic situation in which one economic event causes a series of similar events to happen

one after the other. For example, experts believe that the falling of share indices around the world in early-2008 was a domino effect of the sub-prime crisis faced by the US economy. A similar case is cited from the mid-1996 when all major stock markets crashed around the world due to the domino effect emanating from the South East Asian currency crisis.

DOW-JONES INDEX

The US share price index which monitors and records the share price movements of all compaines listed on the New York Stock Exchange (*with the exception of high-tech companies which are listed on the nasdaq stock exchange*). India has its equivalent in the BSE *Sensex*.

DRUG PRICE CONTROL

Drug price control, as the term suggests, means a mechanism or a policy that ensures that *essential* and *life-saving* medicines are available at reasonable prices. Control over cost of medicines to the consumer exists in one form or the other in most countries. Government's control over drug pricing in India had begun in the wake of the Sino-Indian war, but a structured price control mechanism was only first instituted in 1979 with the issuance of the first Drug Price Control Order (DPCO).

The Drugs Price Control Order, 1995 is an order issued by the Government of India under Section 3 of the Essential Commodities Act, 1955. The Order provides the list of price-controlled drugs, procedures for fixation of prices of drugs, method of implementation of prices fixed by government and penalties for contravention of provisions among other things. For the purpose of implementing provisions of DPCO, powers of the government have been vested in the National Pharmaceutical Pricing Authority. As of now, 74 bulk drugs are under price control and there is no price control on 70 to 75 per cent of the retail pharma market.

Drugs and formulation have been subjected to price control for more than three decades now and the industry's stand is that when price control has been abolished in a large number of industries, it is unfair to stifle the pharmaceutical industry with rigorous price control. While the government has expressed that it wants to provide a stable policy environment to the pharmaceutical industry, it has also said that it will ensure the availability of essential and life-saving drugs at reasonable prices to the public.

DUMPING

Exporting a good at a price lower than its price in the domestic market. To neutralise the effects of dumping the importing country may impose a *surcharge* on such imports which is known as the *anti-dumping duty.*

DUTCH DISEASE

When an increase in one form of net exports drives up a country's exchange rate, it is called the Dutch Disease. Such instances make other exports non-competitive in the world market and impairs the ability of domestic products to compete with imports.

The term originated from the supposed effect of natural gas discoveries on the Netherlands economy.

DUTY DRAWBACK SCHEME

The Duty Drawback Scheme (DDS) is provided by the Government of India as a part of export incentives to make exports competitive. Exporters get refund of the central excise (censat) and custom duties on the inputs they use in manufacturing the exportables. Those who are covered by the Duty Entitlement Passbook Scheme (DEPS) are not

covered by it. The rates are announced from time to time.

DUTY ENTITLEMENT PASSBOOK SCHEME

The Duty Entitlement Passbook Scheme (DEPS) is an export incentive scheme of the GoI under which exporters get credit (pre-determined by the Direcor General of Foreign Trade) on the export value which they use in future imports thus neutralising all the taxes. No cash is given (unlike the Duty Drawback Scheme). It has been abolished by the GoI, w.e.f. October 1, 2011 after using it for 14 years – the WTO provisions do not allow member countries to carry such schemes.

E-BUSINESS

Using computers and the Internet to link both the *internal* operations (i.e., transactions and communications between the various departments/divisions of the business firm) and its *external* operations (i.e., all its dealings with the suppliers, customers, etc.).

E-COMMERCE

Method of buying and selling goods and services over the Internet – a kind of direct marketing i.e. without the help of any middle arrangement of sales.

ECONOMIES OF SCALE

The long-run reduction in average/unit cost that occurs as the scale of the firm's output increases. The opposite situation is known as *diseconomiess of scale.*

ECONOMIES OF SCOPE

The long-run reduction in average/unit cost that occurs as the scope (diversification) of the firm's activities increase.

EDGEWORTH BOX

A concept for the purpose of analysing the possible relationships between two individuals or countries. It is done using indifference curve.

The concept was developed by Francis Ysidro Edgeworth (1845–1926) who is also credited for analytical tools of *indifference curves* and *contract curves.*

EFFECTIVE REVENUE DEFICIT

[See Chapter 18, *Public Finance in India*]

ENGEL'S LAW

The law which says that people generally spend a smaller part of their budget on food as their income rises. The idea was suggested by Ernst Engel, a Russian statistician in 1857.

ENVIRONMENTAL ACCOUNTING

The method of accounting which includes the ecological and environmental damages done by the economic activities in monetary terms. Integrated environment and economic (green) accounting attempts at accounting for both socioeconomic performance and its environmental effects and integrates environmental concerns into mainstream economic planning and policies. The *green GDP* of an economy is measured by the same method—experimented in Costa Rica, Mexico, Netherlands, Norway, and Papua New Guinea, among others. Indicative estimates suggest that conventionally measured GDP may exceed GDP adjusted for natural resources depletion and environmental degradation by a range between 1.5 per cent and 10 per cent.

ENVIRONMENTAL AUDIT

Assessment of the environmental impact of a firm/public body through its activities. This is

done with an objective to reduce or eliminate the pollution aspect.

ENVIRONMENTAL TAXES

As against the Command and Control approach to managing environment, the Economic or Market Based Instruments (MBIs) approach sends economic signals to the polluters to modify their behaviour. The MBIs used for environmental taxes include pollution charges (emission/affluent & tax/pollution tax), marketable permits, deposit refund system, input taxes/product charges, differential tax rates, user administrative changes and subsidies for pollution abatement, which may be based on both price and quality. India has been already collecting taxes on *water* and *air* via thewater Act and the air Act. due to its experience India is among the chief participant in devising the MBIs in the world.

EQUITY LINKED SAVING SCHEME

Equity linked savings schemes (ELSS) are open-ended, diversified equity schemes offered by mutual funds. They offer tax benefits under the new section 80C introduced in the Finance Bill 2005–06. Till the fiscal year 2004–05, maximum investment of Rs. 10,000 was eligible for tax benefits under the erstwhile Section 88 of the I-Tax Act. Effective April 1, 2005, the investment is included in the overall '1,00,000 limit set by the new Budget.

Besides offering the tax benefits, the scheme invests in shares of frontline companies and offers long-term capital appreciation. This means unlike a guaranteed return by assured return schemes like Public Provident Fund or National Savings Certificate, the investor gets the benefit of the upside (if any) in the equity markets.

Unlike other mutual fund schemes, there is a three-year lock in period for investments made in these schemes. Investors planning to build wealth over the long-term and save on tax can use these schemes.

Returns in these schemes are linked to the fortunes of the stock market. It falls in the high risk and high return category. Over the past one year, these schemes have clocked a return of over 30 per cent. The BSE 200 index rose 7 per cent over the past one year. This indicates that these funds outperformed the broader market. However, past performance is not a guarantee for future growth. Investors should assess their respective risk appetites before investing.

EQUITY SHARE

A security issued by a company to those who contributed capital in its formation shows ownership in the company. The other terms for it are 'stock' or 'common stock'.

Such shares might be issued via public issue, bonus shares, convertible debentures, etc. and may be traded on the stock exchanges.

Such shareholders have a claim on the earnings and assets of the company after all the claims have been paid for. This is why such shareholders are also known as the *residual owners*.

ESCROW ACCOUNT

In simple terms, an 'escrow account' is a *third party account*. It is a separate bank account to hold money which belongs to others and where the money parked will be released only under fulfilment of certain conditions of a contract. The term ***escrow*** is derived from the French term 'escroue' meaning a scrap of paper or roll of parchment, an indicator of the deed that was held by a third party till a transaction is completed.

An escrow account is an *arrangement for safeguarding* the 'seller' against its 'buyer' from the payment risk for the goods or services sold by the former to the latter. This is done by removing the control over cash flows from the hands of the

buyer to an independent agent. The independent agent, i.e, the holder of the escrow account would ensure that the appropriation of cash flows is as per the agreed terms and conditions between the transacting parties. Escrow account has become the standard in various transactions and business deals. In India escrow account is widely used in public private partnership projects in infrastructure. RBI has also permitted Banks (Authorised Dealer Category I) to open escrow accounts on behalf of Non-Resident corporates for acquisition / transfer of shares / convertible shares of an Indian company.

ESOPs

Employee Stock Option Plans (ESOPs) is a provision under which a foreign company (i.e., MNC) offers shares to its employees overseas. Till February 2005 in the case of local firms, an MNC needed a permission from the RBI before allotting ESOPs, but since then, it does not need any permission provided the company has a minimum of 15 per cent holding in the Indian arm.

EXPLODING ARMS

A term associated with the mortgage business which became popular after the subprime crisis hit the US financial system in mid-2007. Exploding arms are mortgages with initial low, fixed interest rates which escalate to a high floating rate after a period of two to three years.

EXTERNALITIES

Factors that are not included in the gross income of the economy but have an effect on human welfare. They may be *positive* or *negative*–training personnel is an example of the former while pollution falls in the latter.

FCCB

Foreign Currency Convertible Bond, (FCCB) is an unsecured instrument to raise long-term loan in foreign currency by an Indian company which converts into shares of the company on a predetermined rate. It is counted as the part of external debt. It is a safer route to raise foreign currency requirements of a company.

FEDERAL FUND RATE

The federal fund rate (also popular as *Fed Fund Rate* or *Fed Rate*) is the rate of interest banks charge each other on overnight loans in the USA. The rate is fixed by the US central bank Federal Reserve. This is equivalent to the *Repo rate* of India which is fixed by the RBI.

The Federal Reserve cut the Fed Rate by 0.75 per cent on January 22, 2008 (now the rate stands at 3.5 per cent) to ward off the increased fear of a recession in the US economy which has also generated worldwide free fall of share indices since mid-January 2008. In wake of the sub-prime real estate crisis wrecking havoc on the US economy, the Fed Rate has been cut time and again to counter the possible future recession.

FIDUCIARY ISSUE

Issuance of currency by the government not matched by gold securities, also known as *fiat money*.

FINANCIAL CLOSURE

Financial closure is defined as a stage when all the conditions of a financing agreement are fulfilled prior to the initial availability of funds. It is attained when all the tie ups with banks or financial institutions for funds are made and all

the conditions precedent to initial drawing of debt is satisfied.

In a Public Private Partnership (PPP) project, financial closure indicates the commencement of the *Concession Period*—the date on which financial closure is achieved is the appointed date which is deemed to be the date of commencement of concession period. In order to give a uniform interpretation to the term, the RBI has provided a definition for 'Greenfield' projects, financial closure is *"a legally binding commitment of equity holders and debt financiers to provide or mobilise funding for the project. Such funding must account for a significant part of the project cost which should not be less than 90 per cent of the total project cost securing the construction of the facility"*.

FINANCIAL STABILITY BOARD (FSB)

The Financial Stability Forum (FSF) was established by the G7 finance ministers and central bank governors in 1999 to promote international financial stability through enhanced information exchange and international cooperation in financial market supervision and surveillance. It decided at its plenary meeting in London on March 2009 to broaden its membership by inviting the new members from the G20 countries, namely, Argentina, Brazil, China, India, Indonesia, Korea, Mexico, Russia, Saudi Arabia, South Africa, and Turkey. the FSF was relaunched as the Financial Stability Board (FSB) on April 2, 2009, in order to mark a change and convey that the FSF in future would play a more prominent role in this direction.

FISCAL DRAG

The restraining effect of the progressive taxation economies feel on their expansion—fall in the total demand in the economy due to people moving from lower to higher tax brackets and the government tax receipts go on increasing. To neutralise this negative impact, governments usually increase personal tax allowances.

FISCAL NEUTRALITY

A stance in policy making by governments when the net effect of taxation and public spending is neutral—neither encouraging nor discouraging the demand. As for example, a *balanced budget* is the same attempt of fiscal policy when the total tax revenue equals the total public expenditure.

FISHER EFFECT

A concept developed by *Irving fisher* (1867–1947) which shows relationship between inflation and the interest rate, expressed by an equation popular as the *fisher equation,* i.e., the nominal interest rate on a loan is the sum of the real interest rate and the rate of inflation expected over the duration of the loan:

$$\mathbf{R = r + F;}$$

where R = nominal interest rate, r = real interest rate and F = rate of annual inflation.

The concept suggests a direct relationship between inflation and nominal interest rates—changes in inflation rates leads to matching changes in nominal interest rates.

The Fisher effect can be seen each time one goes to the bank; the interest rate an investor has on a savings account is really the nominal interest rate. For example, if the nominal interest rate on a savings account is 4 per cent and the expected rate of inflation is 3 per cent, then money in the savings account is really growing at 1 per cent. The smaller the real interest rate the longer it will take for savings deposits to grow substantially when observed from a purchasing power perspective.

FLAG OF CONVENIENCE

Shipping rights in oceans and seas are governed by international treaties. Flag of convenience is a

grant of a shipping 'flag' by a member of these treaties to a non-member nation establishing the legality of shipping to the latter (*usually used for illegal activities*).

FORCED SAVING

The enforced reduction of consumption in an economy. It may take place directly when the government increases taxes or indirectly as a consequence of higher inflation—a tool usually utilised by the developing countries to generate extra funds for investment. Also known as *involuntary saving*.

FOB

This is the abbreviation of 'free-on-board'—when in the balance of payment accounting, only the basic prices of exports and imports of goods (including loading costs) are counted. It does not count the 'cost-insurance-freigth' (CiF) charges incurred in transporting the goods from one to another country.

FORM OF A LIFE INSURANCE FIRM

A life insurance company can be a joint-stock or mutual entity. If joint-stock, it has to have some capital, to begin with. A mutual fund company need not have any. Prudential, the second largest life insurance company in the UK was a mutual fund company till a few years ago and had no capital. Standard Life, another big company, was a mutual company till a few months ago. If such big companies could function without any capital till recently, there is no reason why LIC cannot.

The policyholders are the owners of a mutual company and the entire profit goes to them. A significant proportion of the profit goes to shareholders in the case of joint-stock companies. The LIC, owned fully by the Government, is effectively a mutual fund company and it is not surprising, therefore, that pressure is being mounted to privatise it, so that a chosen few could not corner its huge profits.

FORWARD CONTRACT

A transaction contract of commodity on an agreed price which binds the seller and buyer both to pay and deliver the commodity on a future date. The price agreed upon is known as *forward* rate.

One must not confuse this with the term 'future contract' as in it, the term of the contract cannot be decided by the mutual needs of the parties involved (which is possible in a 'forward contract').

FORWARD TRADING

A trading system in certain shares (as allowed by the SEBI in India) in which buyers and sellers are allowed to postpone/defer payment and delivery respectively after paying some charges. If the buyer wants deferment, it is known as *badla* (an Indian term for *contango*) and if the seller goes for deferment of delivery of shares, it is known as *undha badla* (in India, elsewhere it is known as *backwardation*).

FRACTIONAL BANKING

A system of banking in which banks maintain a minimum reserve asset ratio in order to maintain adequate liquidity to meet the customer's cash demands in its everyday business (*the SLR in India is such a provision,*).

FREE GOODS

The goods which are in abundance (*as air and water*) and are not considered as scarce economic goods. As such goods have *zero supply price* and they will be used in large volumes resulting into rising environmental pollution (point should be noted that today air and water may not be

considered as the typical free goods, at least the 'pure air' and 'pure water').

FREE TRADE

The international trade among an agreed-upon group of countries without any barriers (such as tariffs, quotas, forex controls, etc.), promoted with the objective of securing international specialisation and an edge in their foreign trade.

FREE PORT

A port that is designated as such is the one where imports are allowed without any duty, provided they are re-exported (i.e., *entrepot*). If the same is correct in the case of an area, it is known as the *free trade zone.*

FRINGE BENEFIT TAX

The fringe benefit tax is an additional tax imposed by the Union government in order to bring under the tax net fringe benefits received by the employees from his employer.

The various categories of employers are defined under the new provision. This includes an individual or a Hindu Undivided Family engaged in a business or profession, a company, a firm, an association of persons, a body of individuals, a local authority and every artificial juridical person. The key point is that even individuals running small businesses are covered and thus would include someone who even employs a single person.

It is very important to note the exact definition of fringe benefits because only those items that get covered here would be included for the purpose of taxation. It means any privilege, service, facility or amenity, directly or indirectly provided by an employer to his employees. It also includes such facilities provided to former employees. Any reimbursement made either directly or indirectly to the employer will also be considered as a fringe benefit. Travelling ticket provided by the employer to the employees and his family members would be a fringe benefit. Even an amount, which is a contribution by the employer to an approved superannuating fund would be called a fringe benefit.

This is not the end of the matter for there is a category called *deemed* fringe benefits which will suffer the same tax effect. These are benefits that are deemed to have been provided if the employer has in the course of business or profession incurred any expenses on or made any payment for a whole host of fringe benefits. These include entertainment, festival celebration, gifts, use of club facilities, provision of hospitality facilities, maintenance of any accommodation in the nature of a guest house, conference, employee welfare, use of health club, sports and similar facilities, sales promotion including publicity; conveyance tour and travel including foreign travel, hotel, boarding and lodging, repair, running and maintenance of motorcars, repair running and maintenance of aircrafts, consumption of fuel other than imnndustrial fuel, use of telephone, scholarship to the children of the employees.

Tax calculation has to follow a specific procedure. First one has to check whether the benefit falls under the head of fringe benefits. Once this is determined a certain percentage of the expense is then taken as the value on which the tax is to be levied. These percentage has been listed in the budget. For example, the amount to be considered is 50 per cent of the expenses for entertainment and 20 per cent for conveyance, tour and travel. On this a rate of 30 per cent (i.e., 30 per cent of 50 per cent in case of entertainment) is applied as a tax.

GALLUP POLL

A method of survey in which a representative sampling of public opinion or public awareness concerning a certain subject/issue is done and on this basis a conclusion is drawn.

The credit of developing this research methodology goes to *George H. Gallup* (1901–84), a US journalist and statistian who in 1935 did set up the *American Institute of Public Opinion.* Through his efforts the method developed between the period 1935–40. In the coming times, the poll technique was immensely used by business houses for their market research and the psephologists for election forecasting, around the world.

GAME THEORY

The analysis of situations involving two or more interacting decision makers (that may be individuals, competing firms, countries, etc.) who have conflicting objectives. It is a technique which uses logical deduction to explore the consequences of various strategies that might be adopted by game players having competing interests.

Game theory is a branch of *Applied Mathematics* that studies strategic interactions between agents–where the agents try maximising their pay off. It gives *formal modelling approach* to social situations in which decision makers interact with other agents. The theory generalises maximisation approaches developed to analyse markets such as supply and demand model.

The field dates back from the 1944 classic *Theory of Games and Economic Behaviour* by John von Neumann and Oskar Morgentern (Princeton University Press, N. Jersy, 1944 & 2004; 60th Anniversary Ed.). Neumann was a mathematician and Morgenstern an economist and this book was based on the former's prior research published in 1928 on the *Theory of Parlour Games* (in German).

The theory has found significant applications in many areas outside economics as usually construed, including formulations of nuclear strategies, ethics, political science, and evolutionary theory.

GDRS

While ADRs are denominated in dollars and traded on US National Stock Exchanges, GDRs can be denominated either in dollars or Euros and are commonly listed on European Stock Exchanges. Investors can cash in on the difference in price between local and foreign markets. Some time back ADRs and GDRs were *fungible* one way i.e. foreign investors could convert their ADRs/GDRs into underlying shares and sell them in the local market. However, they were not permitted to reconvert shares bought on the local exchange into ADRs/GDRs. In 2002, *two-way fungibility* was permitted. Under these rule reissuance of depositary receipts is permitted to the extent to which they have been redeemed into underlying shares and sold in the domestic market.

GIFFEN GOOD

The good for which the demand increases as its price increases, rather than falls (opposite to the *general theory of demand*)—named after Robert Giffen (1837–1910). It applies to the large proportion of the goods belonging to the household budget (as flour, rice, pulses, salt, onion, potato, etc. in India)—an increase in their prices produces a large *negative income effect* completely overcoming the normal substitution effect with, people buying more of the goods.

GINI COEFFICIENT

An inequality indicator in an economy. The coefficient varies from 'zero' to 'one'. A 'zero' Gini coefficient indicates a situation of perfect equality (i.e., every household earning the same level of income) while a 'one' signifies a situation of absolute inequality (i.e., a single household earning the entire income in an economy).

GOLDEN HANDSHAKE

A payment (usually generous) made by a company to its employees for quitting the job prior to their service.

GOLDEN HANDCUFF

A royalty/bonus payment by a company to its staff (usually top ranking) to keep them with the company or to save them from poaching by the other companies.

GOLDEN HELLO

A large sum paid by a company to attract a new staff to its fold.

GOLDEN RULE

A fiscal policy stance which suggests that over the economic cycle, government should borrow only to 'invest' and not to finance the 'current expenditure'. The attempts towards 'balanced budgeting', 'zero-based budgeting' developed under influence of this rule.

GOODHART'S LAW

The idea of goodhart which suggests that attempts by a central bank (as RBI in India) to regulate the level of lending by banks imposing certain controls can be circumvented by the banks searching the alternatives out of the regulatory preview.

GO-GO FUND

The highly speculative mutual funds operating in the USA with the objective of earning high profits out of capital appreciation–adopt risky strategies for the purpose (investing in volatile unproven and small shares, etc.), also called the *performance funds*.

GREATER FOOL THEORY

A theory evolved by the technical analysts of stocks/shares according to which some even buy overvalued stocks with the conviction that they will find a *greater fool* who will buy them at higher prices. This is also popular as *castle-in-the-air theory*.

GREENFIELD INVESTMENT

An investment by a firm in a new manufacturing plant, workshop, office, etc.

GREENFIELD LOCATION

An area consisting of unused or agricultural land (*i.e., 'greenfield'*) developed to set up new industrial plants.

GREEN REVOLUTION & INSTITUTIONS

The support of institutions and the governments of the world did play a very vital role in the success of the Green Revolution all over the world.

The International Maize and wheat Improvement Centre (CIMMYT), Mexico and the International Rice Research Institute (IRRI), Manila were the two institutions in strong partnership with national programmes which developed the miracle varieties of rice and wheat that fuelled the green Revolution around the world.

The Consultative Group on International Agricultural Research (CGIAR), set up in 1971 (in Washington DC under the aegis of the World Bank) played a central role in Green Revolution, supporting the works of the CIMMYT and IRRI. Today, the 16 CGIAR support centres around the world generate new knowledge and farming technology for the agriculture sector. Its research products are "global public goods", freely available to all.

GREENSHOE OPTION

A term associated with the security/share market. This is a clause in the underwriting agreement of an initial public offer (IPO) by a company which allows to sell additional shares (usually 15 per cent) to the public if the demand for shares exceeds the expectation and the share trades above its offering price. It gets its name from the *Green Shoe* company which was the first company to be allowed such an option (in the USA, early 20th century). This is also known as *'over-allotment provision'*.

The company availing this option uses the proceeds (i.e. from the greenshoe option) to prevent any decline in market price of shares below the issue price in the post-listing period (in such cases the aforesaid company uses the money to purchase its own shares from the market—as demand increases, the market price of its shares picks up).

GRESHAM'S LAW

The economic idea that 'bad' money forces 'good' money out of circulation, named after Sir Thomas Gresham, an adviser to Queen Elizabeth I of England. This law does not apply to the economies where paper currencies are in circulation. The economies which circulate metallic coins (gold, silver, copper, etc.) of proportional intrinsic values face such situations when people start hoarding such coins.

GREENSPAN PUT

A financial market terminology named after the former chairman, of the US central bank, Federal Reserve, to mean the helpful way he responded to big declines in the stock market by delivering a cut in interest rates.

GREY MARKET

The 'unofficial' market of the newly issued shares before their formal listing and trading on the stock exchange.

GROWTH RECESSION

An expression coined by economists to describe an economy that is growing at such a slow pace that more jobs are being lost than are being added. The lack of job creation makes it 'feel' as if the economy is in a recession, even though the economy is still advancing. Many economists believe that between 2002 and 2003, the United States' economy was in a growth recession.

In fact, at several points over the past 25 years the US economy is said to have experienced a growth recession. That is, in spite of gains in real GDP, job growth was either non-existent or was being destroyed at a faster rate than new jobs were being added.

3G TECHNOLOGY

3G refers to the third generation of developments in wireless technology. It is a collective term for the new communication procedures, standards, and devices that will improve the speed and quality of services on mobiles. 3G-compatible handsets combine the functionality of a mobile phone with that of a PC and a personal organiser/PDA.

3G divides each call or transmission into little packets of data, marking each one with an individual code to show which connection it belongs to. This is a more efficient way of transmitting data, allowing 3G networks to deliver larger files, like pictures and video, at much faster speeds.

3G devices have greater transmission abilities, both in terms of speed and capacity, than 2G or

2.5G. The International Telecommunications Union (ITU) *defines* 3G as any device that can transmit and receive data at 144Kbps or more. In practice, 3G devices can transfer data at up to 384Kbps.

Besides phone calls, 3G allows fax transmissions, e-mails, including large attachments, while on the move. High-speed internet access allows web browsing and fast downloading of data files, software, image or music files. 3G can be used for video conferencing and some 3G handsets can also function as personal organisers, with electronic diaries, contact lists, and automatic reminders. Most 3G networks offer global roaming.

Japan is the *first* country which introduced 3G on a large commercial scale in 2005. 3G is now also in use in France, Germany, and Austria besides some other countries.

There is no single global 3G standard, but the principal technologies of 3G include:

(i) WCDMA, which has been chosen for 3G mobile phone systems in Europe, Asia, and the US. It first converts raw data into a narrow band digital radio signal and then attaches a marker to each data packet to identify it as belonging to a particular communication.

(ii) Customers who already use CDMA can upgrade to newer models. CDMA 2000 IxEV-DO provides always–on packet data connection like landline-based broadband, for mobile internet use.

(iii) EDGE is the technology that allows existing GSM networks to provide 3G services and allows GSM to transmit data at transmission speeds of up to 384 Kpbs.

GSM operators offering EDGE-based services are already providing some 3G-like services including video on the move. 3G requires spectrum in specified bands and telecom regulator TRAI has identified 450 MHz, 800 MHZ, and 2.1 Ghz as 3G bands. 3G services will be launched in India only after the government announces its spectrum policy and allocates spectrum in the required bands. This is expected by the end of 2008. After that, it will take a minimum of three months for operators to rollout 3G services.

HEDGE FUNDS

These are basically mutual funds (MFs) which invest in various securities in order to contain or hedge risks. They are investment vehicles that take big bets on a wide range of assets and specialise in sophisticated techniques of investment. They are meant to perform well in falling as well as rising markets!

Run by former bankers or traditional investment managers by setting up their own funds, they make a lot of money by charging high fees typically 2 per cent management fees besides 20 per cent of the profits out of the investment. As they are unregulated in most of the economies (for example the USA, India, specially) and risky, they accept investments from wealthy and sophisticated investors.

Hedge funds made news in recent times as some of them were caught out by betting the wrong way on the market movements. Some of them also made huge losses by buying the complex packages of debt that contain many of the US mortgage loans which turned sour. It is believed that 33 per cent of stocks traded on the London Stock Exchange and 20 per cent on the New York Stock Exchange are managed by numerous hedge funds. In the case of India, it is believed that foreign investment in the Indian stocks (which accounted for almost 75 per cent of the total stocks by November 2007) has a heavy share of such funds–the Participatory Notes (PNs) route investment (i.e., 52 per cent of the total foreign investment in shares) is considered as hedge fund investment.

In recent years, there have been several high-profile hedge fund collapses. The Long -Term

capital Management (LTCM) of the US failing in 1998 had threatened the very stability of the US financial system—looking at the level in impact the regulators managed a bail out for it to prevent an imminent financial collapse. In 2006, the world saw the collapse of another hedge fund in the US, the *Amaranth* which lost $6.5 billion in a month in the natural gas market (The fund in place of a bail out was closed down by the regulators with the investors losing heavily.)

HERFINDAHL INDEX

This is a measure of the level of seller concentration in a market which takes into account the total number of firms and their relative share in the total market output. Also known as *Herfindahl-Hirschman Index*.

HIDDEN PRICE REDUCTION

A quantitative or qualitative increase of a product by keeping the price unchanged. We see it taking place in the case of many goods in the market selling '20 per cent or 33 per cent extra' at the same prices.

HIDDEN PRICE RISE

A quantitative or qualitative decrease in a product without changing the price.

HIDDEN TAX

Addition of an indirect tax into the price of a good or service without fully informing the consumer as, for example, the magnitude of the excise duty in tobacco and alcoholic products is so high that the taxes are added to the products directly.

HISTORIC COST

The original cost of purchasing an asset such as land, machine etc., which is shown in the balance sheet of a firm under this title with an adjustment for the replacement cost of the asset.

HOARDING

An act of unproductive retention of *money* or *goods*.

HOG CYCLES

The cycles of over and under production of goods. This takes place due to time lag in the production process–this happens in case of agricultural products specially.

IMPOSSIBLE TRINITY

This is a term to show the central bank's dilemma in targeting for stable exchange rate, interest rate and inflation while announcing the credit and monetary policy for the economy. As this task is not only challenging but also not possible, it is called as the 'impossible trinity'.

INDIA'S SOVEREIGN RATING

Presently, India is rated by six international credit rating agencies, namely Standard and Poor's (S&P), Moody's Investor Services, FITCH, Dominion Bond Rating Service (DBRS), the Japanese Credit Rating Agency(JCRA), and the Rating and Investment Information Inc., Tokyo(R&I). Information flow to these credit rating agencies has been streamlined.

INDIFFERENCE CURVE

A curve on the graph showing the alternative combinations of two products, each giving the same utility/satisfaction.

INDUCED INVESTMENT

The part of investment (increase or decrease) which takes place due to a change in the level of national income.

IIFCL

The India Infrastructure Finance company Ltd (IIFCL), a Government of India company set up in 2006 to promote public sector investments and public-private partnerships (PPPs) in all areas of infrastructure *except* the telecommunication.

INFERIOR PRODUCT

The good or service for which the income elasticity of demand is negative (i.e., as income rises, buyers go to purchase less of the product). For such products, a price cut results into lesser demands by the buyers.

INFLATION

For all types of inflation see the chapter with the same title.

INSIDER TRADING

A stock market terminology which means transactions of shares by the persons having access to confidential informations which are not yet public—such persons stand to gain financially out of this knowledge (the person might be an employee, director, etc. of the share issuing company or the merchant bank or the book runner to the issue, etc.). Such kind of trading in stocks is illegal all over the world.

INSOLVENCY

The situation when the liabilities of an individual or a firm to creditors exceeds its assets—inability to pay the liabilities from the assets. Also known as *bankruptcy*.

INVENTORY

The stocks of finished goods, goods under the production process and raw materials held by a firm.

INVISIBLE HAND

A term coined by Adam Smith (in his magnum opus *The wealth of Nations, 1776*) to denote the way in which the market mechanism (i.e., the price system) coordinates the decisions of buyers and sellers without any outside conscious involvement. For him this maximises individual welfare.

IPO

An IPO or initial public offering refers to the issue of shares to the public by the promoters of a company for the first time. The shares may be made available to the investors at face value of the share or with a premium as per the perceived market value of the share by the promoters. The IPO can be in the form of a fixed price portion or book building portion. Some companies offer only demat form of shares, others offer both demat and physical shares.

The performance of an IPO depends on many factors such as the promoter's track record, experience in running the business, risk factors listed in the offer document, nature of industry, government policies associated with the industry performance of that sector in the previous years, and also any available forecasts for the industry for the near future.

I-S SCHEDULE

Here 'I-S' stands for 'investment saving'. This graphic schedule displays the combinations of levels of national income and interest rate where the equilibirium condition for the real economy (investment = savings) holds.

ISLAMIC BANKING

It is banking practiced as per the Islamic principle as prescribed in the *shariah* known as *Fiqh al-Muamalat* (Islamic rules on transaction). The Islamic law prohibits interest on both loans and

deposits. Interest is also called *riba* in Islamic discourse. The argument against interest is that money is not a good and profit should be earned on goods and services only not on control of money itself. But Islam does not deny that capital, as a factor of production deserves to be rewarded. It, however, allows the owners of capital a share in a surplus which is *uncertain*.

It operates on the principle of sharing both profits and risks by the borrower as well as the lender. As such the depositor cannot earn a fixed return in the form of interest as happens in conventional banking.

But the banks are permitted to offer incentives such as variable prizes or bonuses in cash or kind on these deposits.

The depositor, who in the conventional banking system is averse to risk is a provider of capital here and equally shares the risks of the bank which lends his funds.

Investment finance is offered by these banks through *Musharka* where a bank participates as a joint venture partner in a project and shares the profits and losses. Investment finance is also offered through *Mudabha* where the banks contribute the finance and the client provides expertise, management, and labour, and the profits are shared in a prearranged proportion while the loss is borne by the bank.

Trade finance is also offered through a number of ways. One way is through *mare up,* where the bank buys an item for a client and the client agrees to repay the bank the amount along with an agreed profit later on. Banks also finance on lines similar to *leasing, hire purchase,* and *sell and buyback*. *Consumer lending* is without any interest, but the bank covers expenses by levying a service charge. Besides, these banks offer a host of fee-based products like money transfer, bill collections, and foreign exchange trading where the bank's won money is not involved.

Islamic banks have come into being since the early 1970s. There are nearly 30 Islamic banks all over the world from Africa to Europe to Asia and Australia and are regulated even within the conventional banking system. The whole banking system in Iran has moved over to the Islamic system since the early 1980s and even Pakistan is Islamising its banking system.

Many of the European and American Banks are now offering Islamic banking products not only in muslim countries, but also in developed markets such as the United Kingdom. The concept is also catching up in countries like Malaysia and Dubai.

As per the Islamic experts, with growing indebtedness of many governments and with bulk of the borrowing going to servicing of the past debt and payment of huge interests, it could be an alternative to conventional banking as practiced in the rest of the world. Wherever it is practiced, *studies* have shown that the rate of return is often comparable and sometimes even higher than the interest rate offered by conventional banks to depositors.

Though there is no full-fledged Islamic bank, there are many NBF intermediaries in Mumbai and Bangalore operating on Islamic principles. Besides, their presence in the form of co-operatives in various parts of the country has been there even before independence.

The Reserve Bank of India, which regulates the banking sector in India has recently appointed a committee headed by the Chief General Manager to look into the prospects of introducing certain Islamic products and banks in India. What is unique is that the products are structured according to norms prescribed in the *shariah*.

In many countries, these banks do not have the power of issuing cheques. Besides, many banks which operate on a very small-scale, do not have adequate internal control system because of

which their accounting is not very transparent and also inadequate information is provided to the regulator. Besides, wherever they co-exist with conventional banking, central bank control of bank interest rates is liable to be circumvented by shifts of funds to the Islamic banks.

ISOCOST LINE

A line on the two-axis graph which shows the combination of factor inputs that can be purchased for the same money.

ISOCOST CURVE

A curve on the graph showing the varying combinations of factors of production (i.e., labour, capital etc.) that can be used to produce a given quantity of a product with a given technology.

J-CURVE EFFECT

The tendency for a country's balance of payments deficit to initially deteriorate following a devaluation of its currency before moving into surplus.

JOBBER

An individual active on the floors of the stock exchanges who buys or sells stocks on his own account. A jobber's profit is known as *jobber's spread*. They are also known as *Taravniwalla* on the Bombay Stock Exchange (BSE).

JUNK BOND

An informal term denoting the financial securities issued by a company/bidder as a means of borrowing to finance a takeover bid. Such securities generally include high-risk, high-interst loans, that is why the term 'junk' is used. It is also known as *mezzanine debt*.

KERB DEALINGS

All the transactions taking place outside the stock exchanges.

KHILJI EFFECT

The rulers of the Delhi sultanate didn't understand formal macroeconomics. But they knew one lesson very clearly—it was important to "signal the government's intent to keep expectations in check". Alauddin Khilji personally inspected markets and it worked—checking prices from rising. Such an effect on market is popular in India as the 'Khilji Effect'.

India saw these time-tested lessons followed by the GoI in 2014–15—Central Ministers publicly stated that matters are under control with sufficient quantity of 'onions' and 'potatoes'. The Government brought these two commodities under the purview of the Essential Commodities Act, too. This did show the 'strong intent' of the government to control prices.

Though, the routine statements claiming that 'prices will rise' often started the inflationary spiral (it was repeatedly done by the then Union Minister of Agriculture).

KLEPTOCRACY

A government which is corrupt and thieving—the politicians and bureaucrats in charge using the powers of the state to earn personal benefits/profits. Russia after the disintegration is condsiered to be a clear-cut example when Mafia-friendly government allotted valuable shares of the government companies when they were privatised.

KONDRATIEFF WAVE

A business cycle of 50 years, named after the Russian economist Nikolai kondratieff (wrote

so in his book *The Long Waves in Economic Life,* 1925).

He argued that capitalism was a stable system (the business cycle of 50 years implied it), in contrast to the Marxist view that it was self-destructive and unstable—he died in one of the Stalin's prisons.

LAF

The abbreviated form of the Liquidity Adjustment Facility, is part of a financial policy provided to the banks by the RBI in India. The facility commenced in June 2000 under which the banks operating in India are allowed to park their funds with the RBI for short-term periods (i.e., less than one year which is usually from one day to seven days, in practice), known as the *Reverse Reop.* On such deposits to the RBI, the banks get an interest rate of 6 per cent per annum at present.

LAFFER CURVE

A curve devised by the economist Arthur Laffer in 1974 which links average tax rates to total tax revenue. It suggests that higher tax rates initially increase revenue but after a point further increases in tax rates cause revenue to fall (for instance by discouraging people from working). But it is tough to know whether an economy is on the Laffer curve, as higher taxation breeds evasion of taxes too.

LIAR LOANS

A term associated with the financial world which created news after the US financial system was hit by the subprime crisis in mid-2007.

These are the loans wherein borrowers fraudulently mis-state their incomes often egged on by the lender or broker to the bank. Such frauds have been detected along the entire US mortgage financing chain by September 2007–websites freely advertised that for a nominal fee, they could produce sufficient proof of income by generating bank statements, pay slips, income tax returns, and provide references. Lenders in turn *lied* about the real terms and conditions of the loans to borrowers and lied about the quality of loans sold to investors. The whole gamut of these deeds make such mortgage loans the *'liar loans'.*

LIBOR

The London Interbank Offered Rate (LIBOR) is the interest rate on dollar and other foreign currency deposits at which larger banks are prepared to borrow and lend these currencies in the Eurocurrency market. The rate reflects market conditions for international funds and are widely used by the banks as a basis for determining the interest rates charged on the US dollar and foreign currency loans to the business customers.

LIFE-CYCLE HYPOTHESIS

An idea which states that current consumption is not dependent solely on current disposable income of the consumers but is related to their anticipated lifetime income. This hypothesis has its high applied value in the real life economic management.

LIFE INSURANCE: SOME IMPORTANT TERMS

Endowment Policy

Insurance policies where a lump sum is payable either at the end of the policy term or if the insured dies during the policy tenure, are termed as endowment policies.

Beneficiary

A person or organisation legally entitled to receive benefits.

Term Life Insurance

In most cases, term life insurance refers to a product that provides death benefit protection for a specified period of time, say for 30 years. Benefits are doled out under this scheme only if the insured dies during the term.

Whole Life Insurance

It is a policy that provides insurance coverage for the entire life of the individual for a fixed premium throughout his life insurance, coupled with an investment component. Investments could be made in stocks or bonds that lead to accumulation of cash values. The augmented cash reserves are returned once one decides to surrender the policy.

Universal life insurance was created to provide more flexibility than whole life insurance by allowing the policy owner to shift money between the insurance and saving components of the policy.

Variable Universal Life Insurance Policy

A form of whole life insurance policy, this is a policy for those who weigh high risk threshold. It offers cash values that fluctuate based on the performance of the underlying mutual funds in the investment account. It is this investment of premiums in the equity market that carries with it an element of uncertainty.

Premium

This is the amount that the policy holder pays to the insurance company for the benefits provided under an insurance policy. The frequency of premium payments is opted by the individual. Typical premium modes include monthly, quarterly, semi-annual, and annual.

Annuity

An agreement sold by a life insurance company that provides fixed or variable payments to the policy holder, either immediately or at a future date.

Group Life Insurance

A life insurance policy issued to a group of people, usually through an employer.

Lapse

Defaulting on premium payments leads to the termination of an insurance policy. A lapse notice is sent in writing to the policy holder when the policy has lapsed.

Lump Sum

It refers to the proceeds of the policy that is paid to the beneficiary all at once rather than in installments. Typically, most life insurance policies make lump sum payment settlements.

LIQUIDATION

A process of 'winding up' a joint-stock company as a legal entity.

LIQUID ASSET

The monetary asset that can be used directly as payment.

LIQUIDITY

The extent to which an asset can be quickly and completely converted into currency and coins.

LIQUIDITY PREFERENCE

A term denoting a preference among the people for holding money instead of investing it.

LIQUIDITY TRAP

A situation when the interest rate is so low that people prefer to hold money rather than invest it.

In such situations investors do not go to increase investment even if the interest rates on loans are decreased. J. M. Keynes suggested for increased government expenditure or reduction in taxes to fight such a situation.

L-M SCHEDULE

Here 'L-M' stands for 'liquidity-money'. This is a schedule showing the combinations of levels of national income and interest rates where the equilibrium condition for the monetary economy, L = M, holds.

LOCAL AREA BANK

Announced in the Union Budget 1996–97 to ensure a focussed savings and credit mobilisation by defining the clear boundary of operation, the local Area Bank (LAB) operates to a narrow geographical area of three contiguous districts. The private sector is also allowed entry in the segment.

LOCOMOTIVE PRINICIPLE

The idea that in a situation of worldwide *recession* (see the chapter *Business Cycle*), increase in the total demand in one economy stimulates economic activities in the other economies via foreign trade.

LORENZ CURVE

A graph showing the degree of inequality in income and wealth in a given population or an economy. It is a rigorous way to measure income inequality. In this method (for example), personal incomes in an economy are arranged in increasing order; the cumulative share of total income is then plotted against the cumulative share of the population. The curve's slope is thus proportional to per capita income at each point of the population distribution. In the case of complete equality of income, the lorenz curve will be a straight line and with greater curvature the inequality rises proportionally–the *Gini Coefficient* measures this inequality.

LUMP OF LABOUR FALLACY

The fallacy in economics that there is a 'fixed amount of work' to be done i.e. a lump of labour—this may be shared in different ways to create fewer or more jobs in an economy. An economist, D.F. Schloss in 1891 called it the lump of labour fallacy because in reality, the amount of work to be done is not fixed.

MACRO & MICRO ECONOMICS

In economics, two different ways of looking at the economy have been developed by economists i.e., macroeconomics and microeconomics.

Macroeconomics ('macro' in Greek language means 'large') looks at the behaviour of the economy *as a whole* such as the issues like inflation, rate of unemployment, economic growth, balance of trade, etc. It is the branch of economics which studies the economy in its *total* or *average* term.

Microeconomics (in Greek language 'micro' means 'small') looks on the behaviour of the *units* i.e. the individual, the households, the firms, a *specific* industry, which together make up the economy.

MARGINAL STANDING FACILITY (MSF)

Operationalised on the lines of the existing Liquidity Adjustment Facility (LAF – Repo) in May 2011 under which all Scheduled Commercial Banks can avail overnight funds, up to one per cent of their Net Demand and Time Liabilities (NDTL) outstanding at the end of the second preceding fortnight. The facility is availed at an interest which is 100 basis points above the LAF repo rate, or as decided by the Reserve Bank from time to time. At present it is 9 per cent.

MARGINAL UTILITY

The increase in satisfaction/utility a consumer derives from the use/consumption of one *additional* unit of a product in a particular time period–it goes on decreasing, i.e., the *diminishing marginal utility.*

MARKET CAPITALISATION

A term of security market which shows the market value of a company's share—calculated by multiplying the current price of its share to the total number of shares issued by the company.

MARKET MAKER

An intermediary (may be an individual or a firm) in the secondary market who buys and sells securities/shares simultaneously quoting two-way rates. For example, on the over the counter Stock Exchange of India (OTCEI) only 'market markers' are allowed to operate. The Discount and Finance House of India (SBI DFHI) is the chief market maker in the 'money market' of India.

A market maker plays a very vital role by providing sustainability to liquidity in the secondary market.

MASCS

The Multi-Application Smart Cards (MASCs) system to facilitate simplification of procedures and enhancing the efficiency of Government schemes has been suggested by a Planning Commission Working Group in the context of the Eleventh Five Year Plan. The ***Smart Card*** (i.e., MASCs) has been recognised to be useful in implementation of various Central government schemes like, PDS, Indira Awas Yojana and National Rural Employment Guarantee Scheme (NREGS).

Based on a web-enabled information system the Smart Cards will be based on unique ID, sharing ID, multi-application and access control. The whole system will consist of front, middle, and back end. The electronic card will be the 'front' end of the system which will be the point of delivery where the smart cards will be read and used. The office at 'middle' will be responsible for changing and updating the card periodically (i.e., monthly, quarterly, annually) depending on the type of information and requirement and transfer information from the front end to the back end and vice versa. The office at 'back' end will contain the computerised records, guidelines, accounts and management information systems. The complete digitisation of records will be required by this system.

MARSHALL PLAN

A programme of international aid named after General George Marshall (a US Secretary of State) under which North America contributed around 1 per cent of its GDP in total (between 1948–52) to western Europe to rebuild the economies ravaged in Second World War.

MENU COST

The cost a firm bears in changing the prices of its product—it includes retraining the sales staff, reprinting of the new price list, labelling of goods, and informing the customers about the price change. Higher menu costs discourage the firms going for frequent price changes.

MID-CAP FUNDS

Mutual funds launch sector-specific funds to attract investments. Similarly, they mobilise resources from investors with an objective of investing in mid-cap shares. The Fund Manager chooses the mid-cap shares that can become a

part of the portfolio. His job is to outperform the benchmark like the CNX Midcap 200 indexes in terms of the returns. There are thousands of funds world over that focus on investing in medium or small-cap companies.

MFBS

In August 2007, the Reserve Bank of India released a Manual on Financial and Banking Statistics (MFBS), first of its kind, which works as a reference guide and provides a methodological framework for compilation of statistical indicators encompassing various sectors of the economy.

MID-CAP SHARES

There is no classical definition of mid-cap shares. The name 'mid-cap' originates from the term, *medium capitalised.* It is based on the market capitalisation of the stock. Market capitalisation is calculated by multiplying the current stock price with the number of shares outstanding or issued by the company. The definition of mid-cap shares can vary across markets and countries. In case of India, the National Stock Exchange defines the mid-cap universe as stocks whose average six months market capitalisation is between Rs. 75 crore and Rs. 750 crore. In the US, mid-cap shares are those stocks that have a market *capitalisation* of Rs. 9,000 crore to Rs. 45,000 crore. In India, these shares will be classified as *large cap shares*. Thus, classification of shares into large-caps, mid-cap and small-cap is made on the basis of the relative size of market in a country. The total market capitalisation of US markets is $15 trillion. In India, the market capitalisation of listed companies is around $600 billion.

The theory is that large-cap shares have lesser growth potential since the turnover and profits of large companies are already high in the context of that particular market. On the other hand, mid-cap shares are considered an attractive avenue for investing because their growth rate should be faster. It is analogous to investing in an emerging market, like India, as compared to a mature market. However, on the flip side, mid-cap shares are of small companies where revenue and profits could be more volatile than large companies. At the same time, the availability of shares for trading in the secondary market is also limited in comparison to large-cap shares.

The *free float factor*, as it is called, is a key to active trading in shares since investors want an easy entry and exit. Typically, the promoter holding in these companies is high and there is very little public shareholding. Thus, a volatile financial performance and an inadequate free-float make investing in mid-cap shares more risky than big company shares. Moreover, the faster growth argument is obviously a generalisation which may or may not hold for individual companies.

The National Stock Exchange manages an index called CNX Midcap 200. The objective of such an index is to capture the movement in the mid-cap shares segment. According to the NSE, CNX Midcap 200 represents about 77 per cent of the total market capitalisation of the mid-cap universe and 75 per cent of the total trade value. This index provides investors a broad-based benchmark for comparing portfolio returns in the mad-cap segment.

MERCHANT BANKING

A financial world business of providing various financial services other than lending such as public issue management, underwriting such issues, loan syndication management, mergers and acquisition related services, etc.

MEZZANINE FINANCING

Mezzanine financing is defined as a financial instrument which is a *mix* of 'debt and equity' finance. It is a debt capital that gives the lender

the rights to convert to an ownership or equity interest in the company. It is listed as an asset on company's balance sheet. As it is treated as equity in a company's balance sheet, it allows the company to access other traditional sources of finance.

In the hierarchy of creditors, mezzanine finance is subordinate to *senior debt* but ranks higher than *equity*. The return on mezzanine finance is higher in relation to debt finance but lower than equity finance. It is also available quickly to the borrower with *little* or *no collateral*. The concept of mezzanine financing is just catching up in India. Mezzanine financing is used mainly for small and medium enterprises, infrastructure and real estate. *ICICI Venture's Mezzanine Fund* was the first fund in India to focus on mezzanine finance opportunities.

MIBID

The Mumbai Inter Bank Bid (MIBID) is the weighted average interest rate at which certain banks in Mumbai are ready to borrow from the call money market.

MIBOR

The Mumbai Inter Bank offer Rate (MIBOR) is the weighted average interest rate at which certain banks/institutions in Mumbai are ready to lend in the call money market.

Middle Class

We keep hearing and reading use the term 'middle class' frequently. But who are the middle classes? There are still no universally accepted criteria for defining the middle class. Simply put, they are neither rich nor poor. Even the income criterion has not been settled. According to the National Council of Applied Economic Research (NCAER), a family with an annual income between Rs. 3.4 lakh and Rs. 17 lakh (at the 2009-10 price levels) falls in the middle class category. According to NCAER, by 2015–16, India will be a country of 53.3 million middle class households or about 267 million people.

Microcredit

Smaller credit/loan to small and needy borrowers who are outside the reach of commercial banks, for the purpose of undertaking productive activities.

Misery Index

An index of economic misery that is sum of the rates of inflation and unemployment for an economy–higher the value greater is the misery.

Monetary Neutrality

The idea that changes in money supply have no effect on real economic variables (such as output, real interest rates, unemployment etc.,) if money supply increases by 10 per cent, for example, the price will increase by the same level.

A core belief of Classical Economics, the idea was put forth by David Hume in the 18th century. Today this is not considered a valid idea.

MONEY ILLUSION

A phrase coined by J. M. Keynes to denote the misleading thinking among people that they are getting richer as a result of inflation when in reality the value of money decreases.

The phrase is used by some economists to argue that a small amount of inflation may not be a bad thing and could even be beneficial as it may help to 'grease the wheels' of the economy—a feeling of getting richer (let it be illusory itself!).

MORAL HAZARD

One among the two kinds of market failure often associated with the insurance sector. It means that

the people with insurance cover may take greater risks than the uncovered ones as they know they are protected so the insurer may get more claims it bargained for. the other kind of market failure is the *adverse selections* also related to insurance business.

MOST FAVOURED NATION

As per the WTO agreements, member countries cannot *normally* discriminate between their trading partners. If any country grants one country a special favour such as a lower customs duty rate for one of their products the same would need to be extended to all other WTO members. This principle is known as Most Favoured Nation (MFN) treatment.

MFN is governs trade in ***goods***. MFN is also a priority in the General Agreement on Trade in ***Services*** (GATS) and the Agreement on Trade-Related Aspects of ***Intellectual Property*** Rights (TRIPS). However, there are some *exceptions* under WTO regime which allow mwmber countries to—

(i) Set up a 'free trade agreemen't that applies only to *goods* traded within the group (discriminating against goods from outside).

(ii) Give developing countries special access to their markets.

(iii) Raise barriers against products that are considered to be traded unfairly from specific countries.

(iv) To discriminate, in limited circumstances, in services.

But the agreements only permit these exceptions under strict conditions. In general, MFN means that every time a country lowers a trade barrier or opens up a market, it has to do so for the same goods or services for all its trading partners whether developed or developing.

MULTI-FIBRE ARRANGEMENT (MFA)

Up to the end of the Uruguay Round (1986–94), textile and clothing trade were negotiated bilaterally and governed by the rules of MFA, introduced in 1974. This provided for the application of selective quantitative restrictions (quota) when surges in imports of particular products caused, or threatened to cause, serious damage to the industry of the importing country. The Multi-fibre Arrangement was a major departure from the basic GATT rules and particularly the principles of non-discrimination.

On January 1, 1995 MFA was replaced by the WTO Agreement on Textiles and Clothing (ATC) which sets out a transitional process for the ultimate removal of these quotas in stages. The MFA regime, however, continued till December 31, 2004 until quota was completely phased out.

In the MFA regime, higher quota was allocated to various countries irrespective of cost competitiveness. Apparel exports from countries like Nepal, Bangladesh, Sri Lanka, Taiwan, and other South East Asian nations thrived due to quota protection in the lucrative EU and the US markets. But most of these nations lack competitive edge. Their market share was expected to be grabbed by countries like China and India as they offer cheaper and better products.

The ATC was a transitional instrument meant for progressively integrating textile and clothing products into GATT 1994. It laid down the integration procedure and stipulated how members should integrate textile products into the rules of GATT 1994 over the 10-year period which ended on December 31, 2004. The process was to be carried out progressively in three stages (3, 4, and 3 years) with all textile products being integrated at the end of the 10-year period.

First stage began on January 1, 1995 with the integration by members of products representing not less than 16 per cent of its total 1990 imports of all products under quota. At stage 2, on January 1, 1998, not less than a further 17 per cent was integrated. At stage 3, on January 1, 2002, not less than a further 18 per cent was integrated. Finally at the end, on January 1, 2005, all the remaining products (amounting upto 49 per cent of 1990 imports into a member) stood integrated and the ATC was terminated.

MUTUAL FUNDS

The key consideration while investing in a mutual fund are *safety, liquidity*, and *return*. Safety is assured when investors are able to get back their money. Liquidity enables investors exit the fund any time. There are no assured returns from mutual funds and they vary with the scheme under each fund. The schemes are structured to suit the risk-bearing capacity of unit holders and the nature of deployment of funds by the various schemes.

The structure of mutual funds is governed by the Securities and Exchanges Board of India under the SEBI (Mutual Fund) Regulations 1996. These regulations make it mandatory for mutual funds to have a three-tier structure: a sponsor, a trustee, and an asset management company (AMC). The sponsor is the promoter of the mutual fund and appoints the trustees. The trustees are responsible to the investors in the mutual fund and appoint the AMC for managing the investment portfolio.

The AMC is the business face of the mutual fund, as it manages all the affairs of the mutual fund. The mutual fund and the AMC have to be registered with the SEBI. SEBI regulations also provide for who can be a sponsor, trustee, and AMC, and specify the format of agreements between these entities. These agreements provide for the rights, duties, and obligations of these three entities.

Mutual funds are the preferred route for investors, particularly small and retail investors, who do not have the knowledge or time to directly trade in the equity and debt markets. The funds are managed by qualified investment professionals and other service providers who are paid for their services. Portfolio diversification, professional management, and, reduced risk are among the myriad advantages of mutual funds.

Mutual funds invest in multiple asset classes, enable continuous evaluation and provide higher flexibility in investment plans.

Investors in mutual funds have a wide choice from an assorted variety of funds and schemes with several products on offer. Competition in the industry has led to innovative changes in standard products by fund houses. The product choice enables investors to choose options that suit their return requirement and risk appetite. They can combine the options to arrive at their own mutual fund portfolios that will fit their financial planning objectives. The funds are invested in a portfolio of marketable securities, reflecting the investment objective. The value of the portfolio and investors' holdings alter with change in the market value of investments.

Mutual funds predominantly invest in equity shares and debt instruments. Under *equity funds*, one can invest in diversified equity schemes, primary market schemes, index based funds, and sectoral funds.

Debt funds invest predominantly in debt markets. Diversified debt funds, income funds, gilt funds, liquid and money market funds, fixed term plans, and floating rate funds are among the categories of debt funds. While equity funds suit growth objectives, debt funds fit income objectives.

Mutual fund houses also offer *balanced funds* and *money market funds*. Balanced funds invest in equity and debt in specified proportions while

money market funds are preferred by institutional investors which churn their investments depending on the need and view.

NARROW BANKING

Short-term lending in risk-free asset is narrow banking. A suggestion for such banking was given by the committee on Financial System (CFS) in 1991 for the weak banks of India.

NASDAQ

The National Association of Security Dealers Automated Quotation (NASDAQ) is a US stock exchange based in New York which specialises in the high-tech companies' shares. A similar exchange *Techmark* exists in London too. (It is an arm of the London Stock Exchange.)

NASH EQUILIBRIUM

A concept in game theory named after John Nash, a mathematician and Nobel prize winning economist, which occurs when each player is pursuing their best possible strategy in the full knowledge of the strategies of all the other players—once the equilibrium is reached, none of the players has any incentive to change their strategy.

NEO-CLASSICAL ECONOMICS

The school of economics based on the writings of Alfred Marshall (1842–1924) which replaced the classical economics by the 19th century, also known as the *'marginal revolution'*.

NET WORTH

Net worth for a company is its total assets minus total liabilities. This is an important determinant of the value of a company, considering it is composed primarily of all the money that has been invested since its inception, as well as the retained earnings for the duration of its operation. Net worth can be used to determine creditworthiness because it gives a snapshot of the company's investment history. This is also called as *owner's equity, shareholders' equity,* or *net assets.*

In case of an individual, net wroth is the value of a person's assets, including cash, minus all liabilities – the amount by which the individual's assets exceed their liabilities is considered the net worth of that person.

NEW PENSION SCHEME

Pension reforms in India have evolved primarily in response to the need of reform in the Government pension system. This had been designed to make a shift from defined-benefit to defined-contribution by putting a cap on Government's liability towards civil servants' pension. As a result of implementation of the New Pension System (NPS), all employees of the Central Government and Central autonomous bodies, with the exception of the armed forces, are now covered by this defined-contribution scheme with effect from January 1, 2004. Subsequently, 27 State Governments have notified and joined the NPS for their employees. The NPS to was opened to all citizens of India on May 1, 2009, on voluntary basis - the challenge is to spread the message of the NPS and old age income security to people in the unorganized sector across the country.

The pension fund managers manage three separate schemes, consisting of three asset classes, namely (i) equity, (ii) Government securities, and (iii) credit risk-bearing fixed income instruments, with the investment in equity subject to a cap of 50 per cent.

NINJA

A mortgage business terminology became common word after the US subprime crisis of mid-2007

which is an acronym for the borrowers with no income, no job or assets.

NOMINAL VALUE

The value of anything calculated at the current prices. It does not include the effect of inflation during the periods and gives misleading idea of value.

NON-WORKERS

The *Census of India* defines non-workers as the persons who did not 'work at all' during the reference period. They constitute—

(i) Students who did not participate in anyeconomic activity paid or unpaid,

(ii) Household duties who were attending to daily household chores like cooking, cleaning utensils, looking after children, fetching water etc. and are not even helping in the unpaid work in the family farm or cultivation or milching,

(iii) Dependants such as infants or very elderly people not included as *worker*,

(iv) Pensioners drawing pension post-retirement, not engaged in any economic activity.

(v) Beggars, vagrants, prostitutes and persons having unidentified source of income and with unspecified sources of subsistence and not engaged in any economically productive work.

(vi) Others, which includes all Non-workers who may not come under the above categories such as rentiers, persons living on remittances, agricultural or non-agricultural royalty, convicts in jails or inmates of penal, mental or charitable institutions doing no paid or unpaid work and persons who are seeking/available for work.

[Also see entry *'Worker'*]

NORKA

Indians work abroad and *remit* much of their earnings back home. Kerala is a state where non-residents contribute significantly to the state's resources. Keeping this important revenue channel in mind, the Government of Kerala launched the department of Non-resident Keralites' Affairs (NORKA) in 1996 to redress the grievances of Non-Resident Keralites (NRKs). NORKA is the ***first*** of its kind formed by any Indian state.

It makes efforts to solve the grievances raised in petitions for remedial action on threats to the lives and property of those who are left at home, tracing of missing persons abroad, compensation from sponsors, harassment from sponsors, cheating by recruiting agents, educational facilities for children of NRKs, introduction of more flights, assistance to stranded Keralites, etc.

NORKA has established *NORKA Roots* that acts as an interface between the NRKs and the Government of Kerala. Some important *objectives* are creation of a heritage village for parents of non residents, cultural exchange programmes, promotion of Malayalam language, employment mapping, maintaining a data base, etc.

NORMAL GOODS

The goods whose demand increases as income of the people increases. It is just opposite of *inferior goods*.

NULL HYPOTHESIS

An idea that is put to the test. In econometrics, experts start with a null hypothesis (i.e., a particular variable equals a particular number), then crunch the data to verify it in accordance with the laws of *statistical significance*. The chosen null hypothesis is often just opposite to what the experimenter believes.

Statistical significance means that the probability of getting the result by chance is low. It is most commonly used measure is that there must be a 95 per cent chance that the result is right and only 1-in-20 chance of the result occurring randomly.

NUMERAIRE

A monetary unit which is used as the basis for denominating international exchanges in a product and financial settlements on a common basis. For example, the US dollar being used as the numeraire of international oil trade, the Special Drawing Rights (SDRs) as the numeraire of the IMF transactions, etc.

NVS

Non voting Shares (NVS) are the equity shares not having right to vote at the general meetings of the company. But these shares get higher dividend than the shares having voting rights. A company in India may issue such shares maximum to the 25 per cent of the total issued share capital and such shares cannot get more than 20 per cent higher dividend than the shares with voting rights.

OIL BONDS

Over the last few months there have been many reports on India state-owned oil refining companies like IOC, BPCL, and HPCL reeling under the impact of the rise in crude oil prices. These companies have been hit as they are unable to pass on the rise in price to the consumer due to heavy subsidies on some products. With the oil companies being heavily impacted in the first quarter of this financial year, the government has finally agreed to a package, which proposes issuance of special oil bonds.

The oil bonds are special bonds issued by the government to partly compensate state-owned oil companies for not increasing the retail prices of products like LPG and kerosene in line with the rise in crude oil prices.

OKUN'S LAW

Based on the empirical research of *Arthur Okun* (1928–80), the law describes the relationship between unemployment and growth rate in an economy. As per it, if GDP grows at 3 per cent p.a., the unemployment rate would not change. In the case of faster growth rates, every extra above the 3 per cent will have a decrease in the unemployment rate by its half (i.e., a 4 per cent growth rate will decrease unemployment by 0.5 per cent–half of 1 which is the extra above 3 per cent). Similarly, a growth rate below 3 per cent will have the same but opposite impact on unemployment (i.e., increases it).

Though the law was perfectly correct for the period of the US economy Okun studied, it may not be valid today in either US or anywhere else. But in general, the law is still used by experts and policy makers as a rule of thumb to estimate the relationship between growth rate and job creation.

OPEN MARKET OPERATION

An instrument/tool of monetary policy under which sale/purchase of government Treasury Bills and bonds takes place as a means of controlling money supply.

OPPORTUNITY COST

A measure of the economic cost of using scarce resources to produce one particular good or service in terms of the alternative thereby foregone, also known as the *economic cost.*

OUTCOME BUDGET

An outcome budget measures the development outcomes of all government programmes. For instance, it will tell a citizen if money has been

allocated for building a primary health centre, whether the centre has indeed come up. In other words, it is a means to develop a linkage between the money spent by a government and the results, which follows. The concept has developed in many democratic systems to make budgets more cost-effective. According to experts, it signals the emergence of an important tool for effective government management and accountability. Earlier too, there have been efforts to bind government expenditure to results, like zero-based budgeting. But experts acknowledge that an outcome orientation is a better means to achieve the same objective. In India, the central government decided that with effect from the fiscal year 2006–07, it will put up in the public domain information about spending by ministries so that all stakeholders, including the people's representative, civil society and the intended beneficiaries of the schemes and projects can scrutinise how well a project has been implemented. This will ensure value for money for government expenditure.

This means, every ministry would have to present its preliminary outcome budgets while proposing its demand for grants to the Ministry of Finance. It is a sort of examination of expenditure before they are made, instead to a post expenditure scrutiny. The Expenditure Finance Committee, for instance, which sanctions government plans of upto Rs. 100 crore, has recently modified its rules and decided to ask of real definition of outcomes at the stage of planning a programme. 'At the end of the year, we should ask not how much has been spent, but what has been achieved,' the Finance Minister has said explaining the rationale for the exercise. Admitting that converting outlays into outcomes is a complex process, which may differ from ministry to ministry and programme to programme. The Finance Minister said administrative ministries have to develop a commitment to make the exercise successful.

In addition, converting outlay into outcomes will require ensuring the flow of right amount of money at the right time to the right level, with neither delays nor 'parking' of funds; effective monitoring and evaluation systems, which indicate the areas requiring further calibration and honing of processes to deliver the intended outcomes; and the involvement of the community or target groups for whom the schemes are meant.

The exercise is a joint effort of the finance ministry and the Planning Commission. The latter gave final shape to the consolidated Outcome Budget of the administrative ministries after detailed discussion with them. The document will also be put up on the web for the people to give their comments.

A new division called the Programme Outcome and Response Monitoring Division has been created within the Planning Commission to co-ordinate the initiative. The Division will try to bring a fair degree of uniformity of approach across the ministries, but with due regard to the special nature of their collective responsibilities, programmes, and projects. This means that while it is relatively easy to find out if the defence ministry has spent its budget to buy a new weapons system, it is far more difficult to establish if Rs. 100 crore spent on a block has helped families to move above the poverty line. So the yardsticks have to take into account such differences.

Some of the common yardsticks to be employed to measure outcome include standardising the unit cost of delivery, bench-marking the standards and quality of outcome, and capacity-building of requisite efficiency at all levels, in terms of equipment, technology, knowledge and skills. Accordingly, implementing agencies will have a clearer idea of what is expected of them, and can be assessed against agreed performance indicators.

OVER THE COUNTER

The financial papers/securities which can be bought or sold through a private dealer or bank rather than on a financial exchange. The term has its use in the non-financial world too–purchasing medicines from a medical store without the doctor's prescription is an over-the-counter deal in drugs.

PARALLEL IMPORTING

A type of arbitrage where an independent importer buys product of a particular supplier at low price in one country and resells it in direct competition with the supplier's distributors in another country where prices are higher.

It promotes free trade and competition by breaking down barriers to international trade and undermines price discrimination between markets covered by the suppliers.

PARETO PRINCIPLE

The maximisation of the economic welfare of the community. Named after the Italian economist Vilfredo Pareto (1843–1923), this points to a situation in which nobody can be made better off without making somebody else worse off.

By an efficient use of resources an economy is able to do so i.e., without making somebody else worse off, somebody might be made better off. In reality, change often produces losers as well as winners. Pareto optimality does not help judge whether this sort of change is economically good or bad.

PARKINSON'S LAW

A proposition by C. Northcote Parkinson which suggests that work expands according to the time available in which it is done.

PENNY STOCKS

Very low-priced shares of small companies which have low market capitalisation. The term made news in mid-2006 when some of the 'penny stocks' did show a high rise in their trading prices in India at the BSE as well as the NSE.

PHILLIPS CURVE

A graphic curve depicting an empirical observation of the relationship between the level of unemployment and the rate of change of money wages and, by inference, the rate of change of prices.

It was in 1958 that an economist from New Zealand, A. W. H. Phillips (1914–75) proposed that there was a trade-off between inflation and unemployment–the lower the unemployment rate, the higher the inflation rate–governments simply need to choose the right balance between the two evils.

PIGGYBACK LOAN

A term associated with mortgage business got popular in the wake of the US subprime crisis mid-2007. Piggyback loan is a second mortgage enabling a borrower to buy a house with little or no equity.

PIGOU EFFECT

Named after Arthur Cecil Pigou (1877–1959), a sort of wealth effect resulting from deflation/disinflation (i.e., price fall) – a fall in price level increases the real value of people's money, making them wealthier inducing increased spending by them; higher demand creation leads to higher employment.

PFRDA

In 2002–03, the government announced its intention to move toward a new pension scheme.

The reason for this change was the growing liabilities of both the Central and state governments on account of pension payments. These liabilities are discharged by the government out of general revenues, instead of a specific dedicated sustainable fund. Recognising the inherent dangers, an interim Pension Fund Regulatory Development Authority (PFRDA) was set up on January 1, 2004. subsequently, the Interim authority was disbanded and an ordinance was promulgumated in late December 2004, followed up with the PFRDA bill in the budget session of Parliament.

The PFRDA will be a regulator on the lines of the watchdogs for insurance and capital market, to regulate and supervise pension funds in the country. It will regulate the new pension scheme which has been in vogue since January 1, 2004 for all fresh entrants to the central government, excusing the armed forces. the PFRDA will also regulate the new pension schemes announced by state governments besides all gratuity and superannuating funds. However, other social security schemes which are in operation now like the one offered by Employees Provident Fund, Coal Miners Provident Fund, Seaman Provident Fund, Assam Tea Provident Fund, to name a few, will be out of the purview of PFRDA as they are governed by specific legislations.

Besides regulation of pension funds, the PFRDA will also have a promotional role to play like other regulators in the country. This will also mean an educational awareness role also. The pension fund regulator will evolve guidelines in consultation with the government on opening up of the pension sector. The PFRDA will also have to curb fraudulent and unfair practices in the sector by participants and protect the interests of subscribers. A pension fund subscriber education and protection fund will also be set up down the line in keeping with its mandate.

The PFRDA will decide on how many pension fund managers ought to be allowed initially, the kind of schemes, the norms for selection of the pension fund managers, capital requirements for these players and the investment norms for the pension funds.

It will also grant licences to pension fund managers. In short, all the operational guidelines for pension fund management will be laid down by the PFRDA. Besides, the regulator will also prescribe the level of investment by the pension fund managers in various types of instruments, whether debt or equity, both in the local and overseas markets.

PREFERENCE SHARES

The shares which bear a stated dividend and carry a priority over equity shares (in matters of dividend and assets) are also known as hybrid securities (since they have the qualities of equity shares as well as bond). Such shares in India cannot have a life over 10 years.

PRICE-EARNING RATIO

A concept used in the share market to equate various stocks–is a ratio found/calculated by dividing market price of a share by the earning per share.

PRIMARY AND SECONDARY MARKET

Primary market refers to buying of shares in an initial public offering. The shares are bought by applying through a share application form. Secondary market refers to transactions where one investor buys shares from another investor at the prevailing market price or at an agreed price. The shares are bought and sold in the secondary market on the stock exchanges. The investors may buy and sell securities on the stock exchanges through stock brokers.

PRIMARY DEALER

Primary dealer (PD) is an intermediary participating in the *primary* auctions of the

government securities (i.e., G-See or the Gilt-edge securities or the Gilt) and the Treasury Bills (TBs); through a PD these instruments reach the secondary market.

Primary dealers are allowed participation in the call money market and notice money market. They get liquidity support from RBI via repos or refinance (against the G-Secs.).

PRISONER'S DILEMMA

A popular example in *game theory* which concludes why co-operation is difficult to achieve even if it is mutually beneficial, ultimately making things worse for the parties involved. It is shown giving an example of two prisoners arrested for the same offence held in different cells. Each prisoner has two options, i.e., confess, or say nothing. In this situation there are *three* possible outcomes:

(i) One could confess and agree to testify against the other as a state witness, receiving a light sentence while his fellow prisoner receives a heavy sentence.

(ii) They can both say nothing and may turn out to be lucky getting light sentences or even be let off due to lack of firm evidence.

(iii) They may both confess and get lighter individual sentences than one would have received had he said nothing and the other had testified against him.

The second outcome looks the best for both the prisoners. However, the risk that the other might confess and turn state witness is likely to encourage both to confess, landing both with sentences that they might have avoided had they been able to co-operate by remaining silent.

In reality, firms behave like these prisoners, not setting prices as high as they could do if they only trusted the other firms not to undercut them. Ultimately, the firms are worse off i.e. all firms suffer.

POPULATION TRAP

A situation of population growth rate greater than the achievable economic growth rate. This makes it difficult to alleviate poverty;–government is suggested to implement population control measures.

POVERTY TRAP

A situation where an unemployed getting unemployment allowance is not encouraged to seek work/employment because his/her after-tax earnings as employed is less than the benefits as unemployed, also known as the *unemployment trap*.

PREDATORY PRICING

The pricing policy of a firm with the express purpose of harming rivals or exploiting the consumer. By price-cutting, firstly the rivals are ousted from the market and later the consumers are exploited as monopolistic suppliers by the firm.

PPP

Purchasing power parity (PPP) is a method of calculating the correct/real value of a currency which may be different from the market exchange rate of the currency. Using this method economies may be studied comparatively in a common currency. This is a very popular method handy for the IMF and WB in studying the living standards of people in different economies. The PPP gives a different exchange rate for a currency which may be made the basis for measuring the national income of the economies. It is on this basis that the value of gross national product (GNP) of India becomes the fourth largest in the world (after the US, Japan, and China) though on the basis of market exchange rate of rupee it stands at the *thirteenth rank*.

The concept of the PPP was developed by the great European conservative economist, Gustav Cassel (1866–1944), belonging to Sweden. This concept works on the assumption that markets work on the *law of one price,* i.e., identical goods and services (*in quantity* as well as *quality*) must have the same price in different markets when measured in a common currency. If this is not the case it means that the purchasing power of the two currencies is different.

Let us look at an example. Suppose that sugar is selling $1 in US and Rs. 20 in India a kilo then the PPP-based exchange rate of rupee will be $1 = Rs. 20. This is the way how *The Economist* of London has prepared its 'Big Mac Index' (comparing the Mc Donald's Big Mac burger prices in different economies).

In theory, the value of currencies in terms of their market exchange rate should converge with their value in terms of the PPP in the long run. But that might not happen due to many factors like the fluctuations in inflation; level of money supply; follow-up to the exchange rate regimes (fixed, floating, etc.), and other.

For the calculation of the PPP, a comparable basket of goods and services is selected (a very difficult task) of the identical qualities and quantities. The other difficulty in computing PPP arises out of the flaw in the 'one price theory' i.e., due to transportation cost, local taxes, level of production, etc. The prices of goods and services cannot be the same in different markets (This is correct in theory only, not possible in practice.)

QIP

Qualified Institutional Placement (QIP) is a policy associated with the Indian stock market for raising capital by issuing equity shares. The companies listed on the BSE and the NSE are allowed (since May 2006) to raise capital by issuing equity shares, or any securities other than warrants, which are convertible into or exchangeable with equity shares. The attractive part of the new QIP is that the issuing company does not have to undergo elaborate procedural requirements to raise this capital. These securities have to be issued to Qualified Institutional Buyers on a discretionary basis, with just a 10 per cent reservation for mutual funds.

Q THEORY

As investment theory for firms proposed by the Nobel prize winning (1981) economist James Tobin (1918–2002). He theorised that firms would continue to invest as long as the value of their shares exceeded the replacement cost of their assets–the ratio of the market value of a firm to the net replacement cost of the firm's assets is known as *'Tobin Q'.* If Q is greater than 1, then it should expand the firm by investment as the profit it should expect to make from its assets (reflected by share price) exceeds the cost of the assets.

If Q is less than 1, the firm would be better off by selling its assets which are worth more than shareholders currently expect the firm to earn in profit by retaining them.

RANDOM WALK

When it is impossible to predict the next step. As per the Efficient Market Theory the prices of financial assets (such as shares) follow a random walk–there is no way of knowing the next change in the price. The reason this theory provides is that in an efficient market, all the information that would allow an investor to predict the next price move is already *reflected in the current price.* Such belief has led some economists to conclude that investors cannot outperform the market consistently.

As opposed to this, some economists argue that asset prices are predictable and that markets are not efficient–they follow a *non-random walk* perspective.

REDLINING

The act of not lending to people in certain poor or troubled neighbourhoods shown on the map with a 'red line'. Even if their credit-worthiness has been judged on the basis of other criteria, they are not considered as borrowers by the banks, simply because they live in that area.

RENT

It has two different meanings in economics:

(i) The first is layman i.e. the income accruing from hiring land or other durable goods.

(ii) The second (also known as *economic rent*) is a measure of *market power* i.e. the difference between what a factor of production is paid and how much it would need to be paid to remain in its current use.

For example, a cricket player may be paid Rs. 40,000 a week to play for his team when he would be willing to turn out for only Rs. 10,000, so his economic rent will be Rs. 30,000 a week.

RENT-SEEKING

Spending time and money not on the production of real goods and services, but rather on trying to get the government to change the rules so as to make one's business more profitable.

It is like cutting a bigger slice of the cake rather than making the cake bigger trying to make more money without producing more for customers. The term was coined by the economist Gordon Tullock.

RENT-SEEKING BEHAVIOUR

The behaviour which improves the welfare of someone at the expense of someone else. A protection racket is the most extreme example of it, in which one group (i.e., the protected one) betters itself without creating welfare-enhancing output at all.

REPLACEMENT COST

The cost of replacing an asset (such as machinery, etc.). Opposite to *historic cost* (i.e., the original cost of acquiring an asset), replacement cost adjusts the effects of inflation.

REPO, REVERSE REPO, & BANK RATE

It is a window which enables a bank or a financial institution to borrow money in the *short term*. In the transaction the entity in question sells government securities or bonds to be lender (another bank or institution), with an agreement to buy the securities back after a specified time and price. It is also called a *repurchase* agreement. (In the US, repo has different meaning; it is used to signify the repossession of hypothicated property by a financier).

A *repo* transaction is in the nature of secured borrowing; the difference between the sale and repurchase price is the borrowing cost. It is usually very short term in nature with the market practice being to conclude the sale and repurchase within a time frame of one day, to a fortnight.

When RBI conducts a repo what it does in effect is lend to banks by purchasing securities and selling them back at a predetermined price. When RBI does a *reverse repo,* it borrows from banks by selling them securities and buying them back at a future date. When RBI does reverse repo, it enables banks to park short-term surplus funds; on the other hand, it's a tool for RBI to manage short-term liquidity. RBI pays an interest of 6 per cent to the banks on reverse repo today. The rate serves as a short term interest rate benchmark for banks and other intermediaries. Similarly, RBI makes funds available to banks through repo at 7.75 per cent today.

In India, only select institutions in the financial sector have RBI's permission to enter into repo and reverse repo transactions.

Significantly, on April 28, 2007, RBI, for the first time allowed listed corporates to participate in the repo market as lenders. Thus, a corporate treasurer can choose between a liquid mutual fund and repo to park surplus money in the short term.

Banks have been banned to do repo with brokerage. The ban, still in force was imposed after the '92 stock market scam masterminded by the late Harshad Mehta. Mehta used the repo/reverse repo operation with various banks as a subterfuge to divert funds to the stock market. After the scam, RBI came up with strict guidelines for repo transactions. It also limited the number of players in repo transactions to participants such as banks and primary dealers.

Unlike a general borrowing or lending transactions in the money market, repos are safer as the lender holds government securities (or other special bonds with the repo status) in its own name. Thus, a repo is a *zero-risk* transaction. A repo helps banks to meet their mandatory requirements for investing in government securities (i.e., the SLR). Under the law, banks are required to invest a certain portion of their deposits in government securities. If their holdings are not up to the prescribed level, they face punitive action. So, if a bank needs securities for a short period, it provides the opportunity.

There are two benchmark rates through which RBI influences interest rates in the system. The first is the *bank rate*, the rate at which it lends to banks. The second is the *reverse repo rate*, the rate at which it borrows funds from the banking sector, and repo rate, the rate at which it makes funds available to banks which need it. However, over the years, reverse repo and repo have emerged as the more dynamic indicators of the interest rates. Remember, the reverse repo rate acts as a floor for lending rates in the money market since banks have the option of lending to the Reserve Bank at the reverse repo rate if short-term money market rates fall below that level.

RESIDUAL RISK

What is left after one takes out all the other shared risk exposures to an asset, also known as *alpha* (a).

When one buys an asset one is exposed to a number of risks, many of them not unique to the asset but reflect broader possibilities (such as the future behaviour of stock market, interest rate, inflation or even government policies, etc.). Exposure to this risk can be reduced by diversification.

RETAIL BANKING

A way of doing banking business where the banks emphasise the individual-based lending rather than corporate lending–also known as *high street banking*. Such banking focusses on consumer loans, personal loans, hire-purchase, etc., considered more cumbersome and risky.

RETROCESSION

The term has got *three* different meanings in which it is used—

(i) The purchase of 'reinsurance' by a 'reinsurance company' (as in the case of India, the GIC going for 'reinsurance' on the 'reinsurance' it has provided to other 'insurance companies' operating in India). This limits the risk that a reinsurance company may face, since it has purchased insurance against an 'event' that might affect a company that it had underwritten (reinsured). If a reinsurance company *continues* to purchase insurance it might 'unknowingly' buy back its own risk, which is known as 'spiraling'.

(ii) The 'voluntary' act of returning ceded property by one to another which may be a result of 'request' to have property returned. But, by definition, it is not the result of a 'forced' transaction. Returning of Hong Kong to China by the UK in 1997 is the best such example of the recent times.

(iii) The act of 'differentiating' and 'diversifying' assets by consolidating and then dividing them amongst a number of stakeholders – by doing so the risk involved is 'retroceded' (i.e., cut down or minimised). This is, usually, done by the 'hedge funds' in their day-to-day portfolio management.

REVERSE TAKEOVER

The term is used to mean two different kinds of takeovers:

(i) Takeover of a public company by a private one, and

(ii) takeover of a bigger company by a smaller one.

RESIDUAL UNEMPLOYMENT

Unemployment of those who remained unemployed even in the times of full employment (as for example employing a severely handicapped person may far outweigh the productivity obtained from him).

REVERSE MORTGAGE

A scheme for senior citizens in India announced in the Union Budget 2007–08. Under this scheme, the senior citizens go to mortgage their house owned by them in reverse to a bank and the bank pays them the agreed money either in installments or lumpsum. Guidelines for reverse mortgage announced by the National Housing Bank (NHB) in May 2007 has a provision of maximum period of 15 years for such mortgage. Once the period of mortgage is complete either the house should be vacated or the bank will sell the house at the market price and the loan of the bank will be settled. If the value of the house is more than the loan, the difference is paid to the senior citizens or their heirs. If the heir wants to possess the house, he/she needs to pay the loan.

REVERSE YIELD GAP

An excess of returns on gilt-edged (government) securities above those on equities. This occurs during periods of high inflation because equities provide capital gains to compensate inflation while the gilt-edged securities do not.

REVEALED PREFERENCE

The notion that what one wants is revealed by what one does, not by what one says–actions speak louder than words.

RICARDIAN EQUIVALENCE

An idea which (generated too much controversies) originally suggested by David Ricardo (1772–1823) and more recently by Barro, that government deficits do not affect the overall level of demand in an economy.

This is because tax-payers know that any deficit has to be paid later, and so they increase their savings in anticipation of a higher tax bill in future; thus government attempts to stimulate an economy by increasing public spending or cutting taxes, will be rendered impotent by private sector reaction.

The equivalence can be seen as part of a thread of economic thinking which holds that only decisions about real variables (e.g., consumption and production) matter, and that decisions about financing will, in a perfectly functioning market, never have an effect.

RISK SEEKING

An act whereby investors prefer an investment with an uncertain outcome to one with the same expected returns and certainty that it will deliver them – the act which cannot get enough risk.

RULE OF THUMB

A rough-and-ready decision-making aid that provides an acceptably accurate approximate solution to a problem. Where refined decision-making processes are expensive (in terms of information gathering and processing them), such a method looks justified.

ROUNDING ERROR

The error which comes up due to rounding off the figures in decimals, for example, considering 3.6 as 4 and 3.4 as 3. Such rounding off the data is never going to be mathematically correct.

SALARY

The payment made to employees of an organisation, firm, etc., for the use of labour as a factor of production. It differs from *wage* in the following two ways:

(i) It is not paid on hourly basis (or for the actual number of hours worked by the employee) as wages are paid, and

(ii) It is usually paid on monthly basis whereas wages are paid on daily or weekly basis.

SATISFICING THEORY

A theory which suggests that firms do not want only 'satisfactory' profits but maximum profits as well as other objectives such as sales increase, size increase, etc. might be having equal or greater importance than profits.

SAY'S LAW

Named after the French economist Jean Baptise say (1767–1832), the law proposes that aggregate supply creates its own aggregate demand.

The logic of the law goes like this–the very act of production generates an income (in the form of wages, salaries, profits, etc.) exactly equal to the output which if spent is just sufficient to purchase the whole output produced. Ultimately, it gives an important clue, i.e., in order to reach full-employment level all that is needed is to increase the aggregate supply.

The key assumption behind the law is that the economic system is 'supply-led' and that all income is spent. But in practice, some income 'leaks' into saving, taxation, etc., and there is no auto-guarantee that all income is 'injected' back as spending. This is why others suggest for a 'demand-led' idea of the economic system under which demand creation is attended vigorously.

SECOND-BEST THEORY

The idea was put forward by Richard Lipsey and kelvin Lancaster (1924–99) in 1956 which suggests a way out of the situation when all the assumptions of an economic model are not met. As per the theory, the second-best situation is meeting as many of the assumptions as possible (but it might not give the optimum or the desired results).

SECURITIES TRANSACTION TAX

[See Chapter 17, *Tax Structure in India*]

SEIGNORAGE

A method of generating resource by a government through printing of fresh notes/currency notes. Money printing at higher rate to pay the

government expenditures leads to inflation that enables the government to secure extra resources though that is called 'inflation tax' also.

SEQUESTRATION

The process under which a third party (*the sequestrator*) holds a part of the disputed assets till the dispute is settled.

SHARPE RATIO

The idea of William Forsyth Sharpe (Nobel Economist) which checks whether the rewards from an investment justify the risk. For this Sharpe uses past data of rewards and calculates it using standard deviation. This is why the ratio says nothing about the future performance of the investment.

SHORT SELLING

Selling shares without possessing them. After the prices fell to a certain extent the short-seller covers his position by cheaper shares booking the difference in price as profits. It is also known as *bear operation*. Short-sellers, however, could get caught on the wrong foot if the market reverses the downtrend.

SHUTDOWN PRICE

That lower level of the prices for the product of a firm at which the firm decides to close (*shut*) down – as it has become impossible to recover even the short-run variable cost at the price. Many such instances we get in the Euro-American economies during the period of the Great Depression (1929).

SIXTH PAY COMMISSION

Almost after every 10 years, the central government appoints a pay commission to revise the salary structure of about 5.5 million central government employees. The pay commission is not a constitutional body unlike the Finance Commission, and therefore, the government can have a lot of leeway about which part of the report to adopt and in what time frame.

The first pay commission was constituted in May 1946 and it submitted its report in a year. The abysmal level of salary of the average government employee prompted the establishment of the commission. This may seem surprising, but the appointment of the pay commission was seen as a humane measure—a far cry from today. The average salary of the employees, even after making allowance for the lower living standards of the day, ranged around Rs. 30. The second pay panel was set up in August 1957, based on the recommendation of the first commission to set up one after 10 years. It was also necessitated by the Partition and the need to restructure the bureaucracy accordingly. It gave its report exactly after two years. The financial impact of the report was about Rs. 39.6 crore.

The third pay commission, set up in April 1970, gave its report in March 1973. The implementation of its proposals did cost the government Rs. 144 crore. The fourth commission was constituted in June 1983, and gave its report in three phases within four years. The financial hit on the government was Rs. 1,282 crore. It was the fifth pay commission which really set back the government finances severely. Formed in April 1994, the panel report was acted upon by the government from January 1997. The financial impact of the the fifth pay panel was a whopping Rs. 17,000 crore. If one adds the Rs. 25,000 crore that state governments paid up as salary and pension to their staff, the impact on the country becomes clear. According to a World Bank report the impact of the award of the pay commision on the states was simlar to the Balance of Payments crisis that the Centre faced in 1991. The states had to re-write their fiscal acts considerably.

First, the fifth commission did not suggest the steep hike that the United Front government finally acceded to. It had broadly recommended a 20 per cent rise in salary scale. But the staff unions managed to push it up to 40 per cent from the existing levels.

Recognising the possible fiscal impact of another pay commission, the fifth commission recommended some far-reaching changes in finances. One of the first was a sustained drive to reduce the number of government staff pruning the size of the bureaucracy by at least 30 per cent. It had also asked for introducing a productivity-linked salary structure and other reforms. None of these had been implemented.

However, the carrots have all been implemented. The panel had suggested that for every 100 points rise in DA, the government should merge 50 per cent of the DA with the salaries to revise the pay scales. This was meant to delay the need for another commission but that has not happened.

The best bet against any profligacy by the new commission is the memory of the impact of the last pay commission. The states and Centre have become wiser. So it is on the cards, that there will be no shock like the last time. But just as the last commision led to the enactment of the Fiscal Responsibility and Budget Management Act, the present could result in scuttling of the act, or at least delaying the goals of achieving a 3 per cent fiscal deficit at the Centre and zero revenue deficit by 2009, by another few years. The proposed commision is, however, in a good position to look at the still rising numbers in the government staff rolls and suggest clear cut policy to check it.

SKIMMING PRICE

A pricing method of charging high profits—adopted by a firm when consumers are not price-sensitive and demand is price-inelastic.

SOCIAL COSTS

The costs borne by the society at large resulting from the economic activities by the firms–pollution being a prominent example.

SOLVENCY MARGIN

The term made news in the 1970s concerning a life insurance company. The only requirement, till then, by a life insurance company was that the value of its assets should not be less than the value of its liabilities. The regulators in many conntries felt that the value of assets should exceed the value of liabilities by a certain margin. This margin which came to be known as *'solvency margin'* became a useful device to force shareholder of a life insurance company either to keep in reserve a certain portion of the profit or to bring in additional capital if there is not sufficient profit to meet unforeseen contigencies. The European Union developed an empirical formula taking recourse to the past experience to determine the quantum of margin required. The IRDA has stipulated that the excess of assets (including capital) over liabilities should not be less than 150 per cent of the solvency margin arrived at by the EU formula.

On March 31, 2006, the total liability of LIC stood at Rs. 4,52,000 crore and its assets valued at Rs. 4,52,000 crore, having a comfortable margin that did not require capital infusion (though the IRDA has suggested to raise its capital by Rs. 7000 crore by 2009).

SOVEREIGN RISK

The risk of a government defaulting on its debt or a loan guaranteed by it (all international loans by the private companies are basically guaranteed by the government of an economy).

SPOT PRICE

The price quoted for anything in a transaction where the payment and delivery is to be done now.

SPREAD

A frequently used term of financial market which is the difference between two items, for example, the spread (i.e., the difference) an underwriter pays for an issue of bonds from a company and the price it charges from the public. Similarly, the returns on two different bonds if they are different; the difference is known as the spread.

STANDARD DEVIATION

It is a statistical technique to measure how far a variable moves over time away from its mean (average) value.

STATES' MARKET BORROWING

The state governments, for years, had few worries when it came to raising money from the market as it was done at the tutelage of the centre. However, with the onset of financial sector reforms, the contours of raising funds from the market both for the states and the Centre have changed. In the early days after the central bank had come into existence, Madras had objected to the Reserve Bank of India being given the mandate to manage public debt for states. State loans used to be underwritten then.

However, that practice was stopped in the 1950s. Since then, major reforms have taken place. Starting from the 1990s, increasingly states as well as the Centre have accessed funds at market-related rates. Now increasingly, the onus will be on the states to manage their borrowing programmes adroitly.

The borrowing requirements of states were decided earlier in consultation with the Planning Commission and the finance ministry. The Reserve Bank of India as the banker to states as well as the debt manager handles the floatations. For decades, the borrowings of states or state loans or *tap issues* as they are called used to be on the basis of pre-determined rates. In effect, all states were treated on the same footing when it came to borrowing. Now a part of market borrowings is through the auctions where the rate is determined based on market response with the rest being through the fixed coupon basis.

The Reserve Bank of India used to take into account the borrowing programme of the Central government, liquidity conditions, the cash flow needs of states, future repayment schedules while working out the borrowing programme for states.

A significant change was signalled when the Twelfth Finance Commission recommended the delinking of grants and loans in Plan assistance to states as part of reforms on the borrowing programme front. Earlier, there was a ratio of 70:30 between loans and grants for extending plan assistance to states.

What this meant was that states could access loans from the Central Government for their plan expenditure. These loans were for long tenures of over 20 years and a relatively higher interest spread.

The government has accepted the Finance Commission's recommendations on doing away with such loans. This would mean greater recourse to the markets by states. Now like the Centre, states will have to decide their annual borrowing programme within the framework of their fiscal responsibility programmes. This is expected to help in fiscal discipline.

The Commission and the RBI want to impose some sort of discipline on states on their debt management. If more market borrowings by states governments are carried out through the auction route, it would mean that well-managed states would stand to gain. They would be in a position

to obtain better rates as the market would factor in the fiscal strengths of a particular state when pricing is determined.

When states take a recourse to market borrowings through the auction route, there would be greater price discovery besides enhanced secondary market liquidity for such securities.

A state whose credit rating is strong will get a better rate while borrowing while a weaker state may have to settle for a higher rate. This is expected to lead to greater attention and focus fiscal responsibility and debt management by states especially as they cannot look to the Central Government for loans as in the past. The Reserve Bank of India, which is the debt manager for both the Centre and states, wants to progressively raise the share of market borrowings by states under the auction route so that the entire programme is covered through auctions.

STEALTH TAX

A popular name given to an obscure tax increase as for example stamp duty, property tax etc. Which get implemented months later by the time they usually fade out from the public memory.

STOCHASTIC PROCESS

It is a process that shows random behaviour. As for example, *Brownian* motion which is often used to describe changes in share prices by the experts in an efficient market (random walk), is such a process.

SUB-PRIME CRISIS

The word 'sub-prime' refers to borrowers who do not have sound track record of repayment of loans (*it means such borrowers are not 'prime' thus they could be called as 'less than prime' i.e. 'sub-prime'). The* 'sub-prime crisis' which has been echoing time and again recently has its origin in the United States housing market by Late 2007—being considered as the major financial crisis of the new millenium.

Basically, last few years have seen a gradual softening of international interest rates, relatively easier liquidity conditions across the world motivating the investor (i.e., banks, financial institutions, etc.) to expand their presence in the sub-prime market, too. The risks inherent in sub-prime loans were sliced into different components and packed into a host of securities, referred to as asset-backed securities and *collaterised debt obligations* (CDOs). Credit rating agencies have assigned risk ranks (e.g., AAA, BBB, etc.) to them to facilitate their marketability. Because of the complex nature of these new products, intermediaries (such as hedge funds, pension funds, banks, etc.) who held them in their portfolio or through special purpose vehicle (SPVs), were not fully aware of the risks involved. When interest rates rose leading to defaults in the housing sector, the value of the underlying loans declined along with the price of these products. As a result institutions were saddled with illiquid and value-eroded instruments, leading to liquidity crunch. This crisis of the capital market subsequently spread to money market as well.

The policy response in the US and the Euro area has been to address the issue of enhancing liquidity as well as to restore the faith in the financial system. The sub-prime crisis has also impacted the emerging economies, depending on their exposure to the sub-prime and related assets.

India has remained relatively insulated from this crisis. The banks and financial institutions in India do not have marked exposure to the sub-prime and related assets in matured markets. Further, India's gradual approach to the financial sector reforms process, with the building of appropriate safeguards to ensure stability, has played a positive role in keeping India immune from such shocks.

SUBSIDIES

Are subsidies negative taxes? Are they converse of indirect taxes? What are subsidies and why are they important? These are some questions which always make rounds every time the Union Budgets are presented. *Subsidies include all grants on current account made by the government to depress the price of any good or service below its economic cost.* Often subsidies are grants made by public authorities to government enterprises in compensation of operating losses when these losses are clearly the consequences of the policy of the government to maintain prices at a level below costs of production. The regime of subsidies is, therefore, a *political economic policy* framework typical of welfare states (India is one). Various subsidy regimes are meant to ensure distributive justice. Subsidies are directed at various sections of society to assist them economically. In India, the main beneficiaries have been farmers, needy people and those using various forms of public services, social services and economic services. The first includes fiscal and administrative services like justice, jails and police, which are in the nature of pure public goods. The last two categories include a range of goods and services, which are not purely public and where the users identifiable and user charges can be levied. For example, roads and power. Governments make such goods and services available to users at costs lower than what was expended to produce and/or provide them because social benefits of doing so exceed the aggregate of private benefits to individual consumers. For instance, compulsory and free elementary education, a subsidy provided by the government, aids the social development and uplift of the poor and socially depressed classed by making such education easily accessible to them. Subsidies are financed either from tax or non-tax revenue, or result in a deficit.

Broadly speaking and purely at the level of the central government, there are three major types of subsidies–food subsidies (for farmers and the poor who avail the public distribution system), fertiliser subsidies (for farmers), and petroleum subsidies (for the poor and the middle class, on kerosene and LPG, which they directly consume; or diesel which fuels the transport industry that carries essential goods and thus has an impact on their prices). These are clearly visible in the government's budget document. Apart from these, there are also *minor subsidies* such as on interest rates and subsidies hidden in the provision of social and economic services, mainly healthcare and education. In social services, the Centre's participation is limited. Most of the social sector expenditure pertains either to the Union Territories that figure in the Union budget, or are in the nature of departmental transfers to state governments.

The regime of subsidies has been a contentious issue of higher order in India. The benefits from subsidies can be maximised only when they are transparent, well targeted, and suitably designed for effective implementation without any leakages. Various studies have shown how the proliferation of subsidies in India is an outcome of undue expansion of government activities in the provision of goods and services that are not pure public goods. Subsidies result from the government's inability to recover its costs adequately in many of these activities. Critics have blamed this on the ill-considered use of subsidies by political parties for electoral ends and have been arguing for reduction of some subsidies and the phasing out of others. Those who support the continuing of subsidies, however, argue that the focus on reducing subsidies only comes about because of the government's failure to raise tax revenues.

SUBSIDY BIDDING

It is competitive bidding for subsidies, where companies bid against one another to serve an area at the lowest price—the lure is the subsidy

and other benefits. This system is a way of administrating subsidies without leaving any room for some competitors or technologies gaining an edge over others. But competitive bidding has anticompetitive effects, since it gives a special advantage to one company. Regulators should adopt a consumer choice system, under which any subsidy for each high cost customer it served. If the customer moved to a competing carrier, the subsidy would move, too.

SUBSTITUTION EFFECT

The replacement of one product for another resulting from a change in their relative prices.

SUNK COSTS

The costs in commercial activities that have been incurred and cannot be reversed. The cost on advertisement, research and development, etc. are examples of such costs. Sunk costs are a big deterrant to new entrants in the commercial world as after the venture has failed these costs cannot be recovered—there is no two-way process here.

SWAP

The act of exchanging one by another. It could be of many economic items:

Currency Swap

The simultanous buying and selling of foreign currencies could be *spot* or *forward/future* currency swaps. This is used by MNCs to minimise the risk of losses arising from exchange rate changes.

Debt Swap

Exchanging one debt by another for a fresh term of repayment schedule at the same or usually lower interest rates.

Interest Rate Swap

Exchanging one debt of a particular interest rate for another at lower interest rate.

Product Swap

Exchanging one product for the other as wheat for milk (similar to barter).

SWFs

Sovereign wealth funds (SWFs) are the foreign currency funds held by the governments of the world, specially in Asia and West Asia. After the process of globalisation, freer capital movements to the developing economies had brought enough foreign currencies to some economies. Earlier, such funds used to originate in Singapore and Norway but now we see china, Russia, and the Middle East emerging as the new SWFs economies.

Such funds, estimated to be sitting on a total of $25 trillion, are eagerly looking to diversify into higher yielding riskier assets. Any fast growing economy with open and liberal attitudes to foreign investments with opportunities for investment may face up the inflow of such funds. India is one fit candidate today.

Such funds need to be studied and alllowed entry cautiously as they bring in non-market and extraneous factors with them too, having potential diplomatic, strategic and sovereign dangers to the host economies. In November 2007, the National Security Advisor of India voiced apprehension about such funds.

SWISS FORMULA

Tariff cut formulae are either linear or non-linear. A Swiss formula is a non-linear formula. In a linear formula, tariffs are reduced by the same percentage irrespective of how high the initial tariff is. As opposed to a linear formula, in a non-

linear formula, tariff cuts are directly or inversely proportional to the initial tariff rate.

In the Swiss formula, tariff cuts are proportionally higher for tariffs which are initially higher. For instance, a country which has an initial tariff of 30 per cent on a product will have to undertake proportionally higher cuts than a country which has an initial tariff of 20 per cent on the same product.

In the on-going multilateral trade negotiations at the World Trade Organisation (WTO), it has been decided by all participating countries to use the Swiss formula for reducing import tariffs on industrial goods. After a long-standing debate on the number of reduction coefficients to be used in the formula, a unanimous decision was recently taken that there would be two sets of coefficients—one for the developed countries and another for developing countries. A decision on the value of the coefficient is yet to be taken.

India's average tariffs are much higher than those existing in the developed countries. If a linear formula for tariff reduction was used, then its reduction burden would have been proportional to that of developed countries. However, using a Swiss formula could lead India to taking on a greater reduction commitment than its developed counterparts with lower initial tariffs.

India agreed to a Swiss formula because it was decided that developing countries would be allowed to have a higher reduction coefficient than developed countries which could lower their tariff reduction obligations.

A reduction coefficient is part of the Swiss formula. It has a very important role to play in deciding the final reduction commitment. If all other variables in the Swiss formula remain unchanged, then a higher reduction coefficient could lead to lower reduction commitment and vice versa.

India wants that the reduction coefficient for developing countries should be much higher than the coefficient for developed countries. The difference should be enough to negate the effect of the original Swiss formula which weighs in favour of developed countries with lower initial tariffs. It has proposed that a difference between the coefficients should be at least 25 points to ensure that the reduction burden on developing countries is not higher than that on developed countries.

SYSTEMIC RISK

The risk of damage to the health of the whole financial system. In modern financial world, the collapse of one bank could bring down the whole financial system.

TAKEOVER

The process of one firm acquiring the other, also known as *acquisition*. As opposed to the merger which is an outcome of 'mutual agreement', takeovers are 'hostile' moves.

Takeovers may be classified into three broad categories:

(i) *Horizontal takeovers* involve firms which are direct competitors in the same market;

(ii) *Vertical takeovers* involve the firms having supplier-customer relationship; and

(iii) *Conglomerate takeovers* involve the firms operating in unrelated markets but intend diversification.

TAKEOVER BID

An attempt of acquiring the majority share in a firm by another firm. There are various *terms* to show the *'tactics'* applied in such bids either by the bidder or the bidded firms:

BLACK KNIGHT

The launch of an unwelcome takeover bid (as the Mittal's for the Arcelor in recent past).

Golden Parachute

A generous severance term written into the employment contracts of the directors (of a firm) which makes it expensive to sack them if the firm is taken over.

Green Mail

A situation of takeover bid when the bought-up shares by a potential bidder is actually being bought by the directors of the firm itself.

Leveraged Bid

A takeover bid being financed primarily by the loan.

Pac-man Defence

A situation when the firm being bidded for takeover, bids for the bidder firm itself–also known as *reverse takeover bid.*

Poison Pill

A tactic used by the firm being bidded of merging with some other firm in order to make itself less attractive (financially or structurally) to the potential bidder.

Porcupine

Any agreements between the firm being bidded and its suppliers, creditors, etc., which are so complex that after the takeover the bidder firm feels diffculties integrating it.

Shark Repellants

The measures specially designed to discourage takeover bidders (e.g., altering the firm's articles of association to increase the proportion of shareholder votes needed to approve the bid above the usual 50 per cent level, etc.).

White Knight

The intervention of a third firm in a takeover bid which either merges or takes over the victim firm to rescue it from the unwelcome bidder.

TECHNOLOGICAL UNEMPLOYMENT

Unemployment which results from the automation of the production activities (*i.e., machines replacing men*).

THIRD-PARTY INSURANCE

Motor third-party insurance or third-party insurance is a statutory requirement under the Motor vehicle Act in India–also known as *'act only'* cover. A person purchasing a motor vehicle has to go for this compulsory insurance which benefits the third person (i.e. neither the vehicle owner nor the insurance company)–the person who becomes victim of an accident by the vehicle.

Till December 31, 2005, the premium for the insurance was fixed by the Tariff Advisory Committee (an arm of the IRDA) but since then it has been done away with. However, IRDA still continues to fix the premium for the mandatory third-party insurance, though the insurance companies have the freedom to decide on prices for comprehensive cover.

The amount of compensation is largely decided by the earning capacity of the accident victim.

THIRD WAY

An economic philosophy (better say rhetoric) which propagates it is neither capitalism nor socialism but a third (pragmatic) way.

The idea was popularised in the late 20th century by some political leaders having leftist leanings, including bill clinton and Tony Blair. Though it has been hard to pin down it was earlier used to describe the economic model of Sweden.

TIGHT MONEY

When money has become difficult to mobilise, the term is used to show the 'dear money' when the

rates of interest run comparatively on the higher side.

TILL MONEY

The notes and coins the commercial banks keep to meet everyday cash requirements of their customers (this is counted as part of their CRR).

TOBIN TAX

A prosposal of imposing small tax on all foreign exchange transactions with the obejctive to discourage destabilising speculation and volatility in the foreign exchange markets.

Proposed by the Nobel prize-winning economist James Tobin (1918–2002), the tax has never been implemented anywhere in the world so far.

TOTAL PRODUCT

The main/core product supported by many peripheral products/services, as for example a car, coming with loan facility, warranties, insurance, and after sale service, etc.

TRADE CREATION

The increase in international trade that results from the elimination or reduction of trade barriers (such as quota, customs, etc.).

TRAGEDY OF THE COMMONS

Refers to the dangers of over-exploitation of resources due to lack of property rights over them ('commons' are the resources neither owned privately nor by the state but are open for free use by all). A rationing or imposing of levy on such resources as a check.

The concept was proposed by a 19th century amateur mathematician william Forster Lloyd.

TRANSFER PAYMENTS

The expenditure by the government for which it receives no goods or services. For example, the expenditures on tax collection, social sector, unemployment allowance, etc.

As such expenditures are not done against any products they are not counted in the national income of the economy.

TRANSFER EARNINGS

The return that an asset must earn to prevent its transfer to the next best alternative use. Any earning above the transfer earnings is known as its *'economic rent'*.

TRANSFER PRICE

A term of international economics via which an MNC charges lesser prices for its exportables to its arm in another economy where tax rates are high, for increasing income. The East India Company did it heavily in pre-independent India.

ULIPS & MFS

Unit linked insurance policies (ULIPs) offer insurance plus investment objective to those who want a higher amount of insurance cover at a marginally higher cost. However, unlike mutual funds, which may be a short-term investment play, ULIPs meet long-term investment objectives. Essentially, ULIPs must be treated as long-term (15-plus years) investment vehicles.

Returns are varied across the risk class. One can categorise risks into three classes for both MF and ULIP schemes—high, medium, and low risks. High-risk policies have a higher exposure to equities and low-risk policies might have low or no exposure to equities. For MFs, high-risk comparable products are diversified equity funds,

medium-risks are balanced funds, and low risks are debt instruments.

UNDERWRITING

The process of acceptance by a financial institution of the financial risks of a transaction for a fee. For example, merchant banks underwrite new share issues, guaranteeing to buy up the shares not sold in a public offer (i.e., in the situations of under-subscription).

USURY

Charging an exorbitant rate of interest or even charging interest. Decried by many ancient philosophers and many religions, today most modern economies have some law regulating the upper limit of the interest rates and they consider interest as a reward to the lender for the lending risk.

VEBLEN EFFECT

Named after the American economist Thorstein Bunde Veblen (1857–1929), this is a theory of consumption which suggests that consumers may have an 'upward-sloping demand curve' as opposed to a 'downward-sloping demand curve' because they practice conspicuous consumption (*a downward - sloping demand curve means that the quantity demanded varies inversely to the price i.e. demand falls with price rise*). The concept suggests that quantity demanded of a particular good varies directly with a change in price (*i.e., as price increases, demand increases*).

VELOCITY OF CIRCULATION

A measure of the average number of times each unit of money is used, to purchase the final goods and services produced in an economy in a year.

VENTURE CAPITAL

Generally, a private equity capital which lends capital to the entrepreneurs who are innovative and cannot get the required fund from the conventional set-up of the lending mechanism.

In India, it was the Government of India which did set up the first such fund in 1998–the IVCF.

VULTURE FUNDS

Vulture funds are privately owned financial firms which buy up sovereign debt issued by poor countries at a fraction of its value, then file lawsuits (sue) against the countries in courts, usually in London, New York, or paris, for their full face value plus interest.

A paper prepared for IMF/WB (October 18, 2007) showed that there are now $1.8b lawsuits against poor countries where people typically live below $1 a day; 24 countries that have received debt cancellation under Heavily Indebted Poor Countries (HIPCs)initiative, 11 have been targeted by such creditors (i.e., the VFs) and they has been awarded just under $1b.–money which have gone for schools and hospitals; they are neutralising the good deeds of WB/IMF. As per the IMF, the litigating creditors were concentrated in the US, UK as well as the British Virgin Islands (BVI)—the UK protectorate tax haven. Bush is being pressed by a motion signed by 110 MPs to change the law which allows them to file cases in US courts—VFs contradict US foreign policy.

VOSTRO ACCOUNT

Vostro is an account that one party holds for another. With a view to give more operational leeway, the RBI decided to dispense with the requirement of prior approval of the RBI for opening and

maintaining each rupee **vostro account** in India of non-resident exchange houses in connection with the rupee drawing arrangements (RDAs) that banks enter into with them. The approved dealer banks could now take its permission the first time they entered into such an arrangement with non-resident exchange houses from the Gulf countries, Hong Kong, Singapore and Malaysia. Subsequently, they may enter into RDAs, and inform the RBI immediately.

WALRAS'S LAW

The idea that the total value of goods demanded in an economy is always identically equal to the total value of goods supplied.

This could be only correct in a barter economy not in an economy which uses currency as the mode of exchange.

WASTING ASSET

The natural resource which has a finite but indeterminate life span depending upon the rate of depletion (such as coal, oil, etc.).

WEIGHTLESS ECONOMY

The situation of an economy when the output is increasingly produced from intellectual capital rather than physical materials–a shift in production from iron and steel, heavy machines, etc. to microprocessors, fibre optics and transistors, etc. This is the weightless economy, i.e., the *new economy* which arrived in the US (specially) by the end of the 20th century.

WELFARE ECONOMICS

The branch of economics which is concerned with the way economic activity ought to be organised so as to maximise economic welfare. The idea applies to the welfare of individuals as well as countries.

This is normative economics, i.e., it is based on value judgements. It is also called *'economics with a heart'.* This focuses on questions about *equity* as well as *efficiency.*

It employs value judgements about what *ought* to be produced, how production *should* be organised, the way income and wealth *ought* to be distributed, both in present times and in future. As different individuals in different communities have unique set of value judgements (guided by their attitutdes, religion, philosophy, and politics) it has been difficult for the economists to reach a consensual idea upon which they could advise the governments in policy making, known as the *welfare criteria.* Economists and philosophers have been suggesting their brands of the *welfare criteria* since long–Vilfredo Pareto, Nicholas Kaldor, John Hicks, Scitovsky, Amartya Sen, as the few famous ones.

WILDCAT STRIKE

A strike called on by a group of employees without the support of their organised trade union.

WILLIAMSON TRADE-OFF MODEL

A model for evaluating the possible benefits and detriments of a proposed merger that could be used in the application of a discretionary competition policy. The model was developed by Oliver Williamson.

WINNER'S CURSE

The possibility that the winning bidder in an auction will pay too much for an asset since the highest bidder places a higher value on the asset than all other bidders.

WITHHOLDING TAX

A tax imposed on the income on a foreign portfolio (investments). This tax is imposed to

discourage foreign investments, to encourage domestic investment, and to raise money for the government.

WORKER (CENSUS DEFINITION)

The *first* definition of 'worker' by *Census* was given in 1872. Over time the term 'work' and 'worker' as defined by ***Census of India*** have undergone several amendments to suit the changing dimensions of work. 'Work' is defined as participation in any *economically productive activity* with or without compensation, wages or profit. Such participation may be physical and/or mental in nature. Work involves not only actual work but also includes –

(i) Effective supervision and direction of work;

(ii) Part time help or unpaid work on farm, family enterprise or in any other economic activity; and

(iii) Cultivation or milk production even solely for domestic consumption.

Accordingly, as per Census of India, all persons engaged in 'work' defined as participation in any economically productive activity with or without compensation, wages or profit are workers. The Reference period for determining a person as worker and non-worker is one year preceding the date of enumeration.

The Census *classifies* 'Workers' into two groups namely, *Main Workers* (those workers who had worked for the major part of the reference period, i.e., 6 months or more) and *Marginal Workers* (those workers who had not worked for the major part of the reference period i.e. less than 6 months). The *Main* workers are classified on the basis of Industrial category of workers into the following four categories: (i) Cultivators; (ii) Agricultural Labourers; (iii) Household Industry Workers; and (iv) Other Workers.

[See entry *'Non-Worker'* also.]

WORKER POPULATION RATIO

The employment-to-population ratio is defined as the proportion of an economy's working-age population that is employed. As an indicator, the employment-to-population ratio provides information on the ability of an economy to create jobs. Worker population ratio (WPR) is defined as the number of persons employed per thousand persons [WPR= No. of employed persons X 1000/ Total population]. Worker Population Ratio is an indicator used for analyzing the employment situation in the country. This is also useful in knowing the proportion of population that is actively contributing to the production of goods and services in the economy.

[*Reference:* NSSO (2005), *Report No. 515, Employment Unemployment Situation in India (Part 1), 61st Round (2004–2005)*]

WORKFARE

Government programmes which make the receipt of unemployment-related benefits (as unemployment allowance) conditional upon participation in some local work scheme.

X-INEFFICIENCY

A graphic representation of the 'gap' a firm shows in its actual and minimum costs of supplying its products. As per the traditional theory of supply, firms always operate on minimum attainable costs. As opposed to this, x-inefficiency suggests that firms typically operate at higher costs than their minimum attainable costs. This takes place due to many *inefficiencies* (such as organising the works, lack of co-ordination, lack of motivation, bureacratic rigidities etc.). Large corporates usually face this problem as they lack effective competition which could 'keep them on their toes'.

YIELD GAP

A method of comparing the performance of bonds and shares in an economy. It is defined as the average returns on shares minus the average returns on bonds.

ZERO-COUPON BOND

A bond bearing zero coupon rate (i.e. no interest) sold at a price lower than its face value and investors getting the face value price at maturity.

ZERO-SUM GAME

A situation in the *game theory* when the gains made by winners in an economic transaction is equal to the losses suffered by the losers. This is considered a special case in game theory. Most economic transactions are in some sense *positive-sum games*. But in popular discussion of economic issues, there are often examples of mistaken zero-sum mentality, such as profit comes at the expense of wages, 'higher productivity means fewer jobs', and 'imports mean fewer jobs here.'

ZERO TILLING

A relatively new farm production process, is a one-time operation in which a small drill places the seed and the fertiliser in a small furrow, saving the farmer a lot of time and other resources. At first utilised in Haryana in 1999–2000, by now it has spread to the other wheat growing states like, Punjab, Uttar Pradesh, Uttarakhand, and Bihar particularly. The technique gives comparatively higher yield (by over 5 per cent) than the conventional wheat farming.

CHAPTER

23

SELECTED MCQs

(Economic and Social Development)

*A thing may look specious in theory, and yet be ruinous in practice; a thing may look evil in theory, and yet be in practice excellent.**

** Edmund Burke (1729–1797)*

SET- 1

1. Consider the following statements related to the Central fund allocations to states.
   1. The Central Sector Schemes are formulated on the subjects of the Union List, hundred per cent funded and implemented in states by the Central government.
   2. The Centrally Sponsored Schemes are part formulated on the subjects of the State List, part funded by the Central government and implemented by the states.
   3. The Central assistance is provided by the Government of India to support states' five year plans under three heads: Normal Central Assistance, Special Central Assistance and Additional Central Assistance.
   4. Central assistance is approved by the Planning Commission and is released in the form of grants and/or loans in varying combinations.

   Select the correct statements using the code given below.
   (a) 1, 2 and 3
   (b) 2, 3 and 4
   (c) 1, 3 and 4
   (d) 1, 2 , 3 and 4

2. Which of the following are correct about 'demergers'?
   1. The act of splitting off a part of an existing company to become a new company.
   2. New firms operate completely separate from the original company.
   3. Shareholders of the original company are usually given an equivalent stake of ownership in the new companies.
   4. A demerger is often done to help each of the segment operate more smoothly, as they can focus on a more specific task post demerger.

   Select your answer using the code given below:
   (a) 1 and 2
   (b) 2, 3 and 4
   (c) 1, 2 and 4
   (d) 1, 2, 3 and 4

3. What is correct about the term 'customs value'?
   (a) The value of imported goods as appraised by the customs department and used as the basis for assessing the amount of import duty and other taxes.
   (b) A term to specify the real value of import by deducting any dumping duty imposed by the trading partner.
   (c) The real value of custom duty imposed on the imported item by the custom department.
   (d) None of the above.

4. Consider the following statement about 'terms of trade' of a country.
   1. It is the contractual conditions of sale between a buyer and a seller.
   2. It is the quantity of foreign goods and services that a country can purchase from the proceeds of the sale of its goods and services of a given quantity.
   3. It is a measure of a country's trading clout and is expressed as the ratio of an index of export prices to an index of import prices.

Select the correct statements using the code given below.

(a) Only 1
(b) 2 and 3
(c) 1 and 3
(d) 1, 2 and 3

5. "... India should not be overly obsessed with China, since in the long run, India's growth will be sustainable and durable and is impacted by its democratic character, while its weakness lies in delayed decision-making due to excessive deliberation...."

Which of the following international body recently gave the above cited opinion?

(a) OECD
(b) IMF
(c) APEC
(d) ASEAN

6. Consider the following statements regarding the 'Taylor Rule'.

   1. A rule that suggests appropriate adjustments to interest rates, based on various economic factors such as inflation and employment rate.
   2. The rule indicates that if inflation or employment rates are higher than desired, interest rates should be increased in response to these conditions, and the opposite action should be taken under the opposite conditions.

Select the incorrect statement/statements using the code given below.

(a) Only 1
(b) Only 2
(c) Both 1 and 2
(d) None of the above

7. Consider the following statements about the 'Laffer Curve'.

   1. This is a curve which supposes that for a given economy there is an optimal income tax level to maximise tax revenues.
   2. If the income tax level is set below this level, raising taxes will increase tax revenue.
   3. If the income tax level is set above this level, then lowering taxes will increase tax revenue.

Select the incorrect statements using the code given below.

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

8. Consider the following statements about the 'insurance repository system', recently introduced in India

   1. Insurance policies will be held in electronic form.
   2. This will provide speed as well as accuracy in revisions and changes in the policies.
   3. IRDA has given licences to five firms to function as insurance repositories.
   4. Repositories are expected to cut down the management cost of each insurance policy to almost one-fifth of the present cost.

Select the correct statements using the code given below.

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

9. Consider the following statements about the idea of 'inclusive growth'.
   1. The idea of 'inclusive growth' entered into the domain of planning with the Eleventh Plan.
   2. This is not only about economics but also about 'social' inclusion.
   3. The main idea behind inclusive growth is to include SCs, STs, OBCs, Minorities and Women in the country's development process.
   4. The 3rd Generation of Economic Reforms runs parallel to the idea of inclusive growth.

   Select the correct statements using the code given below.

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

10. The RBI-appointed 'Committee on Comprehensive Financial Services for Small Business and Low Income Households' has recently submitted its report. Consider the following statements with regard to the report of the committee.
    1. A universal bank account to all Indians above the age of 18 years.
    2. A banking system with 'payments banks' for deposits and payments and 'wholesale banks' for credit outreach.
    3. 'Priority sector lending' target to be increased to 50 per cent.
    4. A state-level 'regulatory commission' for supervision of all NGOs and money service businesses.

    Select the correct advices using the code given below.

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

11. Consider the following statements about the *Results-Framework Document (RFD)*.
    1. 'RFD' provides a summary of the most important results that an organisation expects to achieve during the financial year.
    2. It moves the focus of the organisation 'from process-orientation' to 'result-orientation'.
    3. It provides an 'objective' and fair basis to 'evaluate' organisation's overall performance at the year end.

    Select the correct statement/statements using the code given below.

    (a) 1 and 2
    (b) 2 and 3
    (c) 1, 2 and 3
    (d) None of the above

12. Consider the following statements about 'effective revenue deficit'.
    1. "Effective revenue deficit is a Western idea of public finance management, which India used it for the first time in the Union Budget 2011–12.
    2. It is a modified kind of revenue deficit which excludes that part of revenue deficit by which assets have been created.
    3. Effective revenue deficit of India for 2016–17 was aimed at zero by the Union Budget 2013–14.
    4. Revenue deficit for the year 2016–17 has been targeted to be 1.5 per cent by the Union Budget 2013–14.

Select the correct statements using the code given below.

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

13. Consider the following statements about 'farm subsidies' in India.
    1. The input subsidies in India such as on fertilizers fall under indirect farm subsidies.
    2. Reduction in power and irrigation bills offered to farmers fall under direct farm subsidies.
    3. The agricultural provisions of the WTO though allow direct farm subsidies, prohibits indirect subsidies.
    4. All subsidies forwarded by the governments in India fall under the indirect category.

    Select the correct statements using the code given below.

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

14. Consider the following statements related to the Bilateral Investment Promotion and Protection Agreement (BIPA).
    1. The agreement is part of the World Bank's International Centre for Settlement of Investment Disputes (ICSID).
    2. This promotes and protects the Indian investors investing abroad.
    3. Promoting and protecting foreign investment in India is one of its objectives.
    4. The Agreement functions in collaboration with the International Monetary Fund.

    Select the correct statements using the code given below.

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

15. Consider the following statements about NSEL which was recently in news.
    1. This is an NSE (National Stock Exchange) promoted commodity 'spot trading' platform.
    2. 'NCDEX Spot' and 'R-Next' are the other such platforms.
    3. Commodity exchanges in India are regulated by the Ministry of Consumer Affairs under the Forward Contract Regulation Act, 1989.
    4. 'Spot contracts' has to be completed within 11 days, as per the Act.

    Select the incorrect statements using the code given below.

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

16. Participatory Notes (P-Notes) were in news recently. Consider the following statements about P-Notes.
    1. SEBI has classified three possible Categories of P-Notes issuing FIIs in the country.
    2. Category-I are the offshore government entities/institutions investing solely on behalf of a country's central bank.
    3. Category-II are regulated entities as Mutual Funds, supervised by their

regulatory bodies in their countries of origin.

4. Category-III entities neither fall in Category-I or Category-II, which have been recentlyasked by the SEBI not to issue P-Notes.

Select the correct statements using the code given below.

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

17. Consider the statements about tenets of the 'three arrows' of the *Abenomics* which was recently in news.

1. A massive fiscal stimulus activated by quantitative easing targeted at increasing the rate of inflation.
2. Boost to investment in public works and infrastructure to promote jobs and R&D.
3. Structural reforms to boost country's global competitiveness.
4. It follows ideas started by J. M. Keynes, whose most famous contemporary admirer is the Nobel Economist Paul Krugman.

Select the correct statements using the code below.

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

18. Which of the following statements are correct about the Planning Commission members Som Pal, B. K. Chaturvedi and Abhijit Sen?

(a) They headed the Infrastructure Co-ordinating Monitoring Committees of the PC.
(b) They held the charge of being additional members to different Finance Commissions.
(c) They worked as head of the Committees working on inflation reforms in India in a World Bank assisted project.
(d) None of the above.

19. Consider the following statements about the Fourteenth Finance Commission.

1. The need for insulating the pricing of public utility services like drinking water, irrigation, power and public transport from policy fluctuations through statutory provisions.
2. The need for making the public sector enterprises competitive and market oriented; listing and disinvestment; and relinquishing of non-priority enterprises.
3. The need to balance management of ecology, environment and climate change consistent with sustainable economic development.
4. The impact of the proposed Goods and Services Tax on the finances of Centre and states and the mechanism for compensation in case of any revenue loss.

Which of the following does not belong to the 'terms of reference' given to the Fourteenth Finance Commission?

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

20. Consider the following statements about the recently set up Bharatiya Mahila Bank (BMB).

1. The bank will focus on lending predominantly to women and

companies that focus on women's activities/products but there will be no restriction on deposits by men.

2. The bank is looking at providing assistance through credit to set up day-care centers and start organised catering services.
3. BNB will also tie up with NGOs, and train women in various vocations in order to penetrate deeper into rural areas.
4. Chhavi Rajawat, a Sarpanch from Rajasthan is one among the six Board members of the bank.

Select the correct statements using the code given below.

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

21. Consider the following statements related to the recommendations of the RBI-appointed *Urjit Patel Committee* report.
    1. The committee has suggested to privatise the public sector banks by divesting minimum 51 percent of their shares of the government so that they can be Basel III capital compliant.
    2. It has advised the RBI to consider 4–6 per cent of CPI (N) inflation as the healthy range in the long-term, i.e., by 2016-17.
    3. The GoI has been suggested to check its fiscal deficit to 3 per cent by 2015–16.
    4. It has advised an autonomy for the RBI in its function regarding credit and monetary policy.

    Select the incorrect statements using the codes given below.

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

22. Consider the following recommendations of the RBI-appointed *Nachiket Mor Committee* report.
    1. The 'payments banks' will be involved in only payments with no deposits mobilisation functions.
    2. The 'wholesale banks' to be responsible for only 'corporate' lending with no retail lending.
    3. For the supervision of all NGOs and business entities involved in money services there will a 'regulatory commission' at the state level controlled by the concerned state governments.
    4. RBI has adopted some of the advice of the Committee in the first Bi-monthly Credit & Monetary Policy announced, early April 2014.

    Select the incorrect recommendations using the code given below.

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

23. Consider the following statements related to the current provision of using the disinvestment proceeds.
    1. The allocations out of the NIF will be decided by the Union Budget.
    2. Only the profits accruing out of the NIF can be used that too only on the social sector.
    3. During 2013–14, the government approved allocations from the NIF towards spending on recapitalisation of public sector banks.

4. Fund of the NIF can be used for equity infusion in the Metro projects.

Select the correct statements using the code given below.

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

24. Consider the following statements related to the State Food Commissions provisioned in the National Food Security Act, 2013.

1. The five-member commission must have two women and one member each from the SCs and STs.
2. It may enquire into violations of entitlements either suo moto or on receipt of complaints and will hold powers of a civil court.
3. It will prepare an annual report of the Act to be laid before the legislature.
4. The commission will function as one of bodies of the two-tier grievance redressal structure as per the Act.

Select the correct statements using the code given below.

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

25. Consider the following statements related to the recommendations of the RBI-appointed committee to examine the current 'monetary policy framework', which has handed over its report recently.

1. The apex bank should adopt the new CPI (consumer price index) as the measure of nominal anchor for policy communication.
2. Food and fuel account for more than 57 per cent of the CPI on which the direct influence of monetary policy is limited.
3. The panel suggests to adopt a longer-term target of 4 per cent for CPI inflation with a band of +/- 2 per cent.
4. The committee asked the central government to ensure that the fiscal deficit as a ratio of the GDP is brought down to 3.0 per cent by 2016–17.

Select the correct statements using the code given below.

Code:

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

Answer Key with Explanations

1. *(d)* The existing 137 Centrally Sponsored Schemes (CSSs) were recently merged into 66 by the GoI (which also includes 17 flagship programmes). The formula on which the central assistance (also known as the Central Plan Assistance (CPA)) is based was recently in news—on this an Expert Committee (*Composite Development Index of States*, chaired by Raghuram Rajan, the erstwhile Chief Economic Advisor to the Ministry of Finance) handed over its report in September 2013. To change the CPA funding pattern to the states, the central government needs to revisit the existing formula—the Gadgil-Mukherjee Formula (being used since the Eight Plan, 1992–97).

2. *(d)* Every statement is correct about the term 'demerger' (just opposite to 'merger').

3. *(a)* Customs value (or 'customs import value') is the value of imported goods as appraised/decided/calculated by the customs department of a country. This value is used as the basis for assessing the amount of import duty and other taxes. It may be computed in several ways, but the most-preferred method is transaction-value, which includes other costs incurred by the buyer, such as packaging costs, license fee or royalty, and any other expenses that accrue to the seller (in addition to the price paid by a buyer to a seller). It is the customs officer (and not the importer, exporter, or customs broker) who has the final say in assigning this value.
4. *(b)* This is not the contractual conditions of sale between a buyer and a seller, but the quantity of foreign goods and services (i.e., its total imports) that a country can purchase from the proceeds of the sale of its goods and services (i.e., its total exports) of a given quantity. It is a measure of a country's trading clout and is expressed as the ratio of an index of export prices to an index of import prices. Terms of trade of a country improves when the prices of its exports rise in comparison with the prices of its imports and vice versa.
5. *(a)* The statement was given by the body when it was visiting India in October 2013 for the deliberations related to opening of its office in India. It is known that India together with China, Brazil, South Africa and Indonesia are aspiring membership of the body.
6. *(d)* Both the statements are correct about the Rule. The US Federal Reserve Board seems to take this rule under consideration (as many other central banks of the world) but does not always follow its suggestions when adjusting the interest rate. This rule was developed by John Taylor, a 20th century economist.
7. *(d)* All of the statements are correct about the Curve. Although the theory claims that there is a single maximum point of tax rate and moves in either of the directions from this point makes revenues fall, in reality this is only an approximation. This is a 'graphical representation' of a conceptual relationship between *marginal tax rates* and *total tax collections*. Named after the US economics professor Arthur Laffer who proposed that lower tax rates encourage additional output (supply) and thus increase aggregate income. Laffer curve is used by the supporters of 'supply side economics' to back their claim that low income tax policies spur non-inflationary growth by encouraging new investment.
8. *(d)* The present management cost of each insurance policy is Rs. 120, which will come down to Rs. 25 once repositories start functioning. The IRDA has licensed five firms to function as repositories (Karvy Insurance Repositories, NSDL Database Management Ltd, Central Insurance Repositories Ltd., SHCIL Projects Ltd. and CAMS Repositories Services Ltd. Out of the total 52 insurance firms in the country only 20 per cent are ready with the sufficient infrastructure for repositories—GoI may make it mandatory by the 2014–15 fiscal.
9. *(d)* The 3rd generations of economic reforms articulated the idea of 'decentralised' development planning—parallel to the idea of inclusive growth. The concept got reference while the government decided to go for the 2nd and 3rd generation of

economic reforms (in the year 2000–01)—the benefits of reforms were found to be non-inclusive in nature.

10. *(d)* The Nachiket Mor Committee *(Committee on Comprehensive Financial Services for Small Business and Low Income Households)* handed over its report by mid-January 2014. The committee has suggested for providing a universal bank account to all Indians above the age of 18 years. This target is to be achieved by January 1, 2016. To enable this, a vertically differentiated banking system has been advised by it 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. The Aadhaar will be the prime driver towards rapid expansion in the number of bank accounts. For credible monitoring, the committee has laid down certain norms even at the district level such as deposits and advances as a percentage of gross domestic product (GDP). The committee proposes an adjusted 50 per cent priority sector lending target with adjustments for sectors and regions based on difficulty in lending. It advocates fewer NBFCs and substantial regulatory convergence for them with banks on non-performing assets and the extension of securitisation laws to certain NBFCs. A state-level regulatory commission will consolidate supervision of all non-governmental organisations and money service businesses.

11. *(d)* All of the statements are correct about RFD—adopted by about 84 ministries and departments by 2014–15 since 2009–10 as part of the GoI *'Performance Monitoring and Evaluation System (PMES)'* under which each ministries/departments is required to prepare an RFD. This is a step in the direction of improving 'performance' and 'efficiency'.

12. *(b)* The idea was for the first time used by the GoI in the Union Budget 2011–12, but it was not borrowed from the Western nations—this an Indian idea. Other statements are correct about it.

13. *(d)* The agricultural provisions (i.e., the Agreement on Agriculture) of the WTO have put a ceiling on the amount of farm subsidies (both direct and indirect) of the member country—as they distort the free market prices of farm goods.

14. *(b)* The BIPA is a kind of India alternative of the ICSID (one of the World Bank group entity). But it has no links either with the ICISD or IMF. By now, India has signed such agreements with 82 countries.

15. *(c)* NSEL (National Spot Exchange Ltd.) is promoted by a private firm (which owns it by 99 per cent) Financial Technologies India Ltd. and NAFED (National Agricultural Cooperative Marketing Federation of India Ltd.) for 'spot trading' in commodities in India, operating since 2008. Other such bourses—the NCDEX Spot and R-Next, are promoted by the NSE and Reliance Capital, respectively. Since February 2012 'spot contracts' are being looked after by the Forward Market Commission (FMC)—regulated under the Forward Contract (Regulation) Act, 1952.

16. *(d)* All of the statements are correct about the P-Notes.

17. *(d)* Abenomics is the name given to a suite of measures introduced by the Japanese Prime Minister Shinzo Abe after his December 2012 re-election to the post

he has held since 2007. Such measures by a government to boost growth is not possible in the case of the recession-hit economies of the Western world—the Japanese economy has an edge over them due to its low levels of inflation and fiscal deficit.

18. *(b)* In 2002 the GoI decided that from now onwards the Planning Commission (PC) will function more or less as a collaborator to the Finance Commission (FC)—the existing PC member Som Pal was made an Additional Member of the Twelfth Finance Commission. B. K. Chaturvedi was the Additional Member to the Thirteenth Finance Commission, Prof. Abhijit Sen is the Additional Member to the Fourteenth Finance Commission (2015–20), headed by Y. V. Reddy, ex-RBI Governor. Such a suggestion was given by the Fourth Finance Commission headed by P. V. Rajamannar.

19. *(d)* All belong to the terms of reference given to the Fourteenth Finance Commission (2015–20).

20. *(d)* India's first women's bank, the Bharatiya Mahila Bank was inaugurated in Mumbai on November 19, 2013 at the iconic Air India building at Nariman Point in Mumbai.

21. *(d)* The expert panel didn't say anything on the disinvestment of public sector banks. It has suggested a 2–6 per cent flexible target with a 4 per cent CPI (N)-based inflation in the long run (i.e., by 2016–17). The fiscal deficit target of 3 per cent has been advised for the GoI, but to be done by the fiscal 2016–17. The panel did not give any suggestion on the autonomy aspect of the RBI.

22. *(d)* Payment banks will be involved in payments and deposits both while the 'wholesale banks' will take care of credit aspect. The state-level 'regulatory commission' will be functioning under the RBI (not the states). None of the advices of the expert panel has yet been adopted by the RBI though an indication came from the central bank of allowing licences for opening payment banks in coming times (while the RBI delivered two new licences to set up banks, early 2014).

23. *(c)* In January 2013, the government restructured the National Investment Fund (NIF) and decided that the disinvestment proceeds with effect from the fiscal year 2013–14 will be credited to the existing *'Public Account'* under the head NIF and they would remain there until withdrawn/ invested for the approved purpose by an Union Budget. It was decided that the NIF would be utilised for subscribing to the shares of the CPSE, including public sector banks (their recapitalisation, too) and insurance companies, to ensure 51 per cent government ownership in them; investment by the government in RRBs, IIFCL, NABARD, Exim Bank; equity infusion in various Metro projects; investment in Bhartiya Nabhikiya Vidyut Nigam Ltd. and Uranium Corporation of India Ltd.; investment in railways towards capital expenditure.

24. *(d)* The NFSA provisions for a two-tier grievance redressal structure—the State Food Commission (SFC) and District Grievance Redressal Officer (DGRO). The DGROs will be appointed by the state governments for each district to hear complaints and take necessary action according to norms to be prescribed by the state governments. If a complainant

(or the officer or authority against whom an order has been passed by the DGRO) is not satisfied, he or she may file an appeal before the SFC. The SFCs have been given power to impose penalties—if an order of the DGRO is not complied with, the concerned authority/officer can impose a fine of up to Rs. 5,000.

25. *(d)* All the statements are correct regarding the *Urjit Patel Committee* which handed over its report by late January 2014 to the RBI. The inflation-related advices of the panel has been accepted and implemented by the RBI, commencing with its 1st Bi-monthly Credit and Monetary Policy for 2014-15, announced in April 2014.

SET- 2

1. Consider the following statements.

1. RBI takes recourse to open market operations (OMOs) to manage liquidity in the system.
2. In OMOs, RBI generally sells G-Sec in open market, however, in rare cases it also buys back the same from the market.
3. A 'debt switch' is a method in which the RBI buys back G-Secs of short-term maturity and replaces it with G-Secs with longer maturity periods.

Which of the above statements are correct?

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

2. Consider the following statements about Independent Evaluation Office (IEO).

1. It is inspired from an IMF institution with the same name.
2. Together with the Flagship Programmes it may evaluate any scheme run by the GoI.
3. IEO may take the services of civil society and non-governmental research houses of India and abroad.
4. Its reports will be directly put in the public domain.

Which of the above statements are correct?

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

3. CPSE ETF was launched by the GoI in March 2014 for the purpose of meeting the revised targets of disinvestment. Consider the following statements about CPSE ETF.

1. The CPSE ETF will invest its corpus in the CPSE Index, which comprises 10 state-owned stocks.
2. An ETF is a security that tracks an index, a commodity or a basket of assets like an index fund.
3. The ETF will trade like a stock on a stock exchange.

Which of the above statements about CPSE ETF are correct?

Code:

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

4. Consider the following statements regarding the Marginal Standing Facility (MSF).
   1. MSF functions as the last resort for banks to borrow short-term funds.
   2. MSF is on the line of the existing LAF and is part of it.
   3. Being a penal rate, MSF is a costlier route than repo.
   4. MSF is linked to the net demand and time liabilities of the banks.

   Which of the above statements are correct?
   (a) 1, 2 and 3
   (b) 2, 3 and 4
   (c) 1, 3 and 4
   (d) 1, 2, 3 and 4

5. RBI recently announced revised norms for Priority Sector Lending in India. Consider the following statement in the light of the announcement.
   1. Foreign banks' PSL target has been increased to 40 per cent at par with Indian banks irrespective of their number of branches.
   2. Food and Agro-processing and overdrafts up to Rs. 50,000 in no-frill accounts have been included in it.
   3. Off-grid solar and other renewable energy solutions together with vocational education are now under the PSL.
   4. MSE loans up to Rs. 2 crore have also been added under the PSL lending of the banks.

   Which of the above statements are correct?
   (a) 1, 2 and 3
   (b) 2, 3 and 4
   (c) 1, 3 and 4
   (d) 1, 2, 3 and 4

6. Which of the following segments of money is considered as the 'Other' deposits with the RBI?
   1. Deposits of quasi-government bodies
   2. Other financial institutions and primary dealers
   3. Balance in the accounts of foreign central banks and governments
   4. Accounts of international agencies

   Select your answer using the code below:
   (a) 1, 2 and 3
   (b) 2, 3 and 4
   (c) 1, 3 and 4
   (d) 1, 2, 3 and 4

7. As per the New Monetary Aggregates of the RBI which of the following is not regarded as 'broad money'?
   1. Bankers' deposits with the RBI
   2. Demand & Time Deposits of the banks
   3. Other Deposits with the RBI
   4. Currency & coins with the public
   5. Currency in circulation
   6. Savings of Post Offices

   Select your answer using the code below:
   Code:
   (a) 1, 2 and 4
   (b) 3, 4 and 5
   (c) 1, 5 and 6
   (d) 2, 3 and 4

8. Which of the following segments of the money form India's 'Reserve Money'? Give your answer using the code given below:
   1. Net forex reserves with the RBI
   2. GoI currency liabilities to the public
   3. RBI's net credit to Banks and the GoI
   4. Non-monetary liabilities of the RBI

Select your answer using the code below:

(a) 1, 2 and 3

(b) 2, 3 and 4

(c) 1, 3 and 4

(d) 1, 2, 3 and 4

9. Consider the following statements regarding the Regional Rural Banks (RRBs) in India.
   1. The share capital of the RRBs is sponsored by the GoI, RBI and the Scheduled Commercial Banks in the ratio of 50 percent, 35 percent and 15 percent.
   2. Its main objective is to enlarge institutional credit for the rural and agriculture sector.
   3. RRBs are being restructured by the GoI under the recommendations of the Vyas Committee.
   4. Appointments to the RRB's are done by the sponsoring Scheduled Commercial Banks which falls outside the domain of the IBPS recruitment process.

   Which of the above statements about RRBs are correct?

   (a) 1 and 2

   (b) 2 and 3

   (c) 1 and 3

   (d) 3 and 4

10. Which of the following statements is correct about the term 'bank run'?

   (a) The net balance of money a bank has in its chest at the end of the day's business.

   (b) A panic situation when deposit holders start withdrawing cash from the banks.

   (c) The ratio of bank's total deposits and its total liabilities.

   (d) The period in which a bank creates the highest credit in the market.

11. Consider the following statements.
   1. Bond holders and depositors both suffer due to increased inflation.
   2. RBI's profits out of its investments in the Treasury Bills fall due to increased inflation.
   3. Bond holders' income increases with increased inflation in case of an inflation-indexed bond.
   4. Cost of governments' market borrowings increases in deflationary situation.

   Which of the above statements are correct?

   (a) 1, 2 and 3

   (b) 2, 3 and 4

   (c) 1, 2 and 4

   (d) 1, 2, 3 and 4

12. Consider the following statements regarding the operations of the various money market components in India:
   1. Commercial Paper route of borrowing working capital is profitable once inflation has peaked.
   2. Cost of operation for the banks in the Call Money Market falls in the wake of rising inflation.
   3. Earnings from Money Market Mutual Funds see erosion with increased inflation.
   4. Interest payments liabilities of the GoI on account of the Cash Management Bill increases in case of decreased inflation.

   Select the correct statements using the code below.

   (a) 1, 2 and 3

   (b) 2, 3 and 4

(c) 1, 2 and 4
(d) 1, 2, 3 and 4

13. Consider the following statements.
    1. Governments cost of loan repayment is minimum once the inflation is maximum.
    2. Tax collections of governments increase with increased inflation.
    3. Seignorage is a double-edged technique to increase governments' income.

    Select the correct statements using the code below.
    (a) 1 and 2
    (b) 2 and 3
    (c) 1 and 3
    (d) 1, 2 and 3

14. Consider the following statements related to the functions of RBI.
    1. The final decision regarding Credit & Monetary Policy is taken by the Union Ministry of Finance.
    2. Open Market Operations by the RBI comes under its autonomous powers.
    3. Ultimate power of issuing fresh currency notes in India remains with the RBI.
    4. RBI has been given full autonomy in the area of regulating the All India Financial Institutions.

    Which of the above statements are incorrect?
    (a) 1, 2 and 3
    (b) 2, 3 and 4
    (c) 1, 3 and 4
    (d) 1, 2, 3 and 4

15. Consider the following statements about 'market maker'.
    1. Market maker is a kind of broker in India's security market who quotes two-way prices for the securities.
    2. On the platform of the Over the Counter Stock Exchange of India Ltd. (OTCEI) only market makers are allowed to trade.
    3. The Discount and Finance House of India (DFHI) is the chief market maker in India's Money Market.
    4. Brokers have no compulsions of quoting two-way prices of securities though they may do so voluntarily.

    Which of the above statements are correct?
    (a) 1, 2 and 3
    (b) 2, 3 and 4
    (c) 1, 3 and 4
    (d) 1, 2, 3 and 4

16. Consider the following statements regarding Commodity Future Trading in India.
    1. It is the best tool of maintaining stable prices for the commodities.
    2. Price discovery at Commodity Exchanges discounts the local and global factors in the process of price search.
    3. This is highly suitable for the agricultural commodities in India where highest price fluctuations happen due to various natural and man-made reasons.
    4. At times, GoI bans trading in certain agricultural commodities as in short-term it may lead to speculative price rises.

    Which of the above statements are correct?
    (a) 1, 2 and 3
    (b) 2, 3 and 4

(c) 1, 3 and 4
(d) 1, 2, 3 and 4

17. Consider the following statements about the 'private placement' route to raise capital from the primary security market.
    1. Shares are sold to a select group of investors through a process of direct negotiations.
    2. This is completely opposite to the public issue route where no negotiation takes place with the investors.
    3. Other than the foreign and domestic financial institutions, individuals too can participate in it.

    Which of the above statements are correct?
    (a) 1 and 2
    (b) 2 and 3
    (c) 1 and 3
    (d) 1, 2 and 3

18. Consider the following statements related to a limited liability firm.
    1. Nominal Capital of a company is the limit up to which a company can issue shares.
    2. Registered Capital and Authorised Capital of a company are synonyms.
    3. Paid-up Capital of a company can never be more than its Issued Capital.
    4. Upper limit of Paid-up Capital of a company is its Authorised Capital.

    Select the correct statements using the code below.
    (a) 1, 2 and 3
    (b) 2, 3 and 4
    (c) 1, 3 and 4
    (d) 1, 2, 3 and 4

19. Consider the following statements related to the Angel Investors.
    1. Such investors are focused on helping the business succeed rather than reaping a huge profit from their investment.
    2. Conceptually, in profit motive, they are exact opposite of a 'venture capitalist'.
    3. They usually invest in 'person' rather than in the viability of the business.
    4. In India, they are classified as a category of 'venture capital funds'.

    Select the correct statements using the code below.
    (a) 1, 2 and 3
    (b) 2, 3 and 4
    (c) 1, 3 and 4
    (d) 1, 2, 3 and 4

20. Consider the following statements.
    1. Indian Depository Receipts (IDRs) allow Indian investors to invest in foreign companies in rupees.
    2. Global Depository Receipts (GDRs) make it possible for foreign investors to invest in Indian companies in their currencies.
    3. IDRs are issued in India by a Domestic Depository.
    4. Though India has provisions for IDRs, foreign companies are yet to issue IDRs in India.

    Select the correct statements using the code below.
    (a) 1, 2 and 3
    (b) 2, 3 and 4
    (c) 1, 3 and 4
    (d) 1, 2, 3 and 4

21. Consider the following statements about the recently set up Bharatiya Mahila Bank (BMB).

1. Its lending is restricted only to women; men are allowed to deposit money in BMB.
2. The bank is looking at providing assistance through credit to set up day care centres and start organised catering services.
3. The bank may tie up with NGOs in the process of promoting vocations among the rural women.
4. The savings interest rate for one lakh rupee and above is 5 per cent while interest for deposits of one year is 9 percent.

Which of the above statements are correct?

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

22. Consider the following statements related to disinvestment and its proceeds.
    1. Strategic disinvestment had a provision of 74 per cent stake sale in the non-strategic PSUs.
    2. As per the current policy only 49 per cent of shares of a profit-making PSU can be sold.
    3. Funds out of the disinvestment now flow into Public Accounts and its use is decided by the Union Budget.
    4. Since 2009 the government has been using the funds of the NIF itself in place of the profits from it.

    Which of the above statements are incorrect?

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

23. Consider the following statements about 'capital consumption'.
    1. A situation, when due to the losses of a company in consecutive years make it obliged to pay its current expenses using its capital base.
    2. A situation when the listed firms under-report their losses so that they can take higher benefits of depreciation.
    3. The process by which a company shows higher loss in its operation to withhold payments of dividends to its various share holders.

    Which of the above statements are incorrect?

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

24. Consider the following statements about the idea of 'micro-finance' in India.
    1. Micro-finance is a small-scale financial intermediation, inclusive of savings, credit, insurance, business services and technical support provided to the needy borrower.
    2. The thrust of the micro finance initiative is to channelize production and consumption credit in multiple doses based on the absorption capacity of the prospective borrower.
    3. It has evolved through following different models at different times—a 'charity based model' to a 'thrift-based model' and finally to the 'trust and creditworthiness model'.
    4. It was in Australia where the link between microfinance institutions and the formal financial institutions evolved.

Select the correct statements using the code below.

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

25. Consider the following statements regarding the 'Cash-based Accounting System versus Accrual Accounting System' in India.

1. The Indian Government accounts are prepared on a cash based accounting system which does not give a realistic account of the government's financial position.
2. The present system does not reflect accrued liabilities arising from the gap between commitments and transactions of the government on the one hand and payments made.
3. The Twelfth Finance Commission recommended introduction of accrual accounting in the government which have been accepted in principle.

Code:

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

Answer Key with Explanations

1. *(c)* OMOs are an effective quantitative policy tool in the armoury of the RBI by which it modulates the liquidity in the system in the short-term. This is a two-way operation—through sell or buy of the G-Secs. The OMOs is constrained by the stock of the G-Secs available with the RBI—once it needs to siphon out money from the market.

2. *(d)* It has been set up on February 22, 2014 under the Planning Commission, which is headed by a Director General (Ajay Chhibber is its first DG). It is considered a welcome move by the GoI in wake of the increased public scrutiny of the recent years.

3. *(c)* The CPSE ETF basket consists of shares of 10 PSUs and provides an opportunity for investors to become part-owners of Oil & Natural Gas Corp., GAIL India, Coal India, Indian Oil, Oil India, Power Finance Corp., Rural Electrification Corp., Container Corp., Engineers India and Bharat Electronics. Though globally ETF is a very popular investment vehicle, it is at a nascent stage in India and is yet to gain popularity. Through the CPSE ETF, the government is trying to make this product popular. The government hopes to mop in around Rs. 3,000 crore through ETF to meet the revised disinvestment target of around Rs. 16,000 crore (cut from Rs. 40,000 crores) for the year 2013–14.

4. *(c)* RBI announced this route in 2011–12 as a 'penal' route for banks to borrow once they have exhausted all borrowing option, i.e., the repo route. MSF rate is regulated by the RBI above the current repo rate. This route can be used by banks for only overnight borrowings and is linked to their net demand and time liabilities (NDTL).

5. *(b)* Only those foreign banks which have 20 or more branches in the country have been brought at par with domestic banks regarding PSL (in a phased manner over a maximum period of 5 years starting April 1, 2013 to March 31, 2018). The foreign banks with less than 20 branches

have no sub-targets within the overall priority sector lending target of 32 per cent. It is known that the RBI in August 2011 did set up a committee to re-examine the existing classification and suggest revised guidelines with regard to PSL and related issues (chaired by S. M. V. Nair). The committee submitted its report in February 2012.

6. *(d)* The stock of money in 'Other deposits' with the RBI is the liquidity which is available at its disposal for day-to-day uses and are not of any use for long-term purposes. Accounts in international agencies include agencies like IMF and other such bodies.

7. *(c)* In the new monetary aggregate M_3 is the 'broad money' (like the old one). Bankers' deposit is part of the 'reserve money'. Post Offices' saving deposits (excluding National Saving Certificates) are part of M_4. For 'other deposits' see the explanation of the Q. No. 8.

8. *(d)* Non-monetary liabilities of the RBI includes those liabilities which pile up due to its role as 'promoters' to the All India Financial Institutions.

9. *(b)* The share capital of the RRBs are jointly held by the GoI, the sponsoring scheduled commercial banks (SCBs) and the concerned state governments in the ratio of 50 percent, 35 percent and 15 percent. Since December 2012, appointments to the RRBs take place through the Institute of Banking Personnel Selection (IBPS). By now, the RRBs have been amalgamated into 64 only (originally there were 196 such banks set up to 1996 when GoI decided not to further them).

10. *(b)* This happens when there is a fear that the bank has insufficient funds with it—depositors lose confidence in the bank and start withdrawing their deposits in the concerned bank. This term has been used in contemporary journalism recently in the wake of the high loss fetched by the United Bank of India. Similar situations were seen in the wake of the sub-prime crisis in the US economy—by now, over 300 banks have been closed down in the economy due to losses.

11. *(c)* This question is based on the situation where 'borrowers benefit out of inflation while lenders suffer' (i.e., inflation premium). Inflation-indexed bonds are neutral to the effects of inflation; if someone holds such bonds during inflationary pressures, the interest benefit on it does not see any erosion.

12. *(d)* This question is based on the idea of relationship between 'inflation' and 'real interest rate' which borrowers pay on their borrowings. Components of money market are tools of borrowing 'short-term' (i.e., working capital) money from the financial market—thus inflation affects them in similar ways.

13. *(d)* The idea is the same as 'inflation premium'. Seignorage is a technique by which government intends to increase its tax revenues by issuing fresh currency notes, which brings in extra cash to the government in two ways, one via printed currency and the other through increase in tax income.

14. *(b)* RBI avails no autonomy in its functioning—though the Narasimhan Committee-I in 1991 has suggested autonomy in areas of critical importance, similar to many Western economies. It is believed that it has been given a kind of working autonomy in the area of making and announcing the Credit & Monetary

Policy (though there is no change in the official stand hitherto).

15. *(d)* Since market makers quote two-way prices for securities, they seem to 'make' market for the concerned securities. The OTCEI is modelled on the NASDAQ of the USA for listing of SMEs, which face lesser liquidity in their share transactions. The DFHI is a dedicated body for two transactions in the money market of India, operating since 1988.

16. *(d)* All the statements are correct. In case of India's agricultural commodities, such trading doesn't seem functioning well because other related institutional developments have not happened in time and farmers are not yet active players on the commodity exchanges of India (partly due to operational difficulties, smaller capital base and lack of knowledge). Once big farmers (contract/corporate farmers) emerge, it will start functioning in a better way for such commodities.

17. *(d)* Other routes of raising capital from the primary market are: (a) Public Issue and (b) Rights Issue.

18. *(d)* All the options are correct.

19. *(d)* Such investors are usually found among an entrepreneur's family and friends, but they may be from outside also providing financial backing to entrepreneurs for starting their business. The Union Budget 2013–14 promised a provision for them. As per *SEBI (Alternative Investment Funds) Regulations, 2012 (AIF Regulations),* Category I AIF are those AIFs with 'positive spill over effects' on the economy, for which certain incentives or concessions might be considered by SEBI or the GoI or other regulators in India, which shall include *Venture Capital Funds, SME Funds, Social Venture Funds, Infrastructure Funds* and such other *Alternative Investment Funds(AIFs)* as may be specified.

20. *(a)* Standard Chartered Bank is the only company which has issued IDRs in India. In May 2010 it raised Rs. 2,500 crore through this route.

21. *(b)* It will predominantly deal with women clients, but there is no restriction on having male clients. Inaugurated in November 2013, the BMB focuses on Indian women across economic classes, with special attention to economically neglected, deprived, discriminated, under-banked, unbanked, rural and urban women to ensure inclusive and sustainable growth. The bank with a team of professionals with rich experience and expertise has designed and developed new products and services to suit the needs of women across different segments, including self help groups, women entrepreneurs, salaried women, HNIs and corporate—having six exclusive women members on its Board.

22. *(d)* The strategic disinvestment policy was put on hold by the UPA-I government in 2004. The proceeds of disinvestment started flowing into the National Investment Fund since 2005 (a professionally managed fund) with a mandate to use the profits of it for social sector expansion and for upgradation of divested PSUs. But in wake of the economic slowdown after recession in the Western economies, the government decided to use directly the fund since 2009–10. Presently, the proceeds are considered to be part of the Public Account and its uses are decided by the Union Budget. The proceeds may be used in recapitalisation of public sector

banks, purchase of shares in the public sector banks and insurance companies, upcoming metro projects etc.

23. *(d)* Capital consumption is the other term for 'depreciation'. In the process of their uses fixed assets depreciate (go for wear and tear) at the rate decided by the government of the economy—the rates for the same assets may vary across economies.

24. *(d)* Microfinance (MF) is a small-scale financial intermediation, inclusive of savings, credit, insurance, business services and technical support provided to the needy borrower. The thrust of the MF initiative is to channelise production and consumption credit in multiple doses based on the absorption capacity of the prospective borrower. The presumption here is that the borrowers possess basic financial literacy and requisite capacity to operate their self-determined economic ventures profitably. The formal existence of MF was found in 1972. A *charity based model* (interest free loans where repayment was based on peer pressure) of MF was evolved in Ireland. Later on, in *Germany*, a *thrift-based model* was developed with establishment of saving funds. Bangladesh Grameen model is based on the principle of trust and creditworthiness of poor with both, obligatory and voluntary saving schemes. The Foundation for Development Cooperation (FDC) of Australia evolved a research project, The Banking with the Poor (BWTP) network to link microfinance institutions with formal financial institutions.

25. *(d)* The Indian government accounts are prepared on a 'cash based accounting system'. This system recognises a transaction when cash is paid or received. However, it does not give a realistic account of the government's financial position because it lacks an adequate framework for accounting for assets and liabilities, and depicting consumption of resources. Moreover, capital expenditure (expenditure on the creation of new assets) under the cash system is brought to account once in a year in which a purchase or disposal of an asset is made. This is not an effective way to track assets created out of public money. The present system does not reflect accrued liabilities arising from the gap between commitments and transactions of government on the one hand and payments made. The Twelfth Finance Commission recommended introduction of 'accrual accounting' in government. The government has accepted the recommendation in principle and asked the *Government Accounting Standards Advisory Board (GASAB)* in the office of the Comptroller and Auditor General of India (CAG) to draw a roadmap for transition from cash to accrual accounting system, and to prepare an operational framework for its implementation. So far twenty-one state governments have agreed in principle to introduce accrual accounting.

SET- 3

1. Consider the following statements about GIC Re.
   1. The public sector reinsurer provides reinsurance support to the life and non-life insurance companies in the country.
   2. It also manages Marine Hull Pool, Indian terrorism insurance pool and India motor third party insurance pool for commercial vehicles on behalf of Indian insurance industry.
   3. It has emerged as a preferred reinsurer in the Afro-Asian region.
   4. It is the third largest aviation reinsurer globally.

   Select the correct statements unsing the code below.

   Code:

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

2. What is incorrect about the headline inflation of India?
   1. Urjit Patel Committee has advised to measure headline inflation at WPI as well as CPI.
   2. This is the inflation for the Indian economy and is measured at only WPI.
   3. Inflation-indexed bonds are issued in India linked to it only.

   Select the answer from the above statements using the code given below.

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

3. Consider the following statements related to the Central Sales Tax (CST) and the VAT (Value Added Tax).
   1. CST is a destination-based tax of the Centre while VAT is an origin-based tax of the states.
   2. CST is inconsistent with VAT.
   3. CST is a cascading-type tax not rebatable against the VAT.

   Select the correct statement/statements using the code given below.

   (a) Only 1
   (b) 1 and 2
   (c) Only 3
   (d) 1, 2 and 3

4. Consider the given statements regarding subsidies.
   1. They are essential parts of public policy to the extent they are ad hoc arrangements.
   2. While everybody benefits from it, they are not paid by all.
   3. Capital part of subsidies is counted in the planned expenditure of the government.
   4. The FRBM Act has strict provisions regarding subdies.

   Select the incorrect statements using the code given below.

   Code:

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

5. Which among the following is/are not counted as 'public expenditure'.
   1. Expenditure categorised as 'consumption'.
   2. Expenditure known as 'investment' and 'capital creation'
   3. Expenditure in 'running the government'.
   4. Expenditure in forwarding 'external grants'.

   Select the correct answer using the code given below.
   (a) 1, 2 and 3
   (b) 1, 3 and 4
   (c) 2, 3 and 4
   (d) 1, 2, 3 and 4

6. If the RBI decides to adopt an 'expansionist' monetary policy, which of the following it would not do?
   1. Cut CRR and optimise SLR.
   2. Increase MSF Rate.
   3. Cut Bank Rate and increase Reverse Repo Rate

   Select the answer using the code given below.
   (a) 1 and 2
   (b) Only 1
   (c) 2 and 3
   (d) Only 2

7. Which of the following 'redistributive' policies the government will not adopt if it wants to bridge economic inequality?
   1. Rationalising subsidies
   2. Progressive tax policies
   3. Regressive expenditure

   Select the answer using the code given bolow.
   (a) 1 and 2
   (b) Only 2
   (c) 2 and 3
   (d) Only 3

8. Which of the following will be the outcome once an economy is under an inflationary pressure?
   1. Domestic currency heads for depreciation
   2. Exports become less competitive with imports getting costlier
   3. Cost of borrowing decreases
   4. Bond-holders get benefitted

   Select the answer using the code given below.
   (a) 1 and 2
   (b) Only 2
   (c) 1 and 3
   (d) Only 3

9. Consider the following statements related to the Regional Rural Banks (RRBs).
   1. They were conceived as institutions that combine local feel and familiarity with the rural problems, which the cooperatives possess.
   2. They were conceived on the line of a business organisation with the ability to mobilise deposits, like a commercial bank.
   3. Originally they were intended to provide institutional credit to the weaker sections of the society called 'target groups'.

   Select the incorrect statement/statements using the code given below.
   (a) 1 and 2
   (b) 2 and 3
   (c) 1, 2 and 3
   (d) None of these

10. Consider the following statements regarding the marginal standing facility rate of the RBI.
    1. It is similar to the repo rate for the financial institutions.
    2. It is on the lines of the liquidity adjustment facility and part of it.
    3. Though it is a costlier route to fulfil overnight requirement of funds, it is not a penal rate.
    4. Banks use this route once they exhaust all channels to raise short-term fund.

    Select the incorrect statements using the code given below.
    (a) 1, 2 and 3
    (b) 1, 3 and 4
    (c) 2, 3 and 4
    (d) 1, 2, 3 and 4

11. Which one of the following statements is not true about Game Theory?
    (a) It is a branch of economics that uses models to study interactions between countries, individuals and organisations.
    (b) It was devised in 1944 by John Von Neumann and Oscar Morgenstern.
    (c) It was often used in political or military context to explain conflicts between countries but has of late been used to map trends in the business world, ranging from how cartels sell prices to how companies can better their goods and services in new markets.
    (d) Robert J. Aumann and Thomas C. Schelling were awarded Nobel Prize in Economics in 2005 for their work on this theory.

12. Consider the following statements about Base Rate.
    1. It has replaced the idea of prime lending rate.
    2. This is a kind of benchmark rate below which banks are not allowed to lend.
    3. Though it is fixed by banks themselves, an informal consultation with the RBI is must.
    4. Banks maintain their capital adequacy ratios in accordance with their base rate.
    5. It has helped banks to check their rising levels of NPAs.

    Select the incorrect statements using the code given below.
    (a) 1, 2 and 5
    (b) 2, 3 and 4
    (c) 3, 4 and 5
    (d) 2, 3 and 5

13. Due to certain reasons, it becomes difficult for the Export Credit Gaurantee Corporation to cover pure commercial risks of the medium- and long-term exports originating from India. What are these reasons?
    1. Long repayment period
    2. Large value of contracts
    3. Difficult economic and political conditions in the importing countries
    4. Non-availability of reinsurance for such external projects

    Select the answer using the code give below:
    (a) 1, 2 and 3
    (b) 1, 3 and 4
    (c) 2, 3 and 4
    (d) 1, 2, 3 and 4

14. Consider the following statements about derivatives in India.

1. A security derived from a debt instrument, share, secured or unsecured loan.
2. A contract which derives its value from the prices or index of underlying assets.
3. A security derived from exchange rates and interest rates.
4. It may be derived from monsoon forcasting.

Select the correct statements using the code given below.

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

15. Consider the following statements about the security market in India.

1. As the ADRs and GDRs are for the foreigners with respect to Indian companies, the IDRs are for the Indians with respect to the foreign comapanies.
2. Due to availablity of better routes for foreign investments in the Indian security market, the IDR route has lost its relevance.
3. The IDRs are today a very popular route for Indians to invest in the foreign security market.
4. India allows debt and non-debt, both forms of the securities under ADR, GDR and IDR.

Select the correct statements using the code given below.

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

16. Consider the following statements regarding 'angel investors'.

1. Investors who provide financial backing to entrepreneurs for starting their business.
2. They are investors with positive spillover effects.
3. They may provide finance as loan or as share capital in the upcoming business.
4. They usually invest in person rather than the economic viability of business.
5. They are usually from the entrepreneur's family and friends, but may be from outside, too.
6. Venture capital funds serve similar purpose to the extent arrangement of investible capital is concerned.

Select the incorrect statements using the code given below.

(a) 1, 2 and 5
(b) 2, 3 and 4
(c) 3, 5 and 6
(d) None of the above

17. Consider the following items with respect to India's capital account.

1. foreign currency deposits of the banks
2. private remittances
3. security market investments by the RFPIs and QFIs
4. foreign direct investment
5. external bonds issued by the GoI
6. merchandise trade balance
7. interest liabilities of the expernal loans

Which among the above items is associated with India's capital account?

(a) 1, 3, 4 and 5
(b) 2, 4, 6 and 7
(c) 1, 5, 6 and 7
(d) 1, 3, 6 and 7

18. Consider the following statement regarding the India Inclusive Innovation Fund.
    1. The idea is to build innovative enterprise from the bottom of the pyramid (BOP).
    2. The fund will provide risk capital to create solutions aimed at enhancing the quality of life at the BOP.
    3. Will address the social impact objectives by kick-starting an ecosystem of capacity-building around BOP-focused entrepreneurship.
    4. Will address economic return objectives by providing the capacities needed to deliver.
    5. The fund will get mobilised from the government, public sector enterprises, corporate sector, venture funds, angel investment and investment firms.

    Select the correct statements using the code given below.

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

19. As per the circular of the RBI what is correct about the Core Investment Companies (CICs)?
    (a) All those companies with a paid-up capital of over Rs. 1,000 crore, which invest primarily in the core industries.
    (b) All those NBFCs which invest not less than 90 per cent of their total assets in the form of shares and securities for non-trading purposes.
    (c) All the corporate houses with net-owned fund not less than Rs. 1,000 crore invested in the core sector for at least 10 years.
    (d) All the Foreign Institutional Investors (FIIs) with a minimum of Rs. 1,000 crore paid-up capital base with at least 80 per cent of it invested in the core industries for long-term purposes.

20. An upsurge has been seen in the NPAs of the public sector banks, recently.
    1. Lower economic growth in the country
    2. Aggressive lending by banks in the past, especially during good times
    3. Lack of right loan-recovery legal provisions
    4. Banks shwitching over to a system-based identification of NPAs

    Select the correct factors responsible for it using the code given below.

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

21. Which of the following are incorrect when the government starts repuchasing its bonds before their maturity periods?
    1. Promotion of an 'expansionist' monetary policy
    2. An attempt to increase the saving rate of the economy
    3. A tool to check the rising inflation
    4. Promotion to credit creation by the banks

    Select the answer using the code given below.

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

22. Consider the following statements about 'narrow banking'.
    1. A banking business in which banks go for short-term risk-free lending.
    2. A type of retail banking in which banks provide short-term 'open-ended' loans.
    3. When banks prefer short-term 'closed-ended' lending to the corporate sector.
    4. A banking business which adopts long-term collateralised loans to public.

    Select the incorrect statements using the code given below.
    (a) 1, 2 and 3
    (b) 1, 3 and 4
    (c) 2, 3 and 4
    (d) 1, 2, 3 and 4

23. Consider the following statements about the 'ordinary shares' of a limited liability firm.
    1. They undertake maximum entrepreneurial risk associated with a business venture.
    2. These shares do not avail any voting right in the affairs of the company.
    3. If a company is going for closure these shares get their claims after the bank loans have been settled and before the preference shares.
    4. Company Law provides them no investment claims in the situations of closures.

    Select the incorrect statements using the code given below.
    (a) 1, 2 and 3
    (b) 1, 3 and 4
    (c) 2, 3 and 4
    (d) 1, 2, 3 and 4

24. Consider the following statements about Grain Bank.
    1. Run in tribal and non-tribal rural areas by the Ministry of Tribal Affairs and the Ministry of Consumer Affairs, Food and Public Distribution, respctively.
    2. Foodgrains can be borrowed from it by mortgaging dwellings.
    3. Established in the food scarce areas, it aims at providing safeguard to all against starvation during natural calamity and lean period.
    4. Civil society bodies can also run it.

    Select the incorrect statements using the code given below.
    (a) 1, 2 and 3
    (b) 1, 3 and 4
    (c) 2, 3 and 4
    (d) 1, 2, 3 and 4

25. related to the sugar industry. The following statements are
    1. Sugar mills are now free to sell their entire production as per their commercial prudence.
    2. The new procurement systems of sugar for the Public Distribution System is costlier.
    3. Sugar mills pay Rs. 24 per quintal as Sugar Cess to neutralise the government expenditure of sugar distribution through the public distribution system.
    4. Government provides loan to the sugar mills from the Sugar Development Fund for production of anhydrous alcohol.

    Select the correct statements using the code given below.

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

Answer Key with Explanation

1. *(b)* It reinsures only 'non-life' segment of the insurance business and is the fifth largest aviation reinsurer in the world. Recently it has been selected as a Manager for Nat Cat Pool promoted by the Federation of Afro-Asian Insurers and Reinsurers (FAIR). GIC Re is financially strong and is rated 'A' (Excellent) by AM Best and 'AAA' by CARE.
2. *(c)* 'Headline Inflation' is measured at the wholesale prices only (by calculating the price movements of the 676 items which have been put under the basket for inflation). This is the inflation for the Indian economy. Inflation-indexed bonds have been issued linked to CPI also. Advice of the Urjit Patel Committee is for the RBI for monitoring the inflation rate for the economy through its credit and monetary policy.
3. *(d)* CST is levied under the provisions of the CST Act, 1956, on the sale of goods of the course of inter-state trade or commerce—levied by the Centre by virtue of Entry 92A of the Union List, but the same is assigned to the states within which the tax is leviable, by virtue of provisions of Article 269 of the Constitution of India. Thus, CST and VAT are inconsistent (similarly it will be inconsistent with the proposed GST also). This is why after extensive consultations between the Centre and states, the roadmap for *phasing out* the CST by March 31, 2010 (i.e., before the date appointed for the introduction of the GST) has been finalised (the date has got automatically forwarded as the GST was not implemented by that date). Accordingly, the process of phasing out of CST commenced with reduction in CST from 4 per cent to 3 per cent, w.e.f. April 1, 2007, and further to 2 per cent w.e.f. June 1, 2008. Further cut in it is suspended due to delaying of the GST implementation. States have been getting compensation from the Centre for losses accruing due to the CST phase out.
4. *(d)* Basically, subsidies benefit some people while they are paid by the whole population of the economy. Subsidies have been advised by the economists provided they are used as short-term measures—if the ecomony uses them as a long-term measure, they make the population handicapped (those who get them). Subsidies are like putting someone on pain-killers in place of providing the real treatment for the pain! That is why it is always advised by economists that besides subsidies there should be an effective and time-bound long-term policy to impart market-linked purchasing capacity to the population getting subsidy benefit. All subsidies fall under the non-planned expenditure. The FRBM Act has no direct provisions regarding subsidies—it talks about the revenue and fiscal deficits only.
5. *(d)* Every expenditure by the government is part of the public expenditure, be they plan, non-plan, developmental, non-developmental, revenue or capital.
6. *(d)* Following the 'expansionist' policy means encouraging the circulation of money in the economy. Here, except the MSFR increase, all other measures are dedicated to increase liquidity in the system.

7. *(d)* Regressive expenditure will never serve the purpose. The government will need to tax the higher income bracket with higher rate of taxes and rationalise the subsidies so that they go to the needy only and in adequate amount. All these measures are already being operationalised by the GoI.
8. *(c)* Inflation is directly seen converting into proportionate depreciation in the domestic currency. In such situations, exports become cheaper for other countries (which make it more competitive in the world market), besides imports becoming costlier (as the domestic currency loses value in front of the external currency). Real cost of borrowing is calculated by deducting the current rate of inflation (which is higher) from the 'nominal rate of interest/borrowing' (that is the rate of interest banks announce on a certain category of loan). Bond-holders are basically lenders so they suffer—interest income sees dilution.
9. *(d)* The RRBs were modelled to have the local touch of the 'cooperatives' and the business touch of the Scheduled Commercial Banks (SCBs). Since April 1997 they have been allowed to break free from the ceilings interests they forward on deposits or charge on loans (these measures were taken to consolidate the loss-making RRBs). In September 2005 the GoI initiated a process of amalgamation of the banks in a phased manner—accordingly, the total number of RRBs has come down to 46 (from 196) by the end of 2013.
10. *(a)* This route is only for banks, on the lines of the LAF, but it is not its part. It is a penal rate that is why remains always higher than the repo rate. While putting this route in place the RBI has permitted banks to borrow maximum 1 per cent of their Net Demand and Time Liabilities, in coming times it was cut down, too. Similarly, it commenced with a rate of 1 per cent higher than the current repo rate, but over the time it went upto 3 per cent higher than the current repo (in the process of checking inflation, by end 2013).
11. *(a)* Game Theory is a branch of Applied Mathematics which uses models to study interactions between countries, individuals and organisations. It has been used by applied economists in different areas.
12. *(c)* The ideas of prime lending rate (PLR) and benchmark prime lending rate (BPLR) have been abolished by the RBI since July 2010. Banks don't need to consult RBI to decide their base rates as this rate is neither linked to the NPAs nor the capital adequacy rations (CARs) of the banks.
13. *(d)* Overseas projects undertaken by the Indian firms face many political and commercial risks in the importing countries—to provide adequate credit insurance cover to such firms, the government has set up the ECGC under the Ministry of Commerce and Industry, for medium- and long-term exports.
14. *(a)* The derivatives in India has not been allowed to derive their value from the weather forcastings (it is allowed in many developed economies, for example, the USA).
15. *(d)* Today, India allows liberal foreign investments in its security market that is why the American/Global Depository Receipts (ADRs/GDRs) has lost their relevance. The Indian Depository

Receipts (IDRs) were never a popular route of investment for Indians—by now only one company (Standard Chartered Bank) has issued it in India which went for its full redemption by mid-2011.

16. *(d)* All the statements are correct about angel investors—a term introduced in the Union Budget 2013-14. SEBI puts them in the Category I AIF (Alternative Investment Fund) with 'positive spillover effects'. The venture capital funds also come under this. A venture fund invests in business rather then the person (opposite to the angel investor).

17. *(a)* Private remittances, interest liabilities of foreign loans and trade balance are shown in the current account.

18. *(d)* The idea was proposed by the India Innovation Council for the fiscal 2011–12. This fund is based on the idea of inclusion in the promotion of entrepreneurship—it means it emphasises the social return model unlike the most popular model in the world of promoting the innovations on the items which are for the rich. The Union Budget 2014–15 (Interim) proposed a fund of Rs. 100 crore for this fund.

19. (b): CICs are basically the NBFCs carrying on the business of acquisition of shares and securities, which satisfies some conditions, i.e., it holds not less than 90 per cent of its total assets in this form; its investments in the equity shares in group companies constitutes not less than 60 per cent of its total assets; it does not trade in its investments in shares, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment; and it does not carry on any other financial activity except investment in bank deposits, money market instruments, government securities, loans to and investments in group companies.

20. *(c)* Some other factors were also responsible for the increase in NPAs, i.e., increased interest rates in the recent past; current macro-economic situation in the country.

21. *(c)* The money which flows from the government into the system was called the 'cheap currency' by J. M. Keynes. By doing so, governments promote economic activities, which supports the business and trade.

22. *(c)* The term was coined in India by the Narasimhan Committee-II set up on the Banking Sector Reforms (report came in April 1998). This suggestion was given by the committee for the 'weak banks' at that time.

23. *(d)* These shares get voting rigths in their exact proportion as they cover the maximum risk—in a way it is a compensation. As these shares get dividend after all payments have been made by the company, similarly, if the company is being closed down they get their investment claims at the last—after settling the claims of employees, creditors, lenders, government, preference shares etc. Thus, both during life and death of a business, the 'ordinary share holders' are the last to receive their claims.

24. *(a)* Launched in 1996–97 by the Ministry of Tribal Affairs, the centrally sponsored scheme was transferred to the Ministry of Consumer Affairs, Food and Public Distribution in 2004–05. It lends foodgrains without any mortgage to the target population (marginaliged people) only. The bank can be run by NGOs, self help group and gram sabha.

25. *(a)* The levy obligation (10 per cent) of the sugar mills was abolished by the government for the sugar produced after September 2012, on the recommendations of the 'C. Rangarajan Commitee on Deregulation of the Sugar Sector'. Procurement of sugar for PDS is now linked with the market which has increased government expenditure on the head—states/UTs are reimbursed Rs. 18.50 per kg by the GoI for their sugar purchases under the PDS. The sugar cess paid by the sugar mills are not aimed at neutralising the government expenditure on sugar distribution through the PDS, but to strengthen the Sugar Development Fund—the fund is used for the purpose of promoting the sugar industry, cane production etc.

Set- 4

1. The 'Ducth disease' has been recently in news in case of the Indian economy. Consider the following statements about the disease.
   1. This is a situation of resource curse
   2. Country's domestic sector becomes uncompetitive
   3. Exchange rate gets bloated due to low inflow of foreign capital
   4. This may be caused by the foreign investments and high remittances

   Select the corrent statements using the code given below.
   (a) 1, 2 and 3
   (b) 2, 3 and 4
   (c) 1, 2 and 4
   (d) 1, 2, 3 and 4

2. Consider the following statements about the WTO-related groups.
   1. G-33 is the group of agricultural importing countries of the world.
   2. C-4 is the group of sub-saharan countries lobbying for cotton trade reforms.
   3. Crains Group is the lobby of agricultural exporting countries.
   4. G-10 is the group of small countries most vulnerable to agricultural imports.

   Select the correct statements using the code given below.
   (a) 1, 2 and 3
   (b) 2, 3 and 4
   (c) 1, 3 and 4
   (d) 1, 2, 3 and 4

3. Consider the following statement related to the 'developmental' and 'non-developmental' expenditures in India.
   1. Plan expenditure is the leading development expenditure of the government in India.
   2. Maintenance expenses of the assets created by the plan expenditure of the previous years are also considered as developmental expenditures.
   3. Planning Commission mainly deals with plan expenditures though, in practice, it provisions funds for the non-plan expenditures also.

   Select the incorrect statements using the code given below.
   (a) 1 and 2
   (b) 2 and 3

(c) 1 and 3
(d) 1, 2 and 3

4. Consider the following statements regarding depreciation.
   1. Fixed assets losing monetary value over time.
   2. Loss of value in a domestic currency in front of a foreign currency.
   3. Fall in the monetary value of the equipments of a plant due to their use.
   4. It does not happen in case of non-fixed assets.

   Select the correct statements using the code given below.

   Code:

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

5. Deficit financing leads to inflation in general, but it can be checked if—
   (a) Government expenditure leads to increase in the aggregate supply in ratio of the aggregate demand.
   (b) Only aggregate demand is increased.
   (c) All expenditures are used for the national debt payment only.
   (d) Fresh currencies are printed to fulfil its deficit financing needs.

6. Consider the following options if all banks in an economy are nationalised and converted into a monopoly bank.
   1. Deposits will decrease in the new bank
   2. Deposits will increase in the new bank
   3. There will be no effect on either saving rate or lending

   Select the correct option/options using the code given below.

   (a) Only 1
   (b) 1 and 2
   (c) Only 2
   (d) 1 and 3

7. Consider the following statements about the Gross Domestic Capital Formation (GDCF):
   (a) Expenditure dedicated to increase or maintain the capital stock in the economy.
   (b) Expenditure incurred on physical assets only, even in the case of deficit financing.
   (c) Production level overtaking the aggregate demand creating export surpluses.
   (d) Addition to the stock of the economy after adjusting the effects of depreciation.

8. Which of the following factors responsible for a surplus in the current account of an economy?
   1. Its exports are compulsory imports for other economies.
   2. It imports low-technology items and exports high-technology items.
   3. It has huge domestic market.
   4. Its imports are non-compulsive in nature.

   Select the answer using the code given below.

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

9. If RBI cuts down the cash reserve ratio it will have the following impact on the economy.

1. Banks will have higher leverage to liquidity
2. Economy may see increased investment
3. Supply of currency in the economy may broaden
4. Real interest rates may decline

Select the answer using the code given below.

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

10. Which of the following items appear in a company's balance sheet?
    1. Value of raw materials held by the company
    2. Cash held in the banks in company's current account
    3. Sales revenue of the company
    4. The issued capital of the company

    Select the answer using the code given below.

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

11. The idea of 'currency convertibility' as it is used by the economies today originated in which of the following?
    (a) Marshall Plan
    (b) Washington Consensus
    (c) IMF Plan
    (d) None of these

12. Which of the following statement defines the term 'insurance penetration'?
    (a) The number of insured per one hundred population in an economy
    (b) Insured people per one thousand of the population of an economy
    (c) Number of alive and insured per hundred population in an economy
    (d) None of the above

13. The exchange rate of a currency in its forex market depends on
    1. Its twin deficit
    2. The currency regime economy follows for exchange determination
    3. Inflation, printing of fresh currencies, levels of forex earnings

    Select the answer using the code given below.

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

14. Consider the following statements regarding the state of full convertibility of the rupee in the current account.
    1. 100 per cent foreign currency is made available by the government at official rate of exchange for all visible and invisible imports.
    2. Foreign investment in the Indian security market, though an issue of capital account, is considered as a matter of the current account for convertibility purpose.
    3. In case of foreign grants, rupee is partially convertible in India.
    4. Rupee is fully convertible if someone needs foreign currency to go for medical treatment abroad.

    Select the incorrect statement/statements using the code given below.

    (a) 1, 2 and 3
    (b) 2, 3 and 4

(c) 1, 2 and 4
(d) 1, 3 and 4

15. The Reserve Bank of India calculates four components of money supply, viz., M_1, M_2, M_3 and M_4. Select the incorrect pair out of the the following.
(a) M_1 consists of the currency and coins with the public; demand deposits of the banks and other deposits with the RBI.
(b) M_2 consists of M_1 and demand deposits of the post offices.
(c) M_3 includes the sum of M_1 and M_2.
(d) M_4 includes the sum of M_3 and demand as well as time deposits of post offices.

16. Consider the following statements in a situation when a currency goes for devaluation.
1. Fall in the value of currency vis-á-vis a foreign currency
2. Exports become less competitive
3. Trading partners see fall in their export
4. Imports become costlier

Select the correct statements using the code given below.
(a) 1, 2 and 3
(b) 2, 3 and 4
(c) 1, 2 and 4
(d) 1, 3 and 4

17. 'A diverse world with hundreds of languages and dialects comprising scores of ethnic groups and highly industrialised economies and up-coming economies—spanning half of the surface of the earth and are home to two-fifths of the world's population'.

Which of the following economic group the statement refers to?
(a) SAPTA
(b) APEC
(c) EC
(d) OPEC

18. A state of 'equilibirium'for a consumer means—
(a) A state of saving rate equal to the growth rate of the economy for the consumer.
(b) A state of zero saving for the consumer and full expenditure.
(c) The consumer is unable to fulfil needs with the given income.
(d) The consumer is able to fulfil needs with a given level of income.

19. Modern economics defines 'tax' as—
(a) A mode of income redistribution
(b) A method of effecting transfer pricing
(c) A way to mobilise resources for government expenditures
(d) A tool of meeting the social obligations of modern governments

20. Consider the following statements about 'Sensex'.
1. Is the representative share index of Indian stock market.
2. Its rise means an overall rise in prices of shares of a group of companies registered with Bombay Stock Exchange.
3. The shares which are kept in it are of the high net-worth companies.
4. It is a previledge to be in this 30-shares index.

Select the incorrect statement/statements using the code given below.
(a) Only 1
(b) 1 and 2
(c) Only 2
(d) None of these

21. 'Structural reform measures' was one of the two categories of measures aunounced by the government to be taken under the process of economic reforms in India. These measures deal with—
    1. Redefining the role of the state in the economy
    2. Attempting higher participation of private capital—Indian and foreign
    3. Increasing aggregate supply in the economy
    4. Checking the excessive demand in the economy leading to inflation

    Select the answer using the code given below:
    (a) 1, 2 and 3
    (b) 2, 3 and 4
    (c) 1, 2 and 4
    (d) 1, 3 and 4

22. Which of the following is correct about the term 'ex-factory price'?
    (a) It is 'factory price' added with all indirect taxes of the Centre and the state.
    (b) It is the 'ex-showroom price' after deducting the weight of indirect taxes from it.
    (c) It is 'factor cost' added with weight of current rate of inflation.
    (d) None of these above

23. Select the statement which correctly defines the concept of 'debt trap'.
    (a) A situation of an economy which borrows to repay its past borrowings.
    (b) A situation when an economy is borrowing higher than what it is repaying for its past borrowings.
    (c) A situation when an economy is borrowing to repay even the interest of its past borrowings.
    (d) A situation when the forex reserves growth rate of an economy starts lagging behind the growth rate of its external borrowings.

24. Which of the following policy steps a government usually takes to boost demand and support the economy in deflationary situations?
    1. Lowering interest rates together with cutting direct taxes
    2. Emphasising savings and enhancing salaries
    3. Increasing government expenditure
    4. Going for tapering of fiscal stimulus

    Select the answer using the code given below.
    (a) 1 and 2
    (b) 3 and 4
    (c) 1 and 3
    (d) 1 and 4

25. Consider the following statements related to the Companies Act, 2013.
    1. The proposed National Company Law Tribunal will replace the existing Company Law Board.
    2. The President of the Company Law Tribunal has to be a person who is or has been a Judge of a High Court for five years.
    3. The appeals against the orders of the National Company Law Tribunal can only be entertained by the Supreme Court of India.
    4. The existing Company Law Board will be merged into the upcoming Natoinal Company Law Appellate Tribunal.

Select the correct ones by using the code given below.

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

Answer Key with Explanations

1. *(c)* This is a negative consequence of large increase in a country's income. This disease is primarily associated with a natural resource discovery, but it can result from any large increase in foreign currency, including FDI, foreign aid or a substantial increase in natural resource prices.

   Economists often describe resource-rich countries as suffering from the 'Dutch Disease' or 'resource curse'. The expression comes from the experience of the Netherlands half a century back (in 1960s when the country discovered huge natural gas in the North Sea), which brought in foreign revenue, but reduced the competitiveness of the domestic economy (i.e., exports) on account of a rising exchange rate (bloating of exchange rate). There are many other examples of this phenomenon including countries as different as United Kingdom, Australia and Nigeria.

2. *(b)* These are groupings/lobbies of member countries of the WTO which keep lobbying to serve their interests and create pressure for trade reforms on the platforms of the multilateral trade body. G-33 is also called the 'Freinds of Special Product' in agriculture and is a coalition of the developing countries pressing for limited access to their market for agricultural products.

3. *(b)* Planning Commission deals with only the plan expenditures of the economy. It does not provisions any fund for the non-plan responsibility of the government.

4. *(d)* This is 'wear and tear' in a fixed/immovable asset due to their use. For different assets the rates of depreciation are announced by the countries—the rates may vary across countries. Depreciation is also used by countries as a toll of economic policy—for example, to boost the sales of heavy vehicles the Government of India has doubled the rate of depreciation of the vehicles (from 20 per cent to 40 per cent).

5. *(a)* The basic reason for price rises in the situatons of defecit financing is that governemnts fail to equalise the total demand of the economy by the total supply.

6. *(a)* Monopoly will discourage the depositors from putting money in the bank. The saving rate of the economy together with the lending activities of the bank will also get hampered.

7. *(a)* It means the 'net' addition to the national stock. Future growth of the economy depends on the GDCF.

8. *(d)* Having a huge domestic market never supports current account positively; it may impact the account negatively if its consumers are demanding more of the items which are being imported by the economy. In case of India, the situation is: its imports are compulsive and most of its exports are non-complusive for its trade partners.

9. *(d)* The CRR provides more money in the hands of banks, which may be now lent out for investment and increase the supply of currency in the economy. As

the supply of money increases to the banks, they may cut interest rates (cost of money remaining the same).

10. *(c)* The revenues a company gets out of its sale of the manufactured items are not shown in the balance sheet of a company.
11. *(d)* The idea of 'currency convertibility' originated at Bretton Woods, New Hampshire, USA where the twin international economic organisations, viz., the International Monetary Fund and World Bank came into being.
12. *(d)* 'Insurance penetration' is defined as the ratio of underwritten premium in a given year to the GDP of an economy.
13. *(d)* Exchange rate of a currency depends on so many variables as given in the question. If the economy follows the 'floating currency regime' for the exchange rate determination, the exchange rate is directly linked to all those factors which affects the availability of domestic and foreign currencies in the economy—higher the supply of foreign currency, higher the value domestic currency will have and vice versa.
14. *(c)* Foreign investments are of two types, viz., one is in the direct form and another in the indirect form (i.e., in security market), both are considered capital inflows. But in the case of convertibility the security investment part of the foreign investment is considered a matter of current account to make it liquid in which rupee is fully convertible (otherwise no foreign investor will come to invest in the share market). Going abroad is a matter of current account, thus rupee is fully convertible for this purpose.
15. *(c)* M_3 stands for the sum of M_1 and total deposits of the banks (i.e., demand and time deposits of banks). These components of money in India were defined by the 2nd Working Group on Money Stock set up by the RBI in 1972. The 3rd Working Group on the Money Stock submitted its report to the RBI in 1998—as per it the new components of money in India are—M_0, M_1, M_2 and M_3. Together with the new stock of money the Working Group has suggested liquidities formula for the stock, too, namely- L_0, L_1, L_2 and L_3.
16. *(c)* Though, devaluation in currencies are discouraged and negated with excessive pressure coming from the trading partners of the country, it ultimately makes goods of the country cheaper in the world market— the economy earns profit from exports. The increase in profit of export takes place due to increase in 'volume' of the exports (but in reality, exporters forego more goods to earn the same amount of foreign currency). As foreign currency becomes costlier the country sees decrease in its imports (provided its imports are non-compulsive in nature) due to import substitution.
17. *(b)* This is part of a *World Development Report* of the World Bank which got huge media attention across the wolrd.
18. *(d)* Though this ideal stage is reached only in hypothesis—with the changing times, consumers not only demand new goods and services, but new times come with the alternatives of it, too.
19. *(a)* Incomes of citizens get redistributed after tax—this happens at two levels: once after paying tax and once when the governments use this money to provide essential services to the population. The poorer population uses more of the government services than the richer. The

option (c) is also correct but comes later in order.

20. *(b)* Being in this index does not bring any privilige to a company. The shares put here are just for representation purpose of the industry.

21. *(a)* Government never did intend to check the demand—it basically went for the a set of reforms known as the 'macro-economic stabilation measures', which attempts to boost demand in the economy. The whole process of economic reforms in the economy is all about demand and supply management.

22. *(a)* 'Ex-factory Price' and 'Ex-showroom Price' are the same. Factory price is basically, the factor cost.

23. *(c)* Many of the highly indebted countires (HICs) in the sub-Saharan Africa fall under this category. India was very close to a similar situation in early 2000.

24. *(c)* Statement 2 will have contradictory/neutralising effects on the economy as savings cut demand and salary enhancement increases demand. All these measures were taken by the government during 1996–99 in India when aggregate demand in the economy had fell down to a very low level and inflation was, at one time, just 0.5 per cent (the second fortnight of December, 1999). Tapering in the fiscal stimulus cuts demand in the economy as it syphons out liquidity from the market.

25. *(a)* As per the Companies Act, 2013 (which replaces the company law of 1956 vintage), the government has notified the rules pertaining to the National Company Law Tribunal (NCLT). The appeals against the NCLT won't be entertained by the Supreme Court of India, but the newly set up body known as the National Company Law Appellate Tribunal (NCLAT).

Set- 5

1. Consider the following statements regarding the primary function of a 'holding company'.
   1. To invest in other companies, commonly known as subsidiaries.
   2. Usually not involved in day-to-day operations of the operating company.
   3. Lend initial or ongoing financial support via cash reserves or stock sales.
   4. May assist in restructuring the operational model to ensure profits.

   Select the correct statements using the code given below.

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

2. Consider the following statements about 'short-selling'.
   1. Short selling allows to sell those shares which will be owned in future.
   2. Short-selling is done by borrowing shares with a speculation that price of the share will fall in future.
   3. Short-sellers post losses if prices uptrend for the short-selled shares.

   Select the incorrect statements using the code given below.

   (a) Only 1
   (b) 1 and 2

(c) Only 3
(d) None of those

3. Consider the following statements about 'underwriters'.
   1. They are financial firms also known as Merchant Banks, regulated by the RBI.
   2. They subscribe the un-subscribed shares of a company.
   3. Their services are like an insurer, while shares are being issued by a firm.
   4. They are registered with SEBI.

   Select the correct statements using the code given below.
   (a) 1, 2 and 3
   (b) 2, 3 and 4
   (c) 1, 3 and 4
   (d) 1, 2, 3 and 4

4. Consider the following statements.
   1. The value of total goods demanded in an economy is always identically equal to the total value of goods supplied.
   2. Statement 1 is correct in the case of modern economies only, where use of currencies as the mode of exchange, but does not hold correct if it is a barter economy.

   Select the correct statement/statements using the code given below.
   (a) Only 1
   (b) Only 2
   (c) 1 and 2
   (d) None of the above

5. Consider the following statement which defines the 'wildcat strike'.
   1. A strike called by the labourers in between the work.
   2. The strike which is called without informing the management.
   3. The strike which is supported by an outside trade union.
   4. The strike not supported by the organised trade union of the firm.

   Select the incorrect statements using the code given below.
   (a) 1, 2 and 3
   (b) 2, 3 and 4
   (c) 1, 3 and 4
   (d) 1, 2, 3 and 4

6. Which among the following policy decision/decisions a government should take to promote foreign investments in the economy?
   1. Allowing full convertibility to its currency in current and capital accounts.
   2. Reducing or withdrawing the 'withholding tax'.
   3. Prohibitory laws for its nationals for overseas investments.

   Select your answer using the code given below.
   (a) 1 and 2
   (b) 2 and 3
   (c) 1 and 3
   (d) 1, 2 and 3

7. An economy is following the policies given below—
   1. Creating self-employment sources with high speed.
   2. Cutting its expenditures on the heads of salaries, subsidies and pension.
   3. Promoting public-private partnerships in the infrastructure sector.

Select the correct outcome which the economy wants out of such a policy.

(a) Promoting revenue expenditure at the cost of capital expenditures.
(b) Cutting revenue ependitures to promote capital expenditure.
(c) Promoting development expenditures without risking welfare.
(d) both b and c

8. Select the correct statement about 'zero-coupon bond' from the following—
(a) A bond with zero coupon rate which is sold at a price lower than its face value and investors get face value price at maturity.
(b) A bond with zero rate of interest but of the highest value of liquidity for which investors get other concessions like tax breaks.
(c) A special category of bond used as 'express money' to finance immediate needs of the economy which carries zero interest but gives tax credits to investors in their income tax returns.
(d) A kind of bond which is generally issued by governments in the times of financial crises to the high income group citizens, which carries no interest but investors get tax concessions for investing in it.

9. Select the incorrect statement from the following statements regarding deficit financing which an economy might be following.
(a) 'Factory price' of a product at constant prices is always lower than its 'factor cost' at current prices.
(b) 'Ex-factory price' of a product at the current prices is always lower than its 'market cost' at the constant prices.
(c) 'Maximum retail price' of a product is always higher than its 'ex-showroom price' at current prices.
(d) 'Factor cost' and 'market cost' may be calculated both at constant and current prices.

10. Consider the following statements about 'indicative planning'.
1. Dominance of imperative policies in the planning process.
2. Inclusion of incentives-based and co-ordinating policies.
3. Suitable for planned development of the state and mixed economies.
4. This kind of planning commenced in India with the economic reforms.

Select the incorrect statements using the code given below.
(a) 1, 2 and 3
(b) 2, 3 and 4
(c) 1, 3 and 4
(d) 1, 2, 3 and 4

11. Select the correct statement from the following about 'vulture funds'—
(a) The privately-owned funds which lend out capital for hostile bids of takeovers around the world charging high returns in the form of interests.
(b) The privately owned financial firms which buy sovereign debts of highly indebted countries at fraction of their value and collecting full amount via legal intervention.
(c) The enormous amount of private funds which have accumulated in major tax-havens of the world attacking high rising economies in the form of the so-called 'hedge funds'.
(d) The privately-owned equity capital which covers a very high risk of

repayment as they lend money to secretive groups in the world to fight against the nation states—considered playing a major role in promoting majority of terror outfits today.

12. Consider the following statements.
    1. Hedging is similar to insurance.
    2. In badla, a buyer wants postponement of deal—it is called contango in Western economies.
    3. In undha badla, a seller wants postponement of deal—it is called backwardation in the Western economies
    4. Scrip share is the other name for sweat share.

    Select the correct statements using the code given below.
    (a) 1, 2 and 3
    (b) 2, 3 and 4
    (c) 1, 3 and 4
    (d) 1, 2, 3 and 4

13. Consider the following statements about the process of issuing shares through 'private placement'.
    1. This is one among three routes through which a company raises capital in the primary market by issuing shares.
    2. Companies directly negotiates with the investors which may be financial institutions as well as individuals.
    3. This is completely opposite to the public issue route to issue shares.

    Select the correct statements using the code given below.
    (a) 1 and 2
    (b) 2 and 3
    (c) 1 and 3
    (d) 1, 2 and 3

14. Consider the following statements.
    1. Raising capital by public issue is the most broad-based method, though it is the most time taking, too.
    2. Though private placement route to raise capital is the least time taking, it is the riskiest route, too.

    Select the correct statement/statements using the code given below.
    (a) Only 1
    (b) Only 2
    (c) 1 and 2
    (d) Neither 1 nor 2

15. Consider the following statements.
    1. 'Trade creation' has taken place in India via the provisions of the WTO.
    2. Growth stories of the industrialised economies were the outcome of follow-up to 'creative destruction'.
    3. 'Trade creation' may be led by 'creative destructions'.

    Select the correct statements using the code given below.
    (a) 1 and 2
    (b) 2 and 3
    (c) 1 and 3
    (d) 1, 2 and 3

16. What is correct about the term 'transfer payments' which was in news recently?
    (a) The payments which takes place indirectly from the high bracket direct taxpayers to the subsidy-based sectors which are consumed by someone else.
    (b) The expenditure by government for which it receives no goods or services, such as tax collection, unemployment allowance etc.

(c) The minimum return an asset must earn to prevent its transfer to the next best alternative use.

(d) Tax is a mode of income redistribution through which payments get transferred from high to low income group directly and indirectly, both ways.

17. Consider the following statements about 'Venture Capital Fund'.
    1. A dedicated corpus of capital to promote innovative enrepreneurship.
    2. It may be public-owned or privately-owned.
    3. The IVCF was India's first such fund set up under private ownership.

    Select the correct statements using the code given below.

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

18. Consider the following statements.
    1. Higher the price-earning ratio a share has, higher the investment they are able to attract.
    2. Shares with lower price-earning ratios attract lower investment.
    3. Lower the price-earning ratios, higher the investments the shares are able to attract.

    Select the correct statements using the code given below.

    (a) Only 1
    (b) Only 2
    (c) Only 3
    (d) None of those

19. Select the correct statement about the 'unemployment trap'.

    (a) A situation in the economy when the rate of employment growth is less than the rate of increase in the unemployed population.
    (b) A situation of frictional unemployment when there is a heavy rush of labour force from the primary to the secondary activities.
    (c) A situation when existing job loss is higher than the new jobs created.
    (d) A situation when unemployed population of an economy does not feel encouraged to become employed.

20. Consider the following statements.
    1. The risk of a government defaulting on overseas loan is known as sovereign risk.
    2. All kinds of overseas borrowings by private companies also carry the burden of sovereign risk.
    3. A member nation may insure its sovereign risk with the World Bank arm known as Multi-Lateral Insurance Guarantee Agency.

    Select the correct statement using the code given below.

    Code:

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

21. Select the incorrect statement from the given list below—

    (a) The difference in returns of two different bonds is known as 'spread'.
    (b) Payment and delivery done simultaneously is known as 'spot'.

(c) Value of assets exceeding liabilities of an insurance company is called 'solvency margin'.
(d) Charging high prices on goods with high tax weights is a situation of 'skimming price'.

22. Consider the following statements.
    1. Expenditures done on advertisement, research and development are known as 'essential costs'.
    2. The costs which are borne on account of salaries, fringe benefits, pensions and provident funds are known as 'sunk cost'.

    Select the incorrect statement/statements using the code given below.
    (a) Only 1
    (b) Only 2
    (c) 1 and 2
    (d) None of these

23. Consider the following statements.
    1. 'Product swap' functions just opposite to the system of barter.
    2. 'Currency swap' is a mode of hedging against exchange rate fluctuations.
    3. 'Subsidy swap' is a method of cross-subsidising two products.

    Select the correct statement/statements using the code given below.
    (a) 1 and 2
    (b) Only 2
    (c) 2 and 3
    (d) Only 3

24. Consider the following statements.
    1. 'Market cost' is 'factory price' added with all the indirect taxes.
    2. 'Market cost' and 'ex-factory price' are different things.
    3. 'Maximum retail price' and 'market cost' are the same things.

    Select the correct statement/statements using the code given below:
    (a) Only 1
    (b) 1 and 2
    (c) Only 3
    (d) 1 and 3

25. What is the reason for the underdeveloped corporate bond market in the country.
    1. Predominance of bank loans
    2. Limited participation of FIIs in them
    3. Limited participation by pensions/insurance funds and households due to lack of investor confidence
    4. Crowding out by government bonds

    Select the answer using the code given below.
    (a) 1, 2 and 3
    (b) 2, 3 and 4
    (c) 1, 3 and 4
    (d) 1, 2, 3 and 4

Answer Key with Explanations

1. *(d)* The difference between an *operating company* and a *holding company* lies in the fundamental structures of the two, in their management and their interactions with one another. Business goals are often different, and both business types are after profits, but holding companies can still benefit from operating company losses under certain conditions. The primary function of a *holding company* is to invest in other companies, commonly known as subsidiaries. Holding companies are usually not involved in day-to-day operations of the operating company, but lend initial or ongoing financial support via cash reserves or stock sales, and may

assist in restructuring the operational model to ensure profits. Holding companies are normally structured as *corporations* (limited liability firms, i.e., known as a *Ltd.* company in India) to protect assets and absorb financial losses.

Operating companies are owned by the holding company, but are responsible for all day-to-day operations of the company. When a holding company creates or purchases an operating company, they are sometimes allowed to conduct business as usual, especially, if they are profitable. Net profits after expenses are then handed over to the holding company.

Ownership of operating companies, even when purchased, revert to the holding company. Former owners who are kept on-board are often given control of the operating company in the form of executive management responsibility, but have no ownership rights. All major decisions that may affect profitability or involve large expenditures must first be approved by the holding company.

Although operating company's *profitability* should make sense for the holding company, this is not always the case. Especially, for larger holding companies with heavy tax burdens, owning one or more operating companies that lose money can benefit the parent company in the form of a business loss when tax time rolls around. This does not benefit the operating company, as it is responsible for operating income to run the business. If the losses become too great, operating companies can go out of business, but the holding company can still benefit because the operating company can help to balance overall profits and stock prices.

2. *(d)* All are correct about the action of 'short selling'. Short-sellers basically speculate that prices of the short-selled shares will fall in future. Thus, they borrow those shares (it means they don't own it) and post profit. In case the prices increase in place of falling, the short-seller posts loss (as the borrowed shares are to be handed over to the original owner at a higher price now).

3. *(b)* They are registered with the Security and Exchange Board of India (SEBI) but they may be owned by a bank which is registered with the RBI. The shares they underwrite cannot be bought by them as an investment in the company—they only cover the risk (i.e., working as an insurer) of share sell (guaranteeing their complete sale) and charge a pre-agreed fee for it from the share-issuing company.

4. *(a)* This is known as the *'Walras's Law'* which is correct only in the case of a barter economy. This is so because the economies which have currency as a mode of exchange, currency supplies depend on so many factors and not on the level of the goods and services produced in the economy. The best example is shown by the instances of inflation.

5. *(a)* This is a strike which is not supported by the organised trade union of the firm. At times, such strikes may be supported by a trade union from outside.

6. *(a)* The 3rd statement is neutral to the issue of attracting foreign investment and its promotion. Once the domestic currency becomes fully convertible in the capital account such prohibitory laws are not possible—that is why India is believed to not allowing such convertibility at the full scale—as the economy does not want foreign exchange taking flight from the

economy (since it is itself trying to attract it).

7. *(b)* The Government of India also wants to do the same but its subsidy rationalising programmes have not taken place on expected lines.

8. *(a)* G-Secs are issued by the GoI through this route, too.

9. *(b)* Price of anything at current price has to be higher than its price at constant price as the former includes the weight of current inflation.

10. *(c)* Planning in India was already indicative, during reform period it became more so. Imperative policies are the symptom of 'target planning' popular among the State economies (in ex-USSR, China before they switched over to mixed economy). Planning of the mixed economies can only reach its goals once private sector is also included in the process—this requires provision of incentives and co-ordination by the government.

11. *(b)* These funds file lawsuits in London, New York, Paris and collect full face values plus interest of the national debts of the poor nations—many of the nations falling in the Heavily Indebted Poor Countries (HIPC). As per the IMF, these funds are concentrated in the US, UK as well as the British Virgin Islands (the UK protectorate tax haven). These countries have enough political pressure to ban these funds as their activities are against the soul of the foreign policies of the UK and US.

12. *(a)* 'Scrip shares' are given to the existing shareholders without any change and are also called 'bonus shares'. The shares given to employees (usually top officials) by a company without any charge is called 'sweat share'.

13. *(d)* In a 'public issue' the company does not negotiate directly with the public who want to purchase the shares.

14. *(c)* Public issue makes a company to broad-base its share-ownership, but this is a complex and time-consuming process. While private placement is the quickest method to raise capital from the security market, a company covers the risk of takeovers in it (due to shift in the share holders loyalties to a competing firm).

15. *(d)* The increase in international trade which results from the elimination or reduction of trade barriers (such as quota, customs, surcharge etc.), is 'trade creation'. Innovation is known as 'creative destruction' (the term was coined by the Australian economist J. Schumpeter).

16. *(b)* All loss-making activities done by the government in the head of social sector come under it—poverty alleviation, healthcare, education, social security etc.

17. *(a)* The IVCF was a public-owned Venture Capital Fund (VCF), set up in 1998. First such fund in India in which 'I' stands for IFCI (Industrial Finance Corporation of India, set up 1948), a Government of India's wholly-owned Specialised Financial Instituion (SFIs).

18. *(c)* Price-earning ratio of shares are calculated by dividing their market price by their earning per share.

19. *(d)* This is the another term for 'poverty trap'. Such situation arises in an economy where there are provisions of unemployment allowance—disposable income (income after paying direct taxes) becomes less than the allowance they get.

20. *(a)* World Bank arm, MIGA, provides insurance services, but to the companies which go for foreign direct investment; it covers non-commercial risk.

21. *(d)* 'Skimming price' is a mode of pricing when companies charge high profits on its products when consumers are not price-sensitive and demand is price-inelastic (prices not affecting the level of demand).
22. *(c)* The expenditure on the items discussed in Statement 1 are 'sink costs'. There is nothing like 'essential costs' in business economics.
23. *(b)* 'Product swap' is similar to barter while there is nothing like 'subsidy swap' in public finance management.
24. *(a)* 'Market Cost' and 'ex-factory price' are same things. 'Market cost' added with the traders margins and effect of the current inflation is 'maximum retail price' (MRP).
25. *(d)* These reasons have been cited by the *Economic Survey 2011–12* (p. 116). This is the first official document in recent times which has highlighted the immediacy of developing a healthy corporate bond market in the country.

Set- 6

1. Consider the following statements about an 'operating company'.
   1. They are owned by the holding company
   2. Are responsible for all day-to-day operations of the company
   3. Major decisions that may affect profitability are not taken by it
   4. Hands over net profits after expenses to the holding company

   Select the correct statements using the code given below.
   (a) 1, 2 and 3
   (b) 2, 3 and 4
   (c) 1, 3 and 4
   (d) 1, 2, 3 and 4
2. Select the statement which correctly defines the difference between 'factor cost' and 'factory price':
   (a) 'Factor cost' is the manufacturing price of any product, while the 'factory price' includes the burden of indirect taxes on the product, too.
   (b) While 'factory price' of a product includes the current rate of inflation, the 'factor cost' does not.
   (c) When the weight of the state taxes are added to the 'factor cost' it becomes 'factory price'.
   (d) None of the above
3. What is correct about the concept 'transfer earnings'?
   (a) The return that an asset must earn to prevent its transfer to the next best alternative use.
   (b) The private remittances' earnings of an economy with the help of the transferred part of income to it by its nationals living abroad.
   (c) The earnings companies get on their exports by drawing back the full amount of indirect taxes on the exported items popularly known as 'duty drawback scheme'.
   (d) The transfer of the earnings by one arm of a company from one economy to its other arm in another economy under the agreement of 'double taxation'.

4. Select the correct statement about the popular stock market term 'reverse yield gap' from the options given below:
   (a) A situation when the returns of government securities is in excess over the equities.
   (b) A situation when the capital gains compensate the negative impact of inflation on the equities' returns.
   (c) The instance of comparatively higher inflation which depletes the returns earned by investors on the government bonds.
   (d) The situation when due to low long-term capital gains tax, returns on the government securities become higher.

5. Consider the following statements.
   1. 'Liquidity trap' is a situation when people prefer to hold money rather than investing it.
   2. 'Liquidity preference' is the situation when people prefer to invest money rather than hold it.
   3. 'Liquidity crunch' is a situation of short-supply of money in the Money Market.
   4. 'Credit crunch' is a situation of short-supply of money in the loan market.

   Select the corrent statements using the code given below.
   (a) 1, 2 and 3
   (b) 2, 3 and 4
   (c) 1, 2 and 4
   (d) 1, 3 and 4

6. Consider the following statements. about the 'Lorenz curve'.
   1. A straight line on it represents complete equality of income.
   2. With greater curvature in it, inequality of income rises proportionally—this inequality is measured by the 'Gini Coefficient'.

   Select the incorrect statement/statements using the code given below.
   (a) Only 1
   (b) Only 2
   (c) Both 1 and 2
   (d) Neither 1 nor 2

7. What does the term 'Ninja' mean which became a common word in the financial world after the US sub-prime crisis?
   (a) A loan given on false claims of credit-worthiness by the banks.
   (b) Borrower with no assets, no income or no job
   (c) Highly competitive form of lending, compromising the financial fundamentals.
   (d) A loan given to someone who is on the brink of bankruptcy.

8. Select the correct statement about MIBOR (Mumbai Inter Bank Offer Rate) out of the following list—
   (a) This is the weighted average interest rate at which certain banks/institutions in Mumbai are ready to borrow from the Call Money Market.
   (b) This is the weightage average interest rate at which certain banks/institutions inMumbai are ready to lend long-term money.
   (c) This is the weighted average interest rate at which certain banks/institutions in Mumbai are ready to lend in the Call Money Market.
   (d) This is the weighted average interest rate at which certain banks/institutions

areready to borrow from the long-term market.

9. Consider the following statements about 'Pareto Optimality'.
   1. It deals with distribution in an economy at the optimum level of taxation prevailing in the economy.
   2. It suggest that in an economy somebody may be made better off by making somebody else worse off.
   3. The idea works as a guide to finance managers in deciding how to spend limited funds.

   Select the correct statements using the code given below.

   Code:

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

10. Consider the following statements about the 'penny stocks'.
   1. The shares listed on a stock exchange which show high market capitalisation with relatively low volume of shares.
   2. The shares which are issued at a par value of rupee one.
   3. Their trading price shows high volatility.

   Select the incorrect statements using the code given below.

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

11. Consider the following statements about a 'preference share' in India.
   1. These shares bear a stated dividend
   2. They get priority over equity shares
   3. Such shares can be issued for a period of less than 1 year.

   Select the correct statements using the code given below.

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

12. What is correct about a 'hybrid security'?
   (a) A collateral which has the traits of movable and immovable properties—used in banking business
   (b) A stock which has qualities of equity shares as well as bond—used in the stock market
   (c) A lump sum trade conducted in the commodity exchanges in bullion and agricultural produced—allowed in India
   (d) None of the above

13. Select the correct statement about the 'P/E Ratio' from the following list—
   (a) A stock market terminology which is derived by dividing market price of a share by earning per share.
   (b) A ratio used in stock market to show the denomination paid by a company per share in relation to issue price of the share.
   (c) A ratio of the dividends of two consecutive years on a particular share paid by a listed company.
   (d) None of the above

14. Which one of the following decisions follows the idea of 'prisoner's dilemma'?
   1. Companies fixing prices of their products at the levels less than they

could in the trust that other companies do not fix lower prices.

2. The dilemma, ultimately, hampers the companies which fixes the higher prices.

Select the answer using the code given below.

Code:

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

15. Which of the following defines an economy in the situation of a 'population trap'?

(a) When the population control policies of the economy almost fail and it goes for a situation of population boom.
(b) When the population of an economy starts increasing after achieving the stage of 'replacement level'.
(c) When the 'natural rate of increase' in an economy starts falling drastically below the 'replacement level'.
(d) None of the above

16. Select the correct situation which defines 'poverty trap'—

(a) When the population in an economy continues to remain poor even after increase in its 'nominal income'.
(b) When the rise in income of the poor people is equitably neutralised by inflation.
(c) When unemployment rate starts increasing together with the inflation.
(d) When unemployed population getting unemployment allowance does not feel encouraged to become employed.

17. Consider the following statements about 'predatory pricing'.

1. Fixing of exceptionally high prices by the companies for their goods
2. Such pricing policy has an express purpose of harming rivals or exploiting the consumer.

Select the correct statement/statements using the code given below.

Code:

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

18. Which of the following is correct about 'high street banking'?

(a) When banks emphasise retail lending.
(b) When banks emphasise corporate lending.
(c) When banks emphasise long-term but risk-free lending.
(d) When banks emphasise short-term, low interest and risk-free lending.

19. Consider the following statements.

1. The paid-up capital of a company is never more than its authorised capital
2. The issued capital of a company can be maximum upto its authorised capital
3. The subscribed capital of a company can never be higher than its issued capital

Select the correct statements using the code given below.

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

20. Consider the following statements.

1. A situation when people think that they are getting richer during the

times of inflation is known as 'money illusion'.

2. It is believed that lower levels of 'money illusion' are beneficial to 'grease the wheels' of the economy.

Select the correct statement/statements using the code given below.

Code:

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

21. 'Bad' money forces 'good' money out of circulation—proposes the Gresham's Law.

1. it analyses the circulation of 'black' money in the Indian economy—usually getting deposited in the tax havens through hawala route.
2. the Chinese currency Yuan headed to replace the dominance of the US dollar in the world foreign exchange market.

In light of the law select the incorrect statement/statements given above using the code below.

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

22. What does a 'J-curve effect' mean in the area of foreign exchange management?

(a) A deficit in BoP is followed after devaluation before posting surplus.
(b) Though foreign exchange earnings of an economy in primary anticles are lower, they are consistent.
(c) All transactions outside a stock exchange get accounted once the stock exchange opens the next day follows a J-curve.
(d) None of the world economies are as expert at managing their foreign exchange as one preceding successful economy.

23. Consider the following statements about 'earth trilemma'.

1. For economic development world needs increased energy expenditure but thisraises the environmental issues
2. The 'EEE' trilemma is synonymous to it
3. Without limiting the levels of consumption, earth as a system, can not sustain
4. Three issues need attention to sustain the earth—low consumption, high saving and an attitude of conservation

Select the correct statements using the code given below.

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

24. Which of the following is correct about the 'impossible trinity'?

(a) A country can not maintain all three policy goals—stable financial market, global integration and stable exchange rate.
(b) A country can not maintain all three policy goals—free capital flows, a fixed exchange rate and an independent monetary policy.
(c) A country can not maintain all three policy goals—stable exchange rate, global integration and continuous economic growth.
(d) A country can not maintain all three policy goals—small fiscal deficits,

social welfare and high economic growth.

25. Consider the following statements.
    1. Brown Label ATMs are intermediate between bank-owned ATMs and White Label ATMs.
    2. Brown Label ATMs are part managed by the concerned bank and part by third party.
    3. Brown Label ATMs carry the 'logo' of the concerned bank unlike the White Label ATMs which carry their own logo.
    4. Banks have seen fall in their operational cost but increased risk in India.

    Select the correct statements using the code given below.

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

Answer Key with Explanations

1. *(d)* For detailed explanation on the 'holding' and 'operating' companies, see the Answer of Qs. 1, Set- 5.
2. *(d)* 'Factor Cost' and 'Factory Price' mean same thing—the cost of all inputs which are needed to produce a product (such as raw material, labour, power, interest, rent, maintenance, etc).
3. *(a)* Any earning above the 'transfer earning' is known as its 'economic cost'.
4. *(b)* Such a situation arises during the periods of high inflation—because equities provide capital gains which compensate the negative impact of inflation on them while government securities do not get this advantage. This is why during higher inflation it is suggested to invest in equities rather than government bonds (provided the security market in healthy mode).
5. *(c)* 'Liquidity trap' and 'liquidity preference' are used synonymously. Liquidity crunch is short-supply of money in the money as well as capital market.
6. *(d)* The 'Lorenz Curve' is a graphical representation of wealth distribution (US economist Max Lorenz, 1905) in which a straight diagonal line represents perfect equality of wealth distribution—the Lorenz curve lies beneath it, showing the reality of wealth distribution. The difference between the straight line and the curved line is the amount of inequality of wealth distribution, a figure described by the Gini coefficient. The curve is used to show what percentage of a nation's residents possess what percentage of that nation's wealth.

   'Gini Coefficient' (developed by the Italian Statistian and Sociologist, 1912) measures the inequality in income in an economy (also known as the Gini index or Gini ratio). This is a measure of statistical dispersion intended to represent the income distribution of a nation's residents. This measures the inequality among values of a frequency distribution (for example levels of income)—a Gini coefficient of zero expresses perfect equality, where all values are the same (for example, where everyone has the same income) while a Gini coefficient of one (i.e., 100 per cent) expresses maximal inequality among values (for example, where only one person has all the income). However, a value greater than one may occur if some persons represent negative contribution to the total (e.g., have negative income or

wealth). For larger groups, values close to or above 1 are very unlikely in practice. This is commonly used as a measure of inequality of income or wealth.

7. *(b)* Banks require the borrower to show a stable income source or sufficient collateral, a 'ninja loan' ignores the verification process. A ninja loan is often found in the mortgage market. In such loans, generally, interest rate initially remain lower and is increased later. Such borrowers hope to pay their loan once their property appreciate. But in case if the property doesn't appreciate, many borrowers default repayments. This why such loans are very risky for lenders.

8. *(c)* This rate is tracked by the borrowers across India who keep operating in the 'working capital market'.

9. *(b)* The concept is not connected to taxation. This idea of the Italian economist Vilfredo Pareto (1843–1923) suggests that 'nobody can be made better off without making someone else worse off'.

10. *(d)* They are low-priced shares of small companies with very low market capitalisation. They were in news recently as some of such shares did show high rise in their trading prices on the security bourses.

11. *(a)* Such shares may get dividend even if the company has gone in loss and they are issued for a period upto 10 yrs.

12. *(b)* Mutual fund companies offer such stocks—some part of money is invested in share market and the debt market—such option is known as a 'balance fund'.

13. *(a)* Investors in share market take their investment decisions after analysing the 'P/E Ratio' (Price-Earning Rato) of different shares in the market—this is the ratio of the share price and its earning (dividend).

14. *(a)* This is a famous example in the 'game theory' which concludes that why co-operation is difficult to achieve even if it is mutually beneficial, ultimately making things worse for the parties involved.

15. *(d)* This is a situation of population growth rate (i.e., natural rate of increase) greater than the achievable growth rate in the economy.

16. *(d)* Such situations occur since the after tax income (i.e., disposable income) turns out to be less than the benefit of the unemployment allowance.

17. *(b)* Exceptionally low prices are fixed by the firms under such pricing policy which has the objective of harming and finally eliminating rivals from the market—when they have monopolistic presence in the market they start exploiting the consumers.

18. *(a)* This is another term for 'retail lending'—in such lending, banks forward a large number of loans to individual borrowers rather than putting the same money to a few corporate (non-individual i.e. group) borrowers—though the former is more risky and cumbersone, too.

19. *(d)* The limit upto which shares can be issued by a company is upto its authorised capital (the capital which is written in its Article of Association).

20. *(c)* The phrase was coined by the economist J.M. Keynes.

21. *(c)* The Law proposed by Sir Thomas Gresham (an advisor to Queen Elizabeth—I of England) does not deal with 'black', 'white' or any weakening world currency, nor it is correct in the case of paper currencies. The law is

correct once metallic currencies are in circulation which have proportional intrinsic value—such currencies are hoarded (as in the case of price rise).

22. *(a)* This theory states that a country's trade deficit will worsen initially after the depreciation/devaluation of its currency because higher prices on foreign imports will be greater than the reduced volume of imports. The effects of the change in the price of exports compared to imports will eventually induce an expansion of exports and a cut in imports—which, in turn, will improve the balance of payment situation.

23. *(a)* The 'EEE' trilemma is also known as the 'Earth Trilemma' which says that for economic development, mankind needs to increase energy consumption but this accelerates environmental degradation. In a sense, energy model needs re-thinking.

24. *(b)* This remains the prima donna of all 'trilemmas' articulated by the economists. This is also known as 'Mundell's Impossible Trinity' which has strong theoretical foundations in the Mundell-Fleming Model developed in 1960s.

25. *(a)* In case of the *Brown Label ATMs (BLA)* banks only handle part of the process (cash handling and back-end server connectivity) while the ATM machine is owned by the third party along with the physical infrastructure—they carry the 'logo' of the bank.

The *White label ATM's (WLA)* are fully managed by third party service providers (and they have their own label i.e., 'logo'—for example, in case of the Tata-launched Tata Communications Payment Solution carry their logo—'Indicash'. These are branded non-bank ATM machines. Cash handling, management and logistics are provided by third party. Debit cards of all banks can be operated through these machines. The role of the concerned bank is only limited to provided account information and back-end money transfers.

CHAPTER

24

MODEL ANSWERS* TO SELECTED QUESTIONS

*Reading maketh a full man; conference a ready man; and writing an exact man.***

** The answers given to some of the questions may be comprehensive. Readers are suggested to cut it short as per the requirement of the question. Questions in the civil services examination are generally asked in parts, i.e., budgetary measures, monetary measures, administretive measures etc.*

*** Francis Bacon (1561-1626), 'Of Studies' **Essays**, London, UK, 1625.*

Q. 1 Briefly highlight the major reasons for recent upsurge in the NPAs of the public sector banks and also describe the steps taken by the RBI to check them.

Ans. An upsurge has been seen in the non-performing assets (NPAs) of the public sector banks in the past few years. As per the official sources (Economic Surveys), the main reasons for this unpsurge have been as given below—

(i) Switchover to system-based identification of NPAs;

(ii) Current macroeconomic situation in the country;

(iii) Increased interest rates in the recent past;

(iv) Lower economic growth; and

(v) Aggressive lending by banks in the past, especially during good times.

The RBI came out with a **new guidelines** to resolve the NPA issue by ealry 2014. The steps taken under it are:

(a) Banks have to start acting as soon as a sign of stress is noticed in a borrower's actions and not wait for it to become an NPA. Banks to carve out as special category of assets termed special mention accounts (SMAs) in which *early signs* of stress are visible.

(b) Flexibility brought in project loans to infrastructure and core industry projects, both existing and new.

(c) *Non-cooperative* borrowers in NPAs resolution will have to pay higher interest for any future borrowing. Banks will also be required to make higher provisions for further loans extended to borrowers who are considered to be 'non-cooperative'.

(d) Towards strengthening recovery from *non-cooperative borrowers*, the norms for asset reconstruction companies (ARC) have been tightened, whereby the minimum investment in security receipts should be 15 per cent, as against the earlier norm of 5 per cent.

(e) Independent evaluation of large-value restructuring (above Rs. 500 crore) made mandatory.

(f) If a borrower's interest or principal payments are overdue by more than 60 days, a *Joint Lenders' Forum* to be formed by the bankers for early resolution of stress.

(g) The RBI has set up a central repository of information on large credits to collect, store and disseminate credit data to lenders. For this, banks need to furnish credit information on all their borrowers with an exposure of Rs.5 crore and above.

(h) Incentives to banks to quickly and collectively agree to a resolution plan.

Q. 2 Write a note on the current policy regarding the use of disinvestment proceeds and also justify the same.

Ans. The current policy regarding the use of the disinvestment proceeds are of January 2013. The proceeds of disinvestment proceeds with effect from the fiscal year 2013–14 are credited to the existing *'Public Account'* under the head NIF and they remain there until withdrawn/invested for the approved purpose—to be decided by the Union Budgets. Currently, the proceeds are used for the following purposes:

(i) Subscribing to the shares being issued by the CPSE including PSBs and Public Sector Insurance Companies, on *rights basis* so as to ensure government ownership in them at 51 per cent.

(ii) *Recapitalization* of public sector banks and public sector insurance companies.

(iii) Investment by Government in RRBs, IIFCL, NABARD, Exim Bank;

(iv) Equity infusion in various Metro projects;
(v) Investment in Bhartiya Nabhikiya Vidyut Nigam Limited and Uranium Corporation of India Ltd.;
(vi) Investment in Indian Railways towards capital expenditure.

Disinvestment proceeds now getting used for capital expenditures looks quite justified. Disinvestment is actually sale of assets and its proceeds should be used to create again assets.

Q. 3 Write a note on the official criteria regarding the term 'willful defaulter' and also discuss the regulatory norms which apply on such individuals/ entities.

Ans. There are many individuals/entities who borrow money from lending institutions but fail to repay. However, not all of them are called wilful defaulters. As per the provisions of the RBI, a wilful defaulter is one who does not repay a loan or liability, but apart from this there are other things that define a wilful defaulter—

(i) Who is financially capable to repay and yet does not do so;
(ii) Or one who diverts the funds for purposes other than what the fund was availed for;
(iii) Or with whom funds are not available in the form of assets as funds have been siphoned off;
(iv) Or who has sold or disposed the property that was used as a security to obtain the loan.

Diversion of fund includes activities such as using short-term working capital for long-term purposes, acquiring assets for which the loan was not meant for and transferring funds to other entities. *Siphoning of funds* means that funds were used for purposes that were not related to the borrower and which could affect the financial health of the entity.

If an entity's or individual's name figures in the *list of wilful defaulters*, the following restrictions get in action on them—

(a) Barred from participating in the capital market.
(b) Barred from availing any further banking facilities and to access financial institutions for five years for the purpose of starting a new venture.
(c) The lenders can initiate the process of recovery with full vigour and can even initiate criminal proceedings, if required.
(d) The lending institutions may not allow any person related to the defaulting company to become a board member of any other company as well.

Q. 4 Write a shot note on current situation of the capital adequacy of public sector banks and also discuss the government's attempts to make them compliant to the Basel III norms.

Ans. The capital to risk weighted assets ratio (CRAR) of the scheduled commercial banks of India was 13.02 per cent by March 2014 (Basel-III) falling to 12.75 per cent by September 2014. The regulatory requirement for CRAR is **9** per cent for 2015. The decline in capital positions at aggregate level, however, was on account of deterioration in capital positions of PSBs. While the CRAR of the scheduled commercial banks (SCB) at 12.75 per cent as of September 2014 was satisfactory, going forward the banking sector, particularly PSBs will require substantial capital to meet regulatory requirements with respect to additional capital buffers.

In order to make the PSBs and RRBs compliant to the *Basel III* norms, the government

has been following a recapitalisation programme for them since 2011–12. A *High Level Committee* on the issue was also set up by the government which has suggested the idea of 'non-operating holding company' (HoldCo) under a special Act of Parliament (action is yet to come regarding this).

Meanwhile, the government has infused ***three tranches*** of capital into the banks (infused funds go to the RRBs, too through the PSBs under whom they fall) upto March 2015:

(i) Rs. 12,000 crore infused during 2011–12 in seven PSBs.

(ii) Rs. 12,517 crore infused in 2012–13 in 8 PSBs.

(iii) Rs.6,990 crore infused in **nine** PSBs by February 2015. But this capital infusion is based on a new criteria—efficiency parameters such as return on assets and return on equity—efficient banks rewarded with extra capital for their equity so that they can further strengthen their position.

In **March 2015**, the GoI specified its intention to bring down its stake in state run banks to 52 per cent to give them more avenues to raise funds, most banks are expected to approach the market to raise capital only next fiscal once the share market get some synergy.

Q. 5 Briefly discuss the concept 'Divisible Pool' regarding the devolution of resources by the Fianance Commission and also highlight the changes which occured in it in recent times.

Ans. The 'Divisible Pool' is that portion of gross tax revenue which is distributed between the Centre and the States. The divisible pool consists of all taxes, except surcharges and cess levied for specific purpose, net of collection charges.

Before the 80th Constitution Amendment (2000), the sharing of the Union tax revenues with the states was in accordance with the provisions of articles 270 and 272, as they stood then. This amendment altered the pattern of sharing of Union taxes in a fundamental way—dropping the Article 272 and substantially changing the Article 270. The new Article 270 provides for sharing of all the taxes and duties referred to in the Union List putting all in a 'divisible pool'. There are some exceptions to it—the taxes and duties referred in the Articles 268 and 269 of the Constitution, together with surcharges and cesses on taxes and duties (referred in the Article 271) and any cess levied for specific purposes—do not fall under this 'pool'.

The new arrangement of tax devolution came as a follow-up to the recommendations of the 10th FC (1995–2005) which the FC termed as the 'Alternative Method of Tax Devolution' (AMD). A concensus between Union and States was a advised by the FC for such an arragnement to be effected. States were going to get extra 5 per cent share in the Union taxes in the AMD, thus, a serious demand came from them—ultimately, the AMD was accepted by the Centre. To make the AMD irreversible, the GoI went for the 80th Amendment in the Constituion.

Q. 6 Write a short note on the revised liquidity management framework (LMF) put in place recently by the RBI. Also describe the rationale behind this revision.

Ans. In August 2014, the RBI announced a revised Liquidity Management Framework (LMF) Major features of the LMF is as given below:

- RBI started conducting 14-day *term repurchase* auctions four times a fortnight, up to an aggregate amount equal to

0.75% of the system's deposit base or net demand and time liabilities (NDTL).

- Unlike earlier, RBI has announced a fixed schedule for these 14-day *term repo* operations, which are used by banks for their day-to-day liquidity requirements. One-fourth of the total amount of 0.75 per cent of NDTLs would be put up for auction in each of the four auctions, RBI said in a statement.
- No change in the amount that banks can access from the liquidity adjustment facility (LAF) window at fixed repo rate of the time. Banks are currently allowed to borrow up to 0.25 per cent of their deposit base or NDTL from the LAF window.
- Additionally, RBI conducts overnight variable rate repo auctions based on an assessment of liquidity in the system and government cash balances available for auction for the day.

The revised policy framework has been put in place to check volatility in the inter-bank call money markets, where banks lend to each other, and also allow the lenders to manage their liquidity needs better. Better interest signalling and medium-term stability in the loan market are other objectives of it.

Q. 7 What are tax-havens and how are they promoting corruption in India?

Ans. 'Tax havens' are nation-states or dominions imposing low or no taxes on personal and corporate incomes, and as a consequence tend to attract wealthy individuals and corporates seeking to minimise their tax liabilities. Other than saving taxes these havens are also used as a safe hub for parking **'black money'** created in different countries. As per the data of the OECD, there are at present over 70 such destinations in the world—popular ones are British Virgin Islands, Cayman Islands, Cook Islands, Dubai, Isle of Maw, Liechtenstein, Marshall Islands, St. Kitts and Nevis, Switzerland, Marritius, US Virgin Islands etc.

The tax havens are promoting corruption in India in so many ways:

(i) They have emerged safe hubs for parking money earned in India.

(ii) As there are such parking centres, the black money individuals and corporates make in India, are easily hidden with no risk of getting caught.

(iii) Many Indian corporates have their operations in such places which they use for transfer pricing.

(iv) The parked funds get back to India in the form of 'hedge funds' destabilising the economy.

(v) As corruption is supposed to be very high in India, even politicians are believed to park their black money.

(vi) They accelerate hawala, bribery etc., in India.

Recently, we have seen some effective actions being taken by the victim nations to unearth their funds parked in these havens such as the USA, Germany and many of the OECD nations. The Government of India has also started such initiatives recently.

Q. 8 Write a note on the changing dimensions of planning in India.

Ans. In the past one and half decades, we have seen great changes taking place in the process of planning in India. We may analyse the changes according to the below broad classifications:

(i) *Phase-I (1991–2002):* As India moved towards the era of economic reforms, the major change the government

announced was the greater participation of the private sector in the developmental process and the nature of planning tilted more towards *indicative* planning—every new year has been a movement in this direction.

(ii) *Phase-II (Post 2002):* As the Tenth Five year plan (2002–07) commenced, we saw many important changes taking place in the nature of planning—major ones are as given below:

(a) *A serious mention* of the role of the states in the process of planning—a complete departure from the past. Statewise growth targets worked in consultation with states, are clear pointers. "Unless states achieve their targets, nation can't achieve its target", says the plan. Planning heading towards real kind of *decentralisation* (73rd & 74th constitutional amendments were forcing it also).

(b) *Governance* has been recognised as a factor of development—the Plan suggests serious attempts in this direction.

(c) The Plan is now implemented with special reference to economic reforms with the help of the steering committee.

(d) Planning Commission now monitors the progress of various central ministries.

(e) Agriculture sector declared as the *prime moving force* of the economy; governmental investment and attention tilting towards this sector after almost fifty years of the industry's dominance as per Amartya sen's suggestions.

(f) The changes in the view of planning are so pronounced that the government has declared the Plan to be a *'reform plan'*. This Plan really intends to reform the way we plan.

Q. 9 'Economic reforms with a human face'. Examine the rationale behind it and the possible outcomes.

Ans. The UPA Government announced its committment to economic reforms, with this sentence and the proverb got media attention. The political elite looks convinced today that the process of economic reform has not been able to take care of the masses, thus the future of the process will focus on it.

Economic reform with a human face is no empty rhetoric as it is based on stark realities and sound logic. As we know, in the era of reforms, the economy is moving towards a market economy in which demand/supply and price mechanism plays the main role. As vast sections of the population lacks the desired level of purchasing power, the process looks 'anti-poor' and consequeafly 'pro-rich'. Such reform processes might bring higher economic growth, but for equitable development, a conscious attempt for *inclusive growth* is essential.

The masses who lack the real level of purchasing capacity, should be supplied with subsidised goods and services till micro-level growth takes place. This is why the government is emphasising upon the *social sector* and enhancing its expenditure on the delivery of the so-called 'public goods' (education, water, healthcare, shelter etc.).

However, analysts have cautioned the government that such policies are going to hamper growth and to increase fiscal deficit which will ultimately hurt development. But, till the poor are capable of taking on the market forces, the economy has to bear some cost. To sum up,

we need growth for all—development and growth must be distributive; the Directive Principles of State Policy in our constitution envisions the same idea.

Q. 10 Write a note on the present situation regarding current and capital account convertibility of rupee.

Ans. In the Union Budget 1992–93, the liberalised Exchange Rate Mechanism scheme (LERMS) was announced. Since then, India has always been moving ahead in the direction of greater rupee convertibility, which may be seen as given below:

(i) In August 1994, rupee became **fully convertible** in the current account.

(ii) In August 1994, the rupee became **partially convertible** in the capital account (60:40).

(iii) The current policy regarding the capital account convertibility in India stands as given below:

(a) Rupee got full convertibility on Indian corporate's proposal of foreign investment upto US$ 500 million—put in automatic route approval.

(b) Rupee became fully convertible in case of corporates intending to prepay their external commercial borrowings (ECBs) above US$ 500 million—automatic route.

(c) In August 2007, the government allowed individuals to invest abroad with an upper limit of US$ 20,000 per year.

As India is becoming self-dependent in earning foreign exchange, we may hope that in the near future, the government might be announcing rupee's full convertibility in the capital account. India's cautious moves towards full capital account convertibility has been appreciated by the IMF.

Q. 11 What is the term 'balance of payment'? Write a note on recent policies regarding BoP management in India.

Ans. Balance of Payment or BoP is the overall *statement* of a country's economic transactions with the rest of the world over a period, generally a year. The statement shows receivings from the world and the payments to the world basically shown in the current and the capital accounts. This statement is based on the principles of *accounting*—similar to the *balance sheet* of a company. It might turn out to be positive or negative. If it is negative and the economy is incapable to pay it, this is known as a BoP crisis. In such situations, the IMF remains as the last source of rescue.

- India had to rely on emergency operations from abroad to cope up with periodic BoP crises in 1973, 1979, 1981, and 1991. But after the economic reform process started, the situation started to improve.

As India started 'opening up' after 1991, as the part of the external sector reforms, its BoP has become *favourable* with each succeeding year. *Major policies* in this direction could be summed up as given below:

(i) Steps in the direction of opening the economy for healthy levels of foreign investments (FIs)—FDI as well as the (FIIs).

(ii) Optimum levels of convertibility to rupee in the current and the capital accounts.

(iii) Accelerated disinvestment of the prospective PSUs, including 'strategic sale' to the foreign bidders, too.

(iv) Follow up of LERMS (Liberalised Exchange Rate Mechanism System) in 1992–93.

(v) Modifications in FERA–FEMA

(vi) Prudential management of the financial market with inputs of the required kind

of reforms—money market, banking, insurance, stock markets etc.

(vii) Required kind of trade policy etc.

Q. 12 Write a note on the role played by the stock market in the development of the economy in India.

Ans. Aspirations of higher development could only be possible once higher growth rate is maintained. For higher growth rate, we need higher investment. As India had earlier opted industry as the 'prime moving force' of the economy, the fund was managed by 'project financing' institutions. When banks managed to make their presence felt, they also started providing the investible funds. But the most attractive investible fund, i.e., fund made available by the stock market, was not playing any supportive role, as this was not organised. With the help of the conscious efforts made by the successive governments since 1992, Indian stock market has been able to make its presence felt around the world.

The Indian stock market is one of the fastest growing stock market in Asia. Its representative share index has crossed 20,000 mark (sensex). The booming stock market is helping the economy in many ways:

(i) India is becoming less dependent on institutional project financing for investible funds.

(ii) Stock market is not only able to manage investible funds, but is increasing our forex receipts also. The government is trying to make it more lucrative by further liberalisation in the Portfolio Investment Scheme (PIS).

(iii) People's participation in growth and development is increasing day by day.

(iv) Stock market has emerged as the new route to manage investible funds.

This is how stock market has emerged as the most attractive route to manage investible funds and sustained growth rate. Naturally it has emerged as the 'new *mantra*' of growth and development.

Q. 13 Write a note on the logic behind increasing government emphasis on the social sector.

Ans. India's expenditure on the social sector has been rather poor (at 1.5 per cent of GDP) upto 1991, in comparison to the South East Asian economies (15 per cent of GDP since mid-1960s). This was basically responsible for the wretched state of education, healthcare, nutrition, drinking water etc. Once India started economic reforms, the attitude towards its social sector expenditure went for a re-orientation.

As government's role in the economy started shrinking and the nature of planning started shifting more in favour of the 'indicative' kind – emergence of the market economy—the people having lower purchasing capacity were badly hit. In this milieu, the government since then, has shown serious resolve regarding strong social sector and increasing emphasis on this sector, specially education and health.

The idea of common minimum programme had a direct bearing on the social sector and ultimately got a new target-oriented meaning in the UPA government (National Common Minimum Programme). At present the government is giving top priority and increased emphasis to this sector in the following manner:

(i) Poverty alleviation (nutrition) got a new meaning in the NREGA.

(ii) Health is getting a hefty part of the government expenditure.

(iii) Drinking water programmes being run under the targets of the Planning Commission, which are easy to monitor.

(iv) Education (specially primary one) getting more emphasis.

(v) All programmes targeting quality improvement in the lives of the poor people are being synchronised and are more focused now.

Q. 14 Write a short note on the new ideas promoted by the Twelfth Finance Commission in the area of fiscal management.

Ans. The President has been asking all finance commissions (FCs) to advise on the issue of deteriorating fiscal situation of the economy (Centre's as well as states') since the Tenth FC. Though the Centre has tried to improve its fiscal situation via many tools since then, there has been almost no major step taken to do the same in the case of states—their situation had worsened throughout the 1990s. The recommendations of the Twelfth FC are considered as a watershed example in this regard, which could be considered as the new ideas pointing towards fiscal prudence among states:

(i) *Consolidation of state loans:* The commission recommends that once the states pass their Fiscal Responsiblity Acts (FRAs) (on the lines of the Centre's FRBM Act) their loans raised upto March 31, 2004 would be converted into fresh loans for a further 20 years, that too on a cheaper interest rate of 7.5 per cent p.a. (This would cost the Centre Rs. 30,000 crores).

(ii) *Incentive for cut in the revenue deficit:* The amount by which states cut their revenue deficit would be written off by the Centre from their borrowings.

(iii) *Freedom for market borrowings:* Once states start with FRAs, they would be allowed to manage a part of their planned expenditure via market borrowings. This is supposed to bring in fiscal prudence among the states.

States have started following the new ideas suggested by the FC and enacted by the Centre. In this way the historic FRBM Act is getting a new meaning in the economy. At the same time, the complaint of states that they are dependent on central funds is also on the wane.

Q. 15 Write a note on the benefits of the VAT to the Indian economy.

Ans. Value Added Tax (VAT) is an indirect tax to be collected at all those points where value is added to a product. It has the following positive impacts on the economy:

(i) Due to differentiation among the states regarding the rates of sales tax, India was having differentiated market prices, this tax will bring in 'uniformity' in the market.

(ii) Since this tax is imposed at different points of the value addition chain, it does not impose tax upon tax; that's why there won't be any 'cascading effect' of tax on inflation.

(iii) this will automatically check the evasion of the sales tax.

(iv) This is a pro-poor tax without being anti-rich.

(v) This will enhance production levels as prices go down and cousumption increases.

(vi) Supportive to the economic growth.

(vii) It will increase the tax revenue of the states.

(viii) It will become easier to attain fiscal responsibility for the economy.

Q. 16 Write a note on the prospects and challenges to Indian agriculture in the WTO regime.

Ans. As the provision of the WTO came into effect, experts rightly visualised great prospects and at the same time some serious challenges for the Indian agriculture sector. As far as the extent of the prospects are concerned, immense export potential is visible in the following areas:

(i) Cotton textile, yarn, readymade garments, etc.

(ii) Agricultural products, cereals, fishery products and forest goods.

(iii) Processed foods, beverages, and soft drinks. A joint projection of the OECD and the GATT did put an increase in the world merchandise trade by US $745 billion upto 2005 once the WTO provisions get implemented. As per the projection, 99 per cent of this trade almost falls in the agriculture sector. As India has been an agrarian economy and enough prospects for agricultural expansion are possible, it can encash this opportunity (NCAER survey supported this in 1993–94).

We may see the possible major challenges in the WTO regime:

(i) *Food self-sufficiency:* As cheaper food-grains will have unrestricted flow into India, we might become almost dependent upon import supplies for our food requirement—our self-reliance is badly threatened.

(ii) *Price-stability:* The price stability aspect of agricultural products, specially the sensitive foodgrains, will be in great risk as fluctuations in the imports are natural (agriculture being highly prone to weather and climatic variations) hurting the poor people.

(iii) *Cropping pattern:* Cropping pattern of India might go in for a major shift in favour of profitable crops threatening the fragile ecosystem and the balance of biodiversity.

All the above given challenges could be dealt with the suitable type of timely agricultural and trade policies—but WTO provision does not give such kind of sovereign choices to its member countries. It means we need to go for flexibility in the provisions of the WTO.

(iv) *Weaker sections:* Weaker sections of the society will again miss the train of globalisation for their upliftment as the process of globalisation is not neutral to area, crop and the individual. We will need a more focussed distributive kind of economic policies to do it.

(v) *Commitments towards the WTO:* Our agricultural subsidy cannot cross the 10 per cent mark of the agricultural GDP, any year. Though this is still not alarming, the higher subsidies forwarded by the USA and the EU is diluting the competitiveness of Indian agricultural goods—the 'Blue Box' and the 'Green Box' subsidies need redefinition immediately.

Conclusion: Visualising the emerging challenges to the agriculture sector of the developing countries, like-minded nations came together (G-22) and tried to go for a justified change in the provisions of the WTO—Seattle, Doha, Cancun, and Hong Kong. Agriculture was the most important issue because of which the important ministerial conference at Seattle failed. At the Hongkong conference in December 2005, an agreement on the withdrawal of agricultural subsidies by the Euro-American countries came as a help. The 7th WTO Ministerial meeting held in Geneva from November 30–December 3, 2009 provided

for different groups and caucuses to access the direction of the negotiations.

Q. 17 'Hedge funds and black money in India's economy look intertwined'. Comment.

Ans. Hedge Funds are privately owned huge external funds with swift movement tendencies dedicated to minimise the financial risks of external investments. Every economy with high growth rate as well as a vibrant stock market is a possible destination for it. As per a recent IMF report, such funds together amount to over US$1,500 billion. Attractive foreign investment policies of the countries are the main reasons for their inflows, provided there is liberal outflow policies too.

In the case of India, these funds have been blamed to generate black money, by the experts. The government has also taken steps to reign them. The main instrument via which these funds look intertwined with the generation of black money in India has been the 'participatory notes' (PNs) through which an FII may invest into India's share/stock market without disclosing the source of the funds to SEBI. Similarly, Overseas Derivative Instruments (ODIs) are other routes frequently used by the 'Hedge funds' to channelise black money into India, which are kept overseas in major tax-havens. Finally, these funds are not only giving Indian black money a legal re-entry, but also a route to finally exit India.

Q. 18 Write a note on the role of the states in the ongoing process of economic reforms.

Ans. Economic reforms started in 1991–92, but the benefits to the states and the masses looks unbalanced.

Reasons and Solutions

(i) Due to the special federal structure of India, economic reforms though well-started by the Union, could not be complemented by the states.

(ii) A certain degree of working and effective political and financial autonomy are desirable for the states so that they may move towards reaping the fruits of the reform process.

(iii) Lack of political coordination as well as cooperation between the goverments at the Centre and the states.

(iv) Process of reform should have been initiated by the states and facilitated/ supported by the Centre (Union Budget 2002–03 already announced it for future reforms).

(v) The design and centralising nature of the Planning Commission need a change in favour of greater participation from the states so that the deteriorating regional disparities in the reform period (over one and half decades) could be checked (such a change was initiated with the Tenth Plan).

(vi) Panchayati Raj Institutions (PRIs) should be given effective powers by the states so that the benefits could reach the masses via mass participation.

(vii) Streamlining of the rules and regulations from the Centre to the states.

(viii) Better governance, check on the menace of corruption, legal reforms, infrastructure support etc.

(ix) The Twelfth Finance Commission has provided the states greater financial leverage by allowing market borrowings for their plan development.

(x) The implementation of VAT has opened better prospects for tax collections by the states—to be boosted once the GST (goods and services tax) gets implemented.

(xi) The Eleventh Plan has made it compulsory for the states to make their PRIs a working entity for fund devolution for the development of local areas.

(xii) Providing gainful employment to the labour force over the plan period.

Q. 19 Write a note on the situation and importance of Private Remittances for India.

Ans. As per the report of UNDP, by end-2010, Indians were the second biggest diaspora, estimated at 25 million and among the largest 'sending' nations in Asia. Not only now, the 'private remittances' (PRs) of India was of crucial importance in the former decades after Independence. Since then, it has gone swelling every year, with a major jolt to it in the early 1990s due to the Gulf War. As the Gulf became less attractive, the rise of the IT industries saw a major acceleration in PRs with Indian expatriates joining this emerging labour force en a big way.

As per the laterst data provided by the IMF/WB in 2013, India received the highest PRs in the world totalling to US$57 billion (China being 2nd at US$53). Its importance for India could be seen as given below:

(i) The value of PRs today stands at one sixth of its total foreign exchange reserves.

(ii) India is able to promote and sustain its huge current account deficit (2.5 per cent of GDP, now) with comfort.

(iii) Indian diaspora not only plays a vital monetary role for India, but they gave a relative edge to Indian diplomacy too.

(iv) They play a major role in India's emerging economic diplomacy. Looking at their importance, the GoI in recent years has become more concerned about the welfare of its diaspora.

Q. 20 Discuss the challenges related to providing universal healthcare in India.

Ans. Health indicators of India have been always low due to many reasons and they still remain a matter of great concern for the GoI and UN bodies. Despite higher economic growth, India fares poorly when compared to countries like China and Sri Lanka in term of parameters like per capita expenditure on health, number of physician/hospital beds and IMR. In addition, within the country, the improvement has been quite uneven across regions/states, gender, rural/urban areas etc. The health system in India is a mix of the public and private sectors, with the NGO sector playing a small role. In providing universal healthcare, the country faces the following challenges:

Physical challenges are related to having adequate number of trained personnel, hospitals and other infrastructure. The Centre and state need active participation from the private sector and the NGOs.

Economic challenges are related to the mobilisation of funds to meet the physical challenges at one hand, while on the other, delivering the required medical services to the needy people.

Universal health insurance is under consideration with government supported premium payment.

Government plans to promote the private sector and NGOs in its preperation for putting the right kind of physical set up while the delivery is to be taken care via the UID based insurance

smart cards. Planning Commission has targeted to increase health expenditure to 2–3 per cent of the GDP in the Twelfth Plan (from 1 per cent of GDP in the Eleventh Plan). However, sceptics doubt the efficacy of the smart card-based healthcare delivery due to information divide in the country.

Q. 21 Examine India's food security in light of the record foodgrain production is 2010–11.

Ans. India has achieved a record foodgrain production of 241 million tonnes (MT) in the 2010–11 crop year with record production in wheat, maize and pulses. This has really encouraged the hope of attaining food security for the country. We may analyse it as given below:

(i) India's population growth rate at present is 1.76 per cent (as per the provisional data of Census 2011) while its foodgrain growth rate is just at about one per ent per year (since 1996–97). It put a pressure of 0.76 per cent per year on production of foodgrains.

(ii) As per the latest data released by the Governement of India, by 2020–21 the country will need a total of 281 MT of foodgrains for its consumption—it is only possible once we are able to achieve a 2 per cent annual growth rate in foodgrain production.

(iii) Once the Universal Right to food becomes effective, the real pressure on the physical availability of foodgrain will start showing up.

(iv) Scarcity of foodgrains has been a major reason for their price rise in recent years, as with increasing income, there is increased demand of food grains from the newer population of the country.

In the process of attaininy food security the government is going for a multi-dimensional approach:

(i) Second green revolution with emphasis on plant protection, organic farming, new seeds, use of bio-tech etc.

(ii) Promoting contract and corporate farming.

(iii) Action and policies regarding the effects of climate change on agriculture.

(iv) Marketing and distribution reform.

(v) Targeting agricultural subsidies in a right way.

(vi) Promoting agricultural research through private-public participation.

(vii) Trying to make farming a remunerative profession.

Q. 22 Write a note on the strategy of monitorable development targets initiated by the Eleventh Five-Year Plan.

Ans. The Eleventh Plan (2007–12) has identified 27 targets at the national level related to income and poverty, education, health, women and children infrastructure and environment, whereby 13 of the 27 targets, which are easy to monitor, have been set for the states (after due consultations with them). The strategy of setting such development targets is supposed to serve the following purposes to the economy:

(i) It will prevent the Plan faltering from its desired goals and help the Centre to achieve the objectives contained in the National common Minimum Programme (NCMP);

(ii) It will not only give the government a real time picture of development, but allow enough time to intervene without waiting for the plan completion;

(iii) The move would also address the issue of regional and sub-regional inequalities;

(iv) It will increase governmental efficiency in going for more 'inclusive growth';

(v) The idea will promote the cause of 'performance budgeting' in a more timely and transparent way;

(vi) It will increase the element of 'governance' among the states as their performance on the 13 easy-to-monitor targets will be key to timely release of Centre's budgetary allocations to them (the Centre and the Planning commission have been highly critical about the issue of governance at the state level). As the states control the main services (i.e., health, education, drinking water, nutrition etc.) on which people's standard of living depends directly, it has become essential to make the states more equipped and accountable regarding delivery of these services.

Q. 23 'Leakages are the cause by which food subsidies fail to reach the target population adequately'. Comment.

Ans. As the country headed for the Green Revolution in 1965, a proper method of food distribution also began with the commencement of the Public Distribution System (PDS). The PDS will become the main route to pass food subsidies to the needful population due to the lower level purchasing capacity of a large section of the India population. The expenditure on the heads of food subsidies went on increasing even after restructuring of the this PDS. There was a general criticism that these subsidies leak and do not reach the target population. In recent years, several measures were taken to stop the subsidies from going outside the target population, but things do not seem improving. The situation of leakage in the food subsidies through PDS may be seen via two studies released recently—

(i) In 2001–02, 18.2 per cent of PDS rice and 67 per cent of wheat was diverted from the ration shops to the open market—it means over 40 per cent of all foodgrains with subsidies missed the poor masses (Reetika Khera, 211, as cited in the *Economic Survey 2010–11*).

(ii) In 2004-05, there was an overall diversion of 55 per cent of the grain meant for the poor (Sikha Jha & Bharat Ramaswami, 2010, as cited in *Economy Survey 2010–11*).

No matter where the exact figure of leakage lies between 40–55 per cent, once legal rights to food is given using the PDS delivery system, it will double the offtake and food subsidies—increasing expenditure hugely, with no guarantee of a foolproof delivery. This is why the Unique Identification Number (Aadhar) is proposed to be used by the government so that the food subsidies are not diverted and become leakage-proof. The cash delivery will deburden the country of leakage of subsidies.

Q. 24 Write a short note on India's policy steps regarding harnessing the 'demographic dividend'.

Ans. There has been a marked decline in the dependency ratio (ratio of dependent to working age population) in India. The ratio fell down from 0.8 in 1991 to 0.73 in 2001 and is expected to further decline sharply to 0.59 by 2014. This decline sharply contrasts with the demographic trend in the industrialised countries and also in China, where the ratio is rising. It is projected that the proportion of population in the working age group (i.e., 15–64 years) in India will increase from 62.9 per cent (2006) to 68.4 per cent in 2026.

Low dependency ratio and a high proportion of the working population gives India a comparative cost advantage, and a progressively lower dependency ratio will result in improving India's competitiveness in the global economy. The Government of India seems fully aware of this advantage and that is why the Eleventh Plan (2007–12) is implementing a ***three-pronged strategy*** to tap demographic dividend:

(i) Ensuring proper healthcare to all,
(ii) Emphasis on skill development (knowledge industry), and
(iii) Encouragement of labour intensive industries.

The Eleventh Plan document also suggests a word of caution—'if we get our skill development act right, we will be harnessing a demographic dividend, however, if we fail to create skills, we could be facing a demographic nightmare.'

Q. 25 Write a short note on the recently launched National food Security Mission.

Ans. India's food secruity scenario has been a matter of concern for the important national and international agencies in recent times—so has it been for the Government of India. The issue was discussed in a constructive way at the 53rd meeting of the National Development Council (NDC) early 2007. In pursuance of the resolution of the NDC, the Department of Agriculture & Cooperation, Ministry of Agriculture launched a centrally-sponsored scheme on National food Security Mission (NFSM) starting with the Eleventh Plan. The ***objective*** of the Mission is to increase the production of rice, wheat and pulses by 10, 8 and 2 million tonnes, respectively, over the benchmark levels of production, by the end of the Eleventh Plan. The Mission *aims* to do the same through the following ***measures:***

(i) area expansion and productivity enhancement;
(ii) restoring soil fertility and productivity;
(iii) creating employment opportunities, and
(iv) enhancing farm level economy to restore confidence of farmers of targeted districts.

The implementation of the NFSM relates to *various activities* pointed by the government as given below:

(i) demonstration of improved production technology;
(ii) distribution of quality seeds of high yielding varieties (HYVs) and hybrids;
(iii) popularisation of newly released varieties, support for micro-nutrients; and
(iv) training and mass media compaign including awards for best performing districts.

The mission gives flexibility to the identified districts to adopt any local area specific interventions as are included in the strategic Research and Extension Plan (SREP) prepared for the agriculture development of the district. During the Eleventh Plan period, the total outlay of NFSM is Rs. 4,882.5 crore.

Q. 26 Write a concise note on the recently launched Rashtriya Krishi Vikas Yojana.

Ans. There has been a declining trend in the government's share of investment in the agriculture sector for the past few decades due to various reasons. The issue has been a matter of great concern for the governments in recent times. It was highly contemporary that the National Development Council (NDC) in its 53rd meeting (early 2007) decided to launch a programme to incentivise the states to increase the share of investment in agriculture in their state plans. Accordingly, on August 16, 2007 the

government approved the *Rashtriya Krishi Vikas Yojana* (RKVY) with an allocation of Rs. 5,000 crore for the Eleventh Plan period.

The RKVY *aims* at achieving the 4 per cent annual growth rate in the agriculture sector during the Eleventh plan by ensuring a holistic development of agriculture and allied sectors.

This is a State Plan Scheme and the eligibility for assistance under the scheme would depend upon the amount provided in the state budgets for agriculture and allied sectors, over and above the baseline—percentage expenditure incurred on the sectors. The funds under the scheme would be provided to the states as *100 per cent grant* by the Central government. The main objectives of the scheme are as given below:

(i) Incentivising the states to increase public investment in the agriculture and allied sectors;

(ii) Providing flexibility and autonomy to the states in planning and executing the schemes for the sectors;

(iii) Ensuring the preparation of plans for the districts and the states based on agro-climatic conditions, availability of technology and natural resources;

(iv) Ensuring that the local needs, crops and priorities are better reflected in the state plans;

(v) Achieving the goal of reducing the yield gaps in important crops, through focused interventions; and

(vi) Maximising returns to the farmers.

Q. 27 Write a short note on the relationship between stock market and the economy.

Ans. After the Government of India started initiatives in the direction of an organised stock market by late 1980s, too much water has flown since then in this sector. Indian stock market has been making waves throughout the last decade. Today, it is in the headlines due to two paradoxical reasons. Firstly, the pessimism ensuing from the subdued performance of the major stock indices for the last many weeks and secondly, the international opinions and surveys putting Indian stock market among the fastest growing markets of the world. It is right time to analyse the relationship of the stock market to the economy at large. Though experts lack a complete consensus on the issue, we may point out the broader contours of the relationship in the following way:

(i) The equity prices can affect the household income. By their rise, households feel richer as the value of their equity holdings rises, and this 'wealth effect' then spills over into higher consumption ultimately boosting both demand and investment in the economy. The opposite can induce slowdown and even recession as well as sluggish investment.

(ii) Equity prices have a direct impact on the business confidence in an economy.

(iii) A strong and vibrant stock market increases borrowing capacity by raising the value of assets to put as collateral into the banks and the financial institutions.

(iv) Equity price rises raise the market capitalisation of a listed company relative to the replacement cost of its current assets (a factor known as ***Tobin's q***) which induces entrepreneurs to add capacity.

There are many real life examples from around the world which validate the point that a vibrant and rising stock index has been resulting into higher growth rates for the concerned economies between 1951–2005.

Q. 28 Write the main reason of price rise in recent times and discuss the steps taken by the GoI & the RBI to check it.

Ans.[1] Rising prices continued to remain in news throughout the financial year 2012–13. Price rise was basically led by the food products, chiefly the common protein-suppliers like milk, milk products, meat, egg and fishes. To contain price rise the steps taken by the GoI/RBI were as given below (as per the latest *Economic Survey 2012–13,* p. 93)—

(i) *Fiscal Measures*

(a) Import duties for wheat, onions, pulses, and crude palmolein were reduced to zero and 7.5 per cent for refined vegetable & hydrogenated oils.

(b) Duty-free import of white/raw sugar was extended up to 30 June 2012; presently the import duty has been fixed at 10 per cent.

(ii) *Administrative Measures*

(a) Ban on exports of onions was imposed for short periods of time whenever required. Exports of onions were calibrated through the mechanism of minimum export prices (MEP).

(b) Futures trading in rice, *urad, tur,* guar gum and guar seed was suspended.

(c) Exports of edible oils (except coconut oil and forest-based oil) and edible oils in blended consumer packs up to 5 kg with a capacity of 20,000 tons per annum and pulses (except *Kabuli chana* and organic pulses and lentils up to a maximum of 10,000 tonnes per annum) were banned.

(d) Stock limits were imposed from time to time in the case of select essential commodities such as pulses, edible oil, and edible oilseeds and in respect of paddy and rice up to November 30, 2013.

(iii) *Measures to Insulate the Vulnerable Sections*

(a) The central issue prices (CIP) for rice (at Rs. 5.65 per kg for below poverty line [BPL] and Rs 3 per kg for Antodaya Anna Yojana [AAY] families) and wheat (at Rs. 4.15 per kg for BPL and Rs. 2 per kg for AAY families) have been maintained since 2002.

(b) Under the targeted PDS (TPDS) allocation of foodgrains is being made to 6.52 crore AAY and BPL families at 35 kg per family per month at a highly subsidised CIP.

(c) The government has allocated rice and wheat under the Open Market Sales Scheme (OMSS).

(d) The scheme for imports of pulses which envisaged imports for distribution to BPL households through the PDS with a subsidy of Rs 10 per kg operated from November 2008 to June 2012. The government has decided to implement a varied form with a subsidy element of Rs. 20 per kg per month for BPL cardholders for the residual part of the current year. The targeted BPL cardholders will be as estimated by the Department of Food and Public Distribution.

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1. The answer given above looks bigger—here, the complete picture has been presented, and readers are suggested to cut it short as per their requirement—as per the demand of the question. Questions are generally asked in parts, i.e., only the 'budgetary measures', monetary measures, administrative measures, etc.

(e) The Scheme for Distribution of Subsidised Imported Edible Oils has been implemented since 2008–09 through state/union territory (UT) governments for distribution of 1 litre per ration card per month with a central subsidy of Rs. 15 per kg. The scheme has been extended up to 30 September, 2013.

(iv) *Budgetary and other Measures*

(a) A number of measures were announced in Union Budget 2012–13 to augment supply and improve storage and warehousing facilities. The government launched a National Mission for Protein supplements in 2011–12 with an allocation of Rs. 300 crore. To broaden the scope of production of fish to coastal aquaculture, apart from fresh water aquaculture, the outlay in 2012–13 was stepped up to Rs. 500 crore. Recently, the government permitted FDI in multibrand retail trading. This will help consumers and farmers as it will improve the selling and purchasing facilities.

(v) *Monetary Measures*

(a) The RBI had also taken suitable steps to contain inflation with 13 consecutive increases by 375 basis parcentage points (bps) in policy rates from March 2010 to October 2011.

Q. 29 Write a short note on the sub-prime crisis and point out the lessons for India.

Ans. The sub-prime crisis is related to the US mortgage market which first surfaced in July 2007. Simply said, this is a financial crisis generating from the default of the borrowers. It means that it is like the non-performing assets (NPAs) crisis of banks in India. But the analyses of the situation and the mode of financing involved make it highly complex. Let us have a look on the whole matter in the following steps:

Step 1: Borrowers with poor or less than standard (that is why *'sub-prime')* credit records were encouraged (to borrow by some of the world's leading banks and financial institutions).

Step 2: These 'sub-prime loans' were then sold to other investment banks by the original lending banks and institutions.

Step 3: The investment banks (who purchased the sub-prime loans from the original lenders) in turn converted them (the loan papers) into marketable, complex financial instruments to spread risks and manage liquidity (i.e., fund).

Step 4: when the sub-prime borrowers defaulted in their repayment of mortgaged loans, the financial crisis originated—today known as the 'sub-prime crisis' around the world.

As the banks and financial institutions of the world are today more inter-connected due to financial globalisation, the crisis has spread to other non-US economies. The seriousness of the matter is best illustrated by the fact that no one knows who owns the bad debts. Worse, banks do not seem to know the extent of risks in some of the instruments they have created or for that matter when and where to expect them. The credit rating agencies involved with the debt instruments are themselves badly confused. The US government proposed a radical financial reform programme in late March 2008.

Basically, in the name of financial innovation and cut-throat competition in the financial world, there is always a risk that banks start adopting/ promoting highly risky, complex and questionable financial practices. Two long-term measures will help to prevent such crises to occur again:

(i) The financial instruments should be made transparent enough and easily communicated to the buyers, and

(ii) The buyers should have at least basic knowledge of how these instruments work and the risk involved.

India must take lessons from the crisis and every liberal financial move should be guarded with utmost transparency.

Q. 30 Write a descriptive note on the emerging challenge of inflation targeting in India.

Ans. A stable rate of inflation is among the most important things for the growth of an economy—both from domestic and external point of view. It was in the mid-1970s that the RBI was given the function to stabilise inflation—and 'inflation targeting' commenced in India. A new term was born—'threshold rate of inflation' (considered 5 per cent)—in late 1990s to connote the level beyond which prices hurt all sectors of the economy. Now, once the economy has started globalisation vigorously, the challenge of stabilising as well as targeting inflation has become more complex. The current challenge of inflation targeting in India may be seen in two perspectives:

(i) As Indian economy is more open now, it has become necessary to keep its inflation in tandem with global trends to ward off crises with exchange rate, banking, insurance, investment etc. As most of the developed economies have inflation below 3 per cent, we have an immediate obligation to target this level (as we are competing with these economies in the globalised era).

(ii) At another level, the comfortable range of inflation for India is considered 4–5 per cent (almost 2 per cent higher to the obligation of globalisation). But an economy like India which has great growth potential but wretched human development, a lower level of inflation will hinder its growth (there is trade off between inflation and growth). As inflation crossed the 7 per cent level by the first week of April 2009, the government has taken many measures to cool it down. But in the long-run every attempt to cut it to 3 per cent level will hamper investment and growth.

Indian economy is today faced with the above-given twin and paradoxical challenges regarding inflation targeting.

Q. 31 Write a brief note on the role played by the Micro Management of Agriculture (MMA).

Ans. The MMA is a centrally sponsored programme launched in 2000–01 aimed at complementing/supplementing the states' efforts towards enhancement of agricultural production and productivity. The Revised (2008–09) MMA has the following salient features:

(i) Funds are allocated on gross cropped area basis (unlike on historical basis of past).

(ii) Subsidy structure rationalised and made similar to the other schemes sponsored by the Centre.

(iii) Two new components have been added, namely: (a) Pulses and Oilseeds Crop Programmes (POCPs) for the areas not covered under the Integrated Scheme of Oilseeds, Pulses, Oil Palm and Maize (ISOPOM) and (b) Reclamation of Acidic Soil (RAS) launched along with the existing component of Reclamation of Alkali Soil (RAS).

(iv) Ceiling for new initiatives increased to 20 per cent (from 10 per cent).

(v) 33 per cent of the funds earmarked for small, marginal and women farmers.

(vi) Active participation of PRIs in review, monitoring and evaluation.

Funding pattern is in the ratio of 90:10 between Centre and states except the north-eastern states for whom the 100 per cent Central funding is extended as Grant.

Q. 32 What are the causes of the slide of the rupee in recent time?

Ans. Rupee has been showing a serious tendency of depreciation since mid-September 2011 and presently it is at Rs 56, per dollar. The US dollar is at its eight months high today against its major rivals. The reasons for rupee slide and dollar high are driven by the following reasons:

(i) The rupee is sliding on account of strong demand from importers (oil is India's biggest import and domestic oil firms are the largest purchasers of the dollar in the local currency market).

(ii) Banks in India are also creating high demands for dollars.

(iii) The greenback is being seen as a *safe haven*, especially at a time when risk aversion is sweeping through global financial markets. The weakening Euro is the chief concern for the world investors—making them search for a safe heaven.

(iv) Though the downgrading of the US dollar is another concern—as the international investors are still showing hope in the dollar (due to weakening euro) it has not been translated into stronger rupee (as banks and importers are demanding more dollars).

(v) World stocks stumbled from the 1–1/2 month high on October 18, 2011 and government bonds rose as slower-than-expected Chinese growth and a warning on France's AAA sovereign credit rating prompted investors to cut risks.

The depreciating rupee has emerged as a major concern for policymakers/ RBI in India, which puts a threat of spiralling into further price rises. In the given situation, if the central bank intervenes to support the rupee, it will increase its supply into the economy again fueling inflation which has already been the biggest challenge for the government for the past one and half years.

Nevertheless, the decline in the rupee exchange rate has given merchandise and software exporters cause for *cheer*, as they will enjoy better profits from the more competitive export prices. Recently concluded quarter has seen a very high export growth rate in India.

The normalcy in the demand of dollar and cooling down of the rupee is intertwined with the financial health of the crisis-ridden European economies. A strong intervention by the major European economies has every chance of rejuvenating the economy and arresting the slide of the rupee.

Q. 33 Write a contemporary note on the importance and the role played by WIPO.

Ans. The World Intellectual Property Organisation (WIPO) is a specialised agency of the United Nations. It is dedicated to developing a balanced and accessible international intellectual property (IP) system, which rewards creativity, stimulates innovation and contributes to economic development while safeguarding the public interest. WIPO was established by the WIPO Convention in 1967 with a mandate from its member states (today it is 184) to promote the protection of IP throughout the world through cooperation among states and in collaboration with other international organisations. Its headquarters are in Geneva, Switzerland and its present Director General is Francis Gurry.

Strategic Goals

WIPO's revised and expanded strategic goals are part of a comprehensive process of strategic realignment taking place within the organisation. These new goals will enable WIPO to fulfil its mandate more effectively in response to a rapidly evolving external environment, and to the urgent challenges for intellectual property in the 21st Century. The nine Strategic Goals were adopted by Member States in 2008–09 which are:

(i) Balanced Evolution of the International Normative Framework for IP
(ii) Provision of Premier Global IP Services
(iii) Facilitating the Use of IP for Development
(iv) Coordination and Development of Global IP Infrastructure
(v) World Reference Source for IP Information and Analysis
(vi) International Cooperation on Building Respect for IP
(vii) Addressing IP in Relation to Global Policy Issues
(viii) A Responsive Communications Interface between WIPO, its Member States and All Stakeholders
(ix) An Efficient Administrative and Financial Support Structure to Enable WIPO to Deliver its Programs

The Strategic Goals will provide the framework for WIPO's six year Medium Term Strategic Plan (2010–2015).

Q. 34 'India's foreign investment regime has become more liberalized in recent times'. Comment.

Ans. To promote the flow of foreign funds into the economy, the RBI on ***January 24, 2013***, further liberalised the provisions of investment in India's security market—

(i) *FIIs* and ***long-term investors*** [2] investment limit in Government Securities (G-Secs) enhanced by US $5 billion (to US $ 25 b).
(ii) Investment limit in corporate bonds by the above-given entities enhanced by $5 billion (to $50 billion).
(iii) The RBI also relaxed some investment rules by removing the maturity restrictions for first time foreign investors, on dated G-Secs. But such investments will not be allowed in short-term paper like Treasury Bills.
(iv) Foreign investors restricted from investing in the 'money market' instruments—certificates of deposits (CDs) and commercial paper (CPs).
(v) In the total corporate debt limit of US$50 billion, a sub-limit of US$25 billion each for infrastructure and other than infrastructure sector bonds has been fixed.
(vi) Rules requiring FIIs to hold infrastructure debt for at least one year has been abolished.
(vii) The qualified foreign investors (QFIs) would continue to be eligible to invest in *corporate debt securities* (without any lock-in or residual maturity clause) and *mutual fund debt schemes*, subject to a total overall ceiling of US$1 billion (this limit of US$1 billion shall continue to be over and above the revised limit of US$50 billion for investment in corporate debt).
(viii) As a measure of further relaxation, it has been decided to dispense with the

2. Long-term investors' include SEBI-registered 'sovereign wealth funds' (SWFs), multilateral agencies, endowment funds, insurance funds, pension funds and foreign central banks.

condition of one year lock-in period for the limit of US$22 billion (comprising the limits of infrastructure bonds of US$12 billion and US$10 billion for non-resident investment in IDFs) within the overall limit of US$25 billion for foreign investment in infrastructure corporate bond.

(ix) The residual maturity period (at the time of first purchase) requirement for the entire limit of US$22 billion for foreign investment in the infrastructure sector has been uniformly kept at 15 months. The five-year residual maturity requirement for investments by QFIs within the $3 billion limit has been modified to three years original maturity.

Q. 35 What is Double Taxation? Write a current note on the situation of the Double Taxation policy followed by India.

Ans. Due to phenomenal growth in international trade and commerce and increasing interactivity among the nations, residents of one country extend their sphere of business operations to other countries. Cross-country flow of capital, services and technology is the order of the day particularly after our country embarked on the path of globalisation of economy. Presence of double or multiple taxation acts as a major determining factor in decisions relating to location of investment, technology etc. as it affects the bottom-line of a business enterprise. The effort is, therefore, to ensure that heavy tax burden is not cast as a result of double or multiple taxation. The object is achieved by the government entering into agreements with other countries whereby the respective jurisdiction is so identified that a particular income is taxed in one country only or, in case it is taxed in both the countries, suitable relief is provided in one country to mitigate the hardship caused by taxation in another jurisdiction.

The situation of double taxation occurs when an individual is required to pay **two** or **more** taxes for the ***same income***, ***asset,*** or ***financial transaction*** in different countries—mainly due to overlapping tax laws and regulations of the countries where an individual operates his business. When an Indian businessman makes a profit or some other type of taxable gain in another country, he may be in a situation where he will be required to pay a tax on that income in India, as well as in the country in which the income was generated. To protect Indian tax payers from this unfair practice, the Indian government has entered into tax treaties, known as **Double Taxation Avoidance Agreement** (DTAA) with 65 countries, including U.S.A, Canada, U.K, Japan, Germany, Australia, Singapore, U.A.E, and Switzerland. DTAA ensures that India's trade and services with other countries, as well as the movement of capital are not adversely affected. Such agreements are known as "Double Tax Avoidance Agreements" (DTAA) also termed as ***"Tax Treaties"*** (TTs). The statutory authority to enter into such agreements is vested in the Central Government by the provisions contained in *Section 90* of the Income Tax Act.

The Income Tax relief against double taxation is provided in two ways:

(i) Unilateral Relief: Under *Section 91*, the Indian government can relieve an individual from double taxation irrespective of whether there is a DTAA between India and the other country concerned. Unilateral relief may be offered to a tax payer if:

a. The person or company has been a resident of India in the previous year.

b. The same income must be accrued to and received by the tax payer outside India in the previous year.

c. The income should have been taxed

in India and in another country with which there is no tax treaty.

d. The person or company has paid tax under the laws of the foreign country in question.

(ii) Bilateral Relief: Under *Section 90*, the Indian government offers protection against double taxation by entering into a DTAA with another country, based on mutually acceptable terms. Such relief may be offered under two methods:

(a) ***Exemption method:*** This ensures complete avoidance of tax overlapping.

(b) ***Tax credit method:*** This provides relief by giving the tax payer a deduction from the tax payable in India.

Apart from providing ways and means to avoid double taxation of same income, the agreements generally provide for other matters of common interest of the two countries ***such as***: exchange of information; mutual assistance procedure for resolution of disputes; and for mutual assistance in effecting recovery of taxes. Treaties being international agreements, their consequences are determined according to the rules of ***Vienna Convention on the Law of Treaties, 1969***. The Articles 31, 32 and 33 of the convention lay down the rules for interpretation of these treaties. The commentaries by OECD and UN based on respective models also provide material for interpretation of the treaties. The terms and expressions, if not defined in the treaties, take their meaning from respective domestic law in case they are defined there.

Q. 36 Write a short note on the impact of colonialism on the Indian industry in the pre-independence period.

Ans.

(i) The first half of the 19th century saw a sudden and quick collapse of urban handicrafts—railways made it even faster.

(ii) The second half of 19th century saw the entry of modern industries but the pace was very slow—low technology and confined to **cotton** and **jute,** iron/steel, came up in 1907 while sugar, cement and paper industries and a few engineering firms came up in the 1930s—still by 1946, cotton and jute textiles accounted for nearly 30 per cent of all worker employed in factories [CEHI].[3]

(iii) After 1918, modern industry developed quite fast but its growth rate was just 3.8 per cent and had little impact on overall economic situation as its share in the national income was at 7.5 per cent by July 1947 [A. Maddison] in 1913 it was 3.8 per cent [CEHI].

(iv) Modern industries barely compensated for the displacement of traditional handicrafts.

(v) In 1939 only 2 million were employed in industries (population 389 m.)

(vi) A virtual absence of ***capital*** or ***producers goods*** industry—relying almost wholly on imported machinry and tools (89.8 per cent).

(vii) Banking and insurance grossly underdeveloped. Without simultaneous industrialisation, the growth of *railways* further colonised India and they served the British cause.

(viii) Till 1930s, foreign capital dominated after 1918—giant MNCs entered (Unilever, Imperial Chemical Industries, Dunlop and GM).

3. Dharma Kumar (ed.), ***Cambridge Economic History of India***, vol 4, Cambridge, CUP, 1983.

Foreign capital did 'drain' capital from India in place of promoting investment, we may see the *three* chief features:

(i) Contributed to 'the guided underdevelopment of India by concentrating on the production and export of raw materials and food stuffs.
(ii) Focused the sectors which catered to foreign markets and not to India's home market.
(iii) The 'multiplier effects' in terms of income, employment, capital, etc. were largely exported back to the developed countries.

Overall, industries were during encouraged the colonial rule but for the service to the colonial interests, not India—just a tool to drain out wealth, from India.

Q. 37 'Financial development facilitates real economic growth'. In the light of the statement discuss the situation of bond market in India.

Ans. The *Economic Survey 2011–12* raises its concerns for weak 'bond market' in India with this statement of the Australian economist Schumpeter—the issue was raised by the last *Economic Survey*, too. And the latest ***Economic Survey 2012–13*** has also recommended for its strengthening. The Survey highlights the passages from the latest research which prove the idea that to propel economic growth it is necessary to put a strong financial market in place—its depth and diversity in the instruments of raising long-term money support inclusive growth.

Long-term financial needs of Indian firms are mainly met by the banks in India (17.8 per cent, 2011–12) and the bonds play a negligible role. Basically, the vacuum created by the bond market has been compensated by foreign borrowings (costly and secured) by Indian firms which rose sharply in the last decade.

There are some ***reasons*** why the bond market has not developed adequately:

(i) One reason has to do with what economists call 'multiple equilibria'. This is a situation when due to underdeveloped bond market, the instrument lacks liquidity—lesser number of interested buyers and sellers of the bonds.
(ii) Underdeveloped *mechanism of information* about the corporate houses who could issue bonds- information is delayed, inadequate and insufficient.
(iii) A general *erosion of faith* in the corporate world due to recent cases of scams and scandals which involved the politicians, bureaucracy and the corporate houses, too.

Low penetration of the 'unsecured borrowing' (Corporate bonds) provide less incentives to the entrepreneur and discourages investment and growth. Raising funds via bonds are not only easier but faster and safer in comparision to the 'secured loans' provided by the other segments of the organised finacial sector (banks, security market, debentures). Entrepreneurship needs free and quicker means of funds' availability to flourish—India is a typical case of least explored economy on this count. As India decides to garner US$500 billion investment from the private sector in the *12th Plan* period, this is the right time to strengthen the corporate bond market in the country.

Q. 38 Write a current note on the recent steps taken by the government in the area of agricultural extension services.

Ans. Governments have always felt that India lacks a strong extension services in the agriculture

sector. In recent years, the GoI has launched many effective programmes/schemes in this regard:

(i) The Support to State Extension Programmes for Extension Reforms Scheme was launched in 2005–06, aiming at making the extension system 'farmer driven' as well as accountable to farmers by providing for new institutional arrangements for technology dissemination. This has been done through setting up of Agricultural Technology Management Agencies (ATMA) at district level to operationalise the extension reforms;

(ii) 'Mass media support' to agriculture focusing on Doordarshan infrastructure and All India Radio (AIR) broadcasting agriculture-related informations;

(iii) Kisan Call Centres (KCC) to provide agricultural information to the farming community through toll free telephone lines;

(iv) *Agri-clinic* and *agribusiness* centres by agriculture graduates to provide extension services to farmers on 'payment basis' through setting up of economically viable self–employment ventures, and information dissemination through *agri fairs*;

(v) *Extension Education Institutes* at *Nilokher* (Haryana), *Rajendra Nagar* (Andhra Pradesh), *Anand* (Gujarat), and *Jorhat* (Assam) are operating at 'regional level' to improve the 'skills and professional' competence of extension field functionaries of agriculture;

(vi) There are ***model training courses*** on thrust areas of agriculture, horticulture, animal husbandry, and fisheries with the objective of improving the professional competence, upgrading the knowledge and developing technical skills; and

(vii) ***MANAGE,*** Hyderabad, an apex Institute at the national level, provides training to middle and senior level officers of agriculture.

Q. 39 Write a contemporary note on the 'changing dynamics' of the global economy in reference to India.

Ans. The global economy has gone for a big change in its dynamics over the 'last two decades'—and has every potential to go for further change in the coming decades. The shares of major economies in global GDP, manufacturing, and trade suggest that there has been a marked change in the configuration of the world economy, visible by the following points:

(i) Sustained growth of a number of emerging economies, especially the BRICS economies, has resulted in an increase in their share in the global GDP.

(ii) The value addition in the world economy has been moving away from advanced countries towards what have been termed emerging economies. The decline in share is particularly marked in the case of the EU.

(iii) The shift towards Asia has been significant and, within Asia, away from Japan to China and India.

(iv) The *fivefold* increase in share of China in the global GDP has placed it as the second largest economy in the world. The increase in share of India, though less dramatic, is nevertheless of an order that places her as the ***fourth*** largest economy in PPP terms.

(v) The reduction in share of advanced economies, particularly from 2005, has been accentuated by the slowdown that followed the 'sub-prime crisis' in the United States, the eurozone crisis in

2010, and the near stagnation in Japan for nearly two decades on the one side and the significantly higher rate of growth in low and middle income countries, particularly the large countries like India and China, on the other.

(vi) From the perspective of whether there has been a 'catch up' in per capita incomes across a larger set of countries, it is seen that the 'per capita income' (at PPP constant 2005 dollars) of 131 countries from 1980 to 2009 continued to increase for most of the period since the mid-1980s, except in the last two-three years.

The major changes in the *dynamics of the Indian economy* have been as given below:

(i) India has achieved faster growth from the 1980s—not only was this growth higher compared to its own past, it was also much faster than that achieved by a large number of countries. Between 1980 and 2010, India achieved a growth of 6.2 per cent, while the world as a whole registered a growth rate of 3.3 per cent.

(ii) India's share in global GDP, (measured in terms of constant 2005 PPP international dollars) more than doubled from 2.5 per cent in 1980 to 5.5 per cent in 2010. Consequently, India's rank in per capita GDP showed an improvement from 117 in 1990 to 101 in 2000 and further to 94 in 2009, out of 131 countries (China improved its rank from 127 to 74 during the same period).

Underlying the relative decrease in share of advanced economies in the global GDP, there has been a marked shift in the *location of manufacturing*. This process was on in the 1990s, but got accelerated in the current decade. Again, the rise in the share of China is particularly significant while other emerging economies, namely Brazil, India, Indonesia have also moved up in terms of their share in world manufacturing. Even with the change in distribution of global GDP and manufacturing across countries, it needs to be noted that the advanced countries still account for a large share of industrial output, apart from being the repositories of technology and value added in services. The changing dynamics of the global economy has provided a good opportunity to India to expand its econimic presence more strongly.

Q. 40 Write a brief note on the recent steps taken by the Indian government regarding financial inclusion and literacy.

Ans. Financial inclusion plays a crucial role in inclusive development and sustainable prosperity as is being increasingly recognised and acknowledged globally. Large segments of population need to be part of formal payment system and financial markets. Financial inclusion would also broaden and deepen financial savings and lead to higher economic development.

Previous initiatives: While financial sector policies in India have long been driven by the objective of increasing penetration and outreach, the goal of inclusion has eluded us. About 41 per cent of adult population remains unbanked and the number of loan accounts covers only 14 per cent of adult population. The previous initiatives included:

(i) The expansion of network of co-operative banks to provide credit to agriculture and saving facilities in rural areas,

(ii) Nationalisation of banks in 1969 and expansion of branches and

(iii) Creation of an elaborate framework of priority sector lending with mandated

targets as part of a strategy to meet the savings and credit needs of large sections of the Indian population who had no access to institutional finance.

Given the sheer enormity of the challenge, however, the outcomes of these efforts have so far been mixed.

Recent initiatives include: (i) 'no-frill' account for retail purpose; (ii) simplified KYC (Know Your Customer); (iii) Credit counselling centre (GCC) facilities; (iv) use of NGOs and formation of SHGs; (v) Kisan credit cards services; and (vi) extension of Smart cards.

Every Union Budget since 2007–08 has laid down provisions for funding of financial inclusion goals. The *Rangarajan Committee* also spelt out priorities for meeting financial inclusion objectives. **Two** of the more important approaches in the recent times included the use of technology such as ***smart cards*** and ***mobile telephone banking***. The potential for their spread can be vast especially in combination with 'banking correspondence' approach launched recently.

Financial Literacy:[4] Any policy initiative seeking to afford greater access to financial services to a large segment of the population must necessarily address bridging the existing *knowledge gap* in financial education and literacy. Over the last decade or so, researchers all over the world, especially in the developed countries, have, therefore started to study and explore whether individuals are well-equipped to make financial decisions. Financial education and literacy assumes urgency in any given scenario. No wonder policymakers all over are increasingly taking note of this and directing their efforts to address it.

Q. 41 Write a note on the need and prospects of the proposed 'Infrastructure Debt Funds' (IDFs).

Ans. For setting up IDFs the broad guidelines were issued in September 2011 *aimed* to facilitate flow of funds into infrastructure projects. The IDF will be set up either as a trust or as a company. A trust-based IDF would normally be a mutual fund (MF), while a company-based IDF would normally be an NBFC.

An IDF-NBFC would raise resources through issue of either 'rupee-' or 'dollar-' denominated bonds of minimum *five-year* maturity. The investors would be primarily domestic and off-shore institutional investors, especially insurance and pension funds which would have long-term resources. An IDF-MF would be regulated by the SEBI while an IDF-NBFC would be regulated by the RBI. Such entities would be designated as Infrastructure Debt Fund-Mutual Funds (IDF-MF) and Infrastructure Debt Fund-Non Banking Financial Company (IDF-NBFC). All NBFCs, including Infrastructure Finance Companies (IFCs) registered with the bank may sponsor

4. ***Some extra information on the topic:*** In the **UK**, the Financial Services Authority has launched a big campaign to improve the financial skills of the population and enable a better appreciation of risks and rewards inherent in financial instruments and transactions. The **US Treasury**, which established its Office of Financial Education in 2002, is working to promote access to the financial education tools. The Financial Literacy and Education Commission, established by Congress in 2003 was created to improve financial literacy and education. In Australia, the Government established a National Consumer and Financial Literacy Taskforce in 2002. In **Malaysia**, the Financial Sector Master Plan, launched in 2001, includes a 10-year consumer education programme. The Monetary Authority of **Singapore** has launched a national financial education programme (Money SENSE). A nationwide, coordinated effort was also required in **India** and the Financial Stability and Development Council (FSDC) is a step forward in this direction. It is expected that this new initiative will help adequately address the challenge of financial inclusion and literacy. Idioms and metaphors of development economics keep on changing from time to time. Today, new financial sector initiatives in a country like ours—be it in the form of prompt and innovative policy responses from the Government, central bank, other authorities or be it in the form of implementation efficiency and inventiveness from the varied players—need to explicitly prioritise both financial inclusion and financial education and literacy.

IDFs to be set up as MFs. However, only IFCs can sponsor IDF-NBFCs.

Eligibility parameters for NBFCs as sponsors of IDF-MFs include a minimum NOF (net owned fund) of Rs. 300 crore; CRAR (capital to risk-weighted assests ratio) of 15 per cent; net NPAs (non performing assets) less than 3 per cent; the NBFC to have been in existence for at least five years and earning profits for the last three years in addition to those prescribed by SEBI in the newly inserted *Chapter VI B* to the MF Regulations. Only NBFC-IFCs can sponsor IDF-NBFCs with prior approval of the RBI and subject to the following conditions:

(i) The sponsor IFC would be allowed to contribute a maximum of 49 per cent to the equity of the IDF-NBFC with a minimum equity holding of 30 per cent of the equity of IDF-NBFC, post investment, in the IDF-NBFC;
(ii) The sponsor NBFC-IFC must maintain minimum CRAR and NOF prescribed for IFCs;
(iii) There are no supervisory concerns with respect to the IFC.
(iv) The IDF is granted relaxation in credit concentration norms and in risk weights.

Q. 42 Write a note on the 'Interest Subvention Relief to Farmers' programmes being run by the GoI.

Ans. Farmers in the country have been facing financial hardship due to several reasons—consecutive droughts, indebtness and crop failures—farmers' suicide have always been in news in the recent time. Consequent upon the announcement by the Union Finance Minister in Budget Speech 2006–07, public-sector banks, regional rural banks and rural co-operative credit institutions were advised that with effect from Kharif 2006–07, government would provide interest rate subvention of **2** per cent per annum in respect of short-term production credit up to Rs. 3.0 lakh. This subvention was available to public sector banks, regional rural banks and rural co-operatives on the condition that they made short-term credit available at **7** per cent per annum. In case of RRBs and rural cooperatives, this was applicable only to short-term production credit disbursed out of their own funds and did not include such credit supported by NABARD refinance.

Pursuant to the *Union Budget 2010–11* announcement, it was decided to provide interest subvention of 1.5 per cent per annum for short-term agriculture loans up to Rs. 3.0 lakh disbursed by public-sector banks, cooperatives, and RRBs. The additional subvention for prompt repayment has been enhanced to **2** per cent per annum so that the effective interest rate charged to such farmers is 5 per cent per annum up to Rs. 3.0 lakh. In the *Budget 2011–12*, the government of India proposed to provide interest subvention of 1.5 per cent per annum for short term agriculture loans up to Rs. 3.0 lakh disbursed by public sector banks, co-operatives and RRBs. The additional subvention for prompt paying farmers is proposed to be enhanced to 3 per cent per annum so that the effective interest rate charged to these farmers is 4 per cent per annum upto Rs. 3.0 lakh. The programme has also been continued by the *Union Budget 2013–14.*

Q. 43 Write a note on the advantage to India in the world of 'Wellness Tourism'.

Ans. Several studies have estimated the global market for medical tourism ranging from US$ 100 billion to US$ 150 billion. The Asian medical tourism market is being bolstered by initiatives taken by the national governments, as also rising quality standards.

According to a study by the Organization for Economic Cooperation and Development

(OECD), Thailand, India, Singapore, Malaysia, Hungary, Poland, and Malta are promoting their comparative advantage as medical tourist destinations. Singapore Medicine has been established under government-industry partnership to promote Singapore as a destination for advanced medical care. Malaysia has established the Malaysia Healthcare Travel Council to develop and promote the health-care and travel industry. Philippines has launched the Philippines Medical Tourism Programme and included medical tourism in the Investment Policies Plan. Thailand has been leveraging elements such as spas and alternative therapies in its promotional strategies for several decades, coupled more recently with state-of-the-art hospitals and skilled professionals.

Several features like cost-effective health-care solutions, availability of skilled health-care professionals, reputation for treatment in advanced health-care segments, increasing popularity of India's traditional wellness systems, and strengths in IT have positioned India as an ideal health-care destination. India, while strengthening its capabilities in modern health-care systems is also leveraging its inherent strengths in traditional health-care systems such as Ayurveda, Siddha, Yoga, Naturopathy, and Faith healing/Spiritualism. It also holds an edge over competitor countries with its mastery over techniques of 'concentration and 'mind control'.

Q. 44 During India's Struggle for Independence, 'Indian capitalist class was anti-socialist and bourgeois but it was not pro-imperialist'. Elucidate.

Ans. There has been a general misconception about the 'loyality' and 'stand' of the Indian capitalist class (industrialists, traders) throughout the freedom struggle—for which there were valid reasons:

(i) They never wanted their business to suffer so opposed the Civil Disobedience and Non-coperation Movements—seen going against Gandhi in particular and INC is general.

(ii) They opposed 'socialism' and favoured 'capitalism' that is why they looked in opposition to the socialistic leanings of the INC.

(iii) Due to above-given reasons the stand of the Indian capitalist class has been often seen as supportive to the Imperial Rule.

But **objective analysis** of their stand proves it wrong:

(iv) From mid 19th century, Indian capitalists had their independent capital base and did not remain junior partners of foreign capital—which was antagonistic to the foreign capitalism class.

(v) The Bombay Plan (of a wide cross section of the leaders of Indian capitalist class) vehemently demanded land reform, co-operativisation of production, finance and marketing (like nationallist leaders).

(vi) FICCI (1927) soon got relevance which by 1930s started talking of 'unequal exchanges'—the INC saw it as a favour against the fighting imperialist economic hegemony.

(vii) By 1928, FICCI had clearly indicated of entering politics with 'nationalistic stand'—a general approach of strengthening the hands of those who were for freedom of the country.

(viii) They were opposed to Civil Disobedience, reasons being—a prolonged movement could unleash forces which may become revolutionary in a social sense (threatening capitalists) and a 'disregard for authority'

could hamper the future government after getting Swaraj; hampered day-to-day business threating the very existence of the business class; followed constitutional process but not on the terms of the Britishers (participated in councils, conferences, which did show as if they were with the Imperial powers.

(ix) By 1935, FICCI announced that without the INC approval or participation it would not get involved with the Imperial rule at any level—bycotted First Round Table Conference as it was not having Gandhi and the INC.

(x) By 1937, FICCI has started pressurising the British government to come out with a goal of 'self-rule' and informed them that if it was not the outcome, the Congress will go for 'direct action' which meant 'non-violent mass civil-disobedience'.

(xi) The increase in radicalisation of the INC in 1930s (towards Left) made capitalists more active in politics—but it did not push them into the 'lap of imperialism' (as predicted by contemporary radicals) which happened in some other colonial and semi-colonial countries, instead they evolved a subtle, many-sided strategy to contain the Left but no part of it went for imperialisits.

(xii) In 1927 the capitalist class (via FICCI) refused supporting the government on the Public Safety Bill which tried to contain the communists (since they were against the imperial government), but they did not want to destroy capitalism as a force.

(xiii) By 1943 the capitalists also realised the need for socialistic reforms—'Post War Economic Development Committee' was set up by them which drafted the 'Bombay Plan'—with a general aim of incorporating 'whatever was sound and feasible in the socialist movement' without capitalism surrendering any of its essential features (says G.L. Mehta, *FICCI President*).

[Based on the CEHI, op. cit.; Bipan Chandra; Angus Maddison]

Q. 45 'India's economic policies are neo-liberal.' Examine.

Ans. The process of economic reforms started by India in 1991 was a follow-up to liberal policies influenced by current world ideas of neo-liberalism via the IMF (as it agreed with Washington Consensus, 1985). This is why critics of the reform process call Indian economic policies neo-liberal (it was also remarked by the *Supreme Court of India*, in one of its judgements in 2012).

Through reform, India started redefining the economic role of state in the economy—a predominant role was assigned to the 'private sector', but the state today has a different and bigger role. We may cite some examples to show why India's policies are still not neo-liberal:

(i) State still manages majority stakes in the PSUs and many 'very big PSUs' have been newly set up.

(ii) Higher degree of regulation gives more economic authority to the government.

(iii) Even after liberalisation, India is ranked very low in being a liberal economy what to ask of a neo-liberal economy.

(iv) Subsidies are still on the higher side.

(v) Government expenditure on education, healthcare, social security has increased hugely post-1991.

(vi) Even liberal policies of the government are under several official checks and controls.

(vi) Had India followed neo-liberal policies, it would also have faced some financial crisis after the US 'sub-prime' crisis.

Thus, India's economic polices cannot be called neo-liberal—liberal, yes.

Q. 46 What are tax-havens and how they are promoting corruption in India?

Ans. 'Tax havens' are nation-states or dominions imposing 'low' or 'no taxes' on personal and corporate incomes, and as a consequence tend to attract wealthy individuals and corporates seeking to minimise their tax liabilities. Other than saving taxes, these havens are also used as a safe hub for parking 'black money' created in different countries. As per the data of the OECD, there are at present over 70 such destinations in the world—popular ones are British Virgin Islands, Cayman Islands, Cook Islands, Dubai, Isle of Maw, Liechtenstein, Marshall Islands, St. Kitts and Nevis, Switzerland, Mauritius, US Virgin Islands, etc. The tax havens are promoting corruption in India in so many ways which may be understood in the following way:

- They have emerged safe hubs for parking money earned in India.
- As there are such parking centres, the black money individuals and corporates generate in India are easily hidden there with no risk of getting caught.
- Many Indian corporates have their operations in such places which they use for 'transfer pricing'.
- The parked funds get back to India in the form of 'hedge funds' destabilizing the economy.
- As corruption is supposed to be very high in India, even politicians are believed to park their black money there.
- They accelerate hawala, bribery, etc. in India.

Recently, we have seen some effective action being taken by the victims nations to unearth their funds parked in these havens such as the USA, Germany and many of the OECD nations. Recently, the Government of India has also started such initiatives.

Q. 47 Write a note on the restructuring of the Centrally Sponsored Schemes into the new Additional Central Assistance implemented from the financial year 2013–14.

Ans. The Planning Commission (PC), with the commencement of 12th Plan, proposed 'rationalisation' and 'restructuring' of the 16 Centrally Sponsored Schemes (CSS) into Additional Central Assistance (ACA) Schemes. The proposal has been accepted by the Cabinet and the ACA will become effective from 2013–14. As per the PC, together with the government this will 'improve the efficiency' of the Schemes. After the restructuring, the situation will be as below.

(i) It will give more flexibility to the states to utilise the funds,

(ii) It will also give the Planning Commission 'absolute control' over the quantity of money to be released.

(iii) The CSS funds till now were routed through the concerned Central ministries,

(iv) Under the new set up the Planning Commission will release the funds *directly* to the states on the recommendation of the Ministry of Finance.

(v) The concerned ministries will now only *monitor* the implementation of the schemes, which would be evaluated by an external agency.

(vi) The schemes to be restructured include *flagship programmes* such as the Integrated Child Development Scheme, the Mid Day Meal Scheme, the Sarva Shiksha

Abhiyan, the Mahatma Gandhi National Rural Employment Guarantee Scheme, the Indira Awas Yojana, the Pradhan Mantri Gram Sadak Yojana, and the yet-to-be launched National Health Mission.

(vii) Some other important schemes to be restructured are: the Rashtriya Krishi Vikas Yojana, the Rajiv Gandhi Drinking Water Mission and Sanitation Mission, the Backward Regions Grant Fund, and the National Rural Livelihood Mission.

Though states would welcome the *flexibility* in using the funds if based on a normative formula, experts point out that the Planning Commission would have total discretion over funding to the states and each could be treated differently. The present funding structure of ACA varies from one scheme to another.

The point to be noted here is that most of the states of India since the last many years are fiscally broke and they have to tow the lines of the PC to get developmental funds from the Centre. All developmental funds accruing to the states are being 'monitored' by the PC on the 'guidelines' of the 'Monitorable Targets' set by the states themselves. In such a situation, for greater efficiency, accountability and outcome, the restructuring looks logical.

Meanwhile, the political parties. Communist Party) have been demanding ICDS and Midday meal to be made *statutory rights* of the people Experts fear the new funding pattern could be used as a 'political tool' by the Centre to discriminate between states on the basis of the party in power.

Q. 48 Write a short note on recent steps taken by the GoI to make the public sector banks compliant to the Basel III norms.

Ans. As capital is a key measure of banks' capacity for generating loan assets, and is essential for balance sheet expansion, the GoI has regularly invested additional capital in the PSBs to support their growth and keep them financially sound so as to ensure that the growing credit needs of the economy are adequately met. A sum of Rs. 12,000 crore was infused in seven PSBs during 2011–12 to enable them to maintain a minimum Tier-I CRAR of 8 per cent and also to increase shareholding of the GoI in them.

In *2012–13* also, the government has infused capital in PSBs to augment their Tier-I capital so that they maintain their Tier-I CRAR at a comfortable level and remain compliant with the stricter capital adequacy norms under Basel III . This will also support internationally active PSBs in their national and international banking operations undertaken through their subsidiaries and associates. An amount of Rs. 12,517 crore was allocated by the GoI for the year 2012–13 on *January 10, 2013*. The ***High Level Committee*** to assess the capitalisation of PSBs in the next 10 years, headed by the Finance Secretary has recommended various options for funding of PSBs. Given the budgetary constraints, it may not be feasible for the government to infuse huge sums into the PSBs. This is why the committee has recommended the formation of a *'non-operating financial holding company' (HoldCo)* under a special *act of Parliament* with the following key objectives—

(i) To act as an investment company for the GoI;

(ii) To hold a major portion of the GoI's holdings in all PSBs;

(iii) To raise long-term debt from domestic and international markets to infuse equity into PSBs; and

(iv) To service the debt from within its sources.

Due to weakening of the RRBs, their sponsor banks have been incurring huge NPAs. RRBs have played a pivotal role in credit delivery in rural areas,

particularly to the agriculture sector—to enhance their outreach and provide banking services more effectively to rural masses, RRBs need to undertake a continuous process of technology and capital upgradation. With a view to bringing the CRAR of RRBs up to at least 9 per cent, ***K. C. Chakrabarty Committee*** recommended recapitalisation support to the extent of Rs. 2,200 crore to 40 RRBs in 21 states. Pursuant to the recommendation of the Committee, recapitalization amount is to be shared by the stakeholders in proportion to their shareholding in RRBs, i.e., 50 per cent central government, 15 per cent concerned state government, and 35 per cent the concerned sponsor banks. The re-capitalisation will continue upto March 2014.[5]

Q. 49 Write a brief note on the recently released FSLRC Report.

Ans. The *Justice B. N. Srikrishna* headed Financial Sector Legislative Reforms Commission (FSLRC) handed over its report *end-March 2013*—it was set up March 2011 *for examining* the regulatory structure and the laws governing the financial sector. The 10-member committee had a broad mandate covering all financial services as well as everything currently overseen by any financial regulator. Broadly, the commission has recommended what can be called a changeover from an 'area-based' division of regulators to a 'task-based' division. Major highlights of the recommendations are as follows:

(i) Today, each agency like the Sebi or the IRDA or the FMC looks after one type of financial service or one area—this would be replaced by a horizontal structure whereby the basic regulatory and onitoring functions of all areas would be done by a Unified Financial Agency (UFA).

(ii) All consumer complaints, regardless of the area will be handled by a Financial Redressal Agency (FRA).

(iii) There will be a single tribunal, the Financial Sector Appellate Tribunal (FSAT) which will hear appeals regarding the entire sector.

(iv) There are also three other agencies in the recommendations, along with the Reserve Bank of India which will continue to oversee banking.

The horizontal structure will serve the interests of the consumers of financial services (of individuals and businesses, both) much better. For one, it should *eliminate regulatory arbitrage*—the recent IRDA vs SEBI spat on ULIPs happened because the two agencies' views on the characteristics of investment products were very different. Another advantage of the horizontal structure would be that consumer complaints about a sector would get separated from the regulator. This is important because a certain class of consumer complaints have mistakes or oversights by the regulator at their root. Recognising this root cause means admitting to its own flaw, something that is hard for any organisation.

Q. 50 Analyse the reasons why inflation continues to Persist.

Ans. As per the *Economic Survey 2012–13*, inflation in protein foods, particularly eggs, meat and fish, and in fruits & vegetables has persisted because of *changes in dietary habits* and *supply constraints*:

(i) Long time series data from National Accounts on *PFCE* (private final

5. **Basel III** norms prescribe a minimum regulatory capital of 10.5 per cent for banks by January 1, 2019. This includes a minimum of 6 per cent ***Tier I*** capital, plus a minimum of 2 per cent ***Tier II*** capital, and a 2.5 per cent capital conservation buffer. For this buffer, banks are expected to set aside profits made during good times so that it can be drawn upon during periods of stress.

consumption expenditure) indicate a structural shift in per capita consumption.

The share of food consumption in total consumption has declined over time, from an average of 51.34 per cent during 1950–60 to an average of 27.17 per cent during 2007–12.

(ii) Average annual growth in per capita food consumption at 0.94 per cent during 1950–2012 has been significantly lower than the overall growth in consumption averaging 1.84 per cent. The consumption of protein foods, though increasing more slowly than the increase in PFCE, had a growth of 1.50 per cent during 1950–2012, higher than the growth of overall expenditure on food. Therefore, the share of protein foods within overall food expenditure increased from 26.28 per cent during 1950–60 to 33.71 per cent during 2007–12.

(iii) A similar decline in expenditure on food, relative to that in other commodities and services has been as expected, associated with rising income levels.

(iv) Average annual growth of per capita expenditure during 1950–2011 was 2.40 per cent for non-food group. Within non-food commodities and services, average annual growth was 5.53 per cent, 3.97 per cent, 3.60 per cent and 3.42 per cent for transport and communication; recreation and education; medical and health care; and miscellaneous goods and services, respectively. Growth in expenditure for these sub sectors significantly exceeded the growth in expenditure on food. *Post reform* period (1992–93 to 2010–11) has shown a faster shift in consumption expenditure.

(v) An *increase in income* made this desirable shift in consumption feasible. At national level, per capita income, adjusted for inflation continued to rise.

(vi) There was also a significant increase in rural wages. Rural wages in nominal terms went up by an average of over 18 per cent from 2008–09. Inflation-adjusted rural wages also went up by 7.5 per cent during this period.

(vii) The ***input costs*** for producers in both the food and non-food segments, as reflected in the prices of feed, fodder and other inputs also increased. An increase in Minimum Support Price (MSP), while necessary to ensure remunerative returns to farmers, raised the floor prices and also contributed to the rise in input prices.

Q. 51 Briefly describe the recent steps taken by the GoI in the area of sugar sector reforms.

Ans. India is the largest consumer and second largest producer of sugar after Brazil. Sugar and Sugarcane are notified as essential commodities under the Essential Commodities Act 1955. The production of sugarcane during 2012–13 is estimated at 334.54 million tonnes. However, the Indian sugar sector suffers from policy inconsistency and unpredictability. The Sugar industry in India is over-regulated and prone to *cyclicality* due to price interventions. Deregulation of the sugar industry has been widely debated for a long time. From a purely economic point of view, greater play of market forces would provide better prices and serve the interests of all stakeholders. The government should come into the picture only in situations where absolutely necessary. Export bans and controls could be replaced with small variable external tariffs to stabilise prices.

A report on *'Regulation of the Sugar Sector in India: The Way Forward'* has been submitted by the Committee under the chairmanship of Dr. C.

Rangarajan, Chairman of the Economic Advisory Council to the Prime Minister—the measures suggested are as follows :

(i) phasing out cane reservation area;

(ii) dispensing with minimum distance criteria;

(iii) dispensing with the levy sugar system;

(iv) states that want to provide sugar under the PDS may procure it from the market according to their requirement, fix the issue price and subsidize from their own budgets (till April 4, 2013, when the GoI 'decontrolled' the sugar industry from the burden of 'levy' to the tune of 10 per cent of their total production, there was an implicit cross-subsidy on account of the levy as sugar mills were under a transition). The Report suggested some level of central support to help states meet the cost to be incurred on this account may be provided for a transitory period (which has been announced on April 4, 2013);

(v) dispensing with the regulated release mechanism (of non-levy) sugar;

(vi) stable trade policy;

(vii) no quantitative or movement restrictions on byproduct like molasses and ethanol and dispensing with compulsory jute packing.

(viii) a stable, predictable, and consistent policy reforms to be brought about in a fiscally neutral manner and issues considered for implementation in a phased manner.

In the meanwhile, following on the path of ongoing *'factor market reforms'* the GoI decontrolled the sugar industry in *April 2013*—effective for the 'sugar year' September 2012–August 2013. It abolished the decades-old practice of regulating 'how much sugar a mill can sell in the open market' and the 'levy' system in which a company is forced to sell 10 per cent of the output at a loss to the FCI for supplies through the PDS (Public Distribution System)—they will be no more under the levy obligation. The *next move* of reform may be 'linking sugar and sugarcane prices'.

To continue subsidised supply to the poor, states will now have to buy sugar at market rates and maintain the existing PDS sale price of Rs 13.50 per kg, which has not been revised for a decade and is substantially lower than the average market price of Rs. 35 per kg.

Q. 52 Describe the role of 'energy pricing' and the recent steps taken by the government in reforming the sector.

Ans. The economic role of rational energy pricing can hardly be under-estimated. Rational energy prices provide the right signals to both the producers and consumers and lead to a demand-supply match, providing incentives for reducing consumption on the one hand, and stimulating production on the other. Aligning domestic energy prices with the global prices, especially when large imports are involved, may be ideal option as misalignment could pose both micro- and macroeconomic problems. At microeconomic level, underpricing of energy to the consumer not only reduces the incentive for being energyefficient, it also creates fiscal imbalances. Leakages and inappropriate use may be the other implications. Underpricing to the producer reduces both his incentive and ability to invest in the sector and increases reliance on imports. Over the years, India's energy prices have become misaligned and are now much lower than global prices for many products. The extent of misalignment is substantial, leading to *large untargeted subsidies*. Several initiatives have been taken by the GoI for rationalising the energy prices in different sectors—

- The Integrated Energy Policy has outlined the broad contours of the pricing system for coal. The *pricing of coal* is done now on gross calorific value (GCV) basis with effect from January 31, 2012, replacing the earlier system of pricing on the basis of useful heat value (UHV) which takes into account the heat trapped in ash content also, besides the heat value of carbon content. The revision in the GCV is likely to increase the prices of domestic coal to some extent, but this is a desirable adjustment because domestic thermal coal, adjusted for quality differences, continues to be underpriced.
- In case of petroleum products pricing, the government dismantled the Administered Pricing Mechanism in 2002. This decision, however, was not fully implemented and domestic pass through of global price increases remained low for petrol, diesel, kerosene, and LPG—in June 2010, the government announced that the *price of petrol was fully deregulated* and the oil companies were free to fix it periodically.
- In *January 2013*, the government announced the new roadmap providing for a gradual price increase for reducing *diesel under-recoveries*.
- Admissibility of subsidised number of liquefied petroleum gas (LPG) cylinders and prices of LPG have also recently been revised. Pricing of gas is presently done under the New Exploration Licensing Policy (NELP). The government provides the operator freedom to sell the gas produced from the NELP blocks at a market-determined price , subject to the approval of pricing formula. The government is reviewing pricing under the PSC (price sharing contract) to clarify the extent to which producers will have the freedom to market the gas.

Q. 53 What is Marginal Standing Facility and what are its objectives? Describe in brief.

Ans. The MSF (Marginal Standing Facility) is a new scheme announced by the RBI in its *Monetary Policy, 2011–12*. Under this scheme, banks can borrow overnight upto 1 per cent of their net demand and time liabilities (NDTL) from the RBI, at the interest rate 1 per cent (100 basis points) higher than the current repo rate.

The MSF would be the last resort for banks *once they exhaust* all borrowing options, including the liquidity adjustment facility by pledging through government securities, which has lower rate (i.e., repo rate) of interest in comparison with the MSF. The MSF would be a **penal rate** for banks and the banks can borrow funds by pledging government securities within the limits of the statutory liquidity ratio. The scheme has been introduced by RBI with the main aim of reducing volatility in the overnight lending rates in the inter-bank market and to enable smooth monetary transmission in the financial system.

Banks can borrow through MSF on all working days except Saturdays, between 3.30 and 4.30 p.m. in Mumbai where RBI has its headquarters. The minimum amount which can be accessed through MSF is Rs.1 crore and in multiples of Rs.1 crore.

MSF represents the upper band of the interest corridor and reverse repo (7.25 per cent) as the lower band and the repo rate in the middle. To balance the liquidity, RBI would use the sole independent policy rate which is the repo rate and the MSF rate automatically adjusts to 1 per cent above the repo rate.

Similar to India's MSF the ECB (European Central Bank) also offers standing facilities

called *marginal lending facilities* (MLF) and the Federal Reserve (the US Central Bank) has *discount window systems* (DWS). Like the MSF, the secondary credit facility made available by the Federal Reserve to the depository institutions in USA is typically overnight credit on a very short term basis at rates above the primary credit rate.

The effectiveness of standing facilities in reducing volatility have been examined by many scholars and certain studies have pointed out that in the Federal Reserve System in the United States, the design of the facility decreases a bank's incentive to participate actively in *interbank market* (i.e., India's Call Money Market) due to the perceived stigma from using such facility. This in turn reduces the effectiveness of standing facility in reducing interest rate volatility.[6]

Q. 54 What are Nidhis and how are they regulated in India?

Ans. Nidhi in the Indian context means 'treasure'. However, in the Indian financial sector, it refers to any *mutual benefit society* notified by the Central / Union government as a Nidhi Company. They are created mainly for cultivating the habit of *thrift* and *savings* amongst its members. The companies doing Nidhi business, viz., borrowing from members and lending to members only, are known under different names such as *Nidhi, Permanent Fund, Benefit Funds, Mutual Benefit Funds* and *Mutual Benefit Company.*

Nidhis are more popular in ***South India*** and are highly localised single office institutions. They are mutual benefit societies, because their dealings are restricted only to the members; and membership is limited to individuals. The principal source of funds is the contribution from the members. The loans are given to the members at relatively reasonable rates for purposes such as house construction or repairs and are generally secured. The deposits mobilised by Nidhis are not much when compared to the organised banking sector.

Nidhis are companies registered under the Companies Act, 1956 and are regulated by Ministry of Corporate Affairs (MCA). Even though Nidhis are regulated by the provisions of the Companies Act, 1956, they are exempted from certain provisions of the Act, as applicable to other companies, due to limiting their operations within members.

Nidhis are also included in the definition of Non- Banking Financial companies or ***(NBFCs)*** which operate mainly in the *unorganised money market.* However, since 1997, NBFCs have been brought increasingly under the regulatory ambit of the RBI. Non-banking financial entities partially or wholly regulated by the RBI include:

(i) NBFCs comprising equipment leasing (EL), hire purchase finance (HP), loan (LC), investment (IC) [including primary dealers (PDs) and residuary non-banking (RNBC) companies;

(ii) Mutual benefit financial company (MBFC), i.e. *nidhi company*;

(iii) Mutual benefit company (MBC), i.e., potential nidhi company; i.e., a company which is working on the lines of a Nidhi company but has not yet been so declared by the Central Government; has minimum net owned fund (NOF) of Rs. 10 lakh, has applied to the RBI for certificate of registration and also to Department of Company Affairs (DCA)

6. The write-up is based on—the *RBI's Credit & Monetary Policy, 2011–12* (in which the Scheme was introduced); and the *European Central Bank*, Frankfurt, Germany and *Federal Reserve System* (also known as the *Federal Reserve*, and informally as the *Fed*) Washington, DC, USA.

for being notified as Nidhi company and has not contravened directions / regulations of RBI/DCA.

(iv) Miscellaneous non-banking company (MNBC), i.e., *chit fund company*.

Since Nidhis come under one class of NBFCs, RBI is *empowered* to issue directions to them in matters relating to their deposit acceptance activities. However, in recognition of the fact that these Nidhis deal with their shareholder-members only, RBI has exempted the notified Nidhis from the core provisions of the RBI Act and other directions applicable to NBFCs. As on date (*February 2013*), RBI does not have any specified regulatory framework for Nidhis.

Q. 55 What are Chit Funds and how are they regulated in India?

Ans. Recently, chit funds was in news after the Kolkata-based *Saradha Chit Fund* scam came to light. Chit funds (also known by their other names such as, *Chitty, Kuri, Miscellaneous Non-Banking Company*) are essentially 'saving institutions'. They are of various forms and lack any standardised form. Chit funds have regular members who make periodical subscriptions to the fund. The periodic collection is given to some member of the chit funds selected on the basis of previously agreed criterion. The beneficiary is selected usually on the basis of bids or by draw of lots or in some cases by auction or by tender. In any case, each member of the chit fund is assured of his turn before the second round starts and any member becomes entitled to get periodic collection again. Chit funds are the Indian versions of 'Rotating Savings and Credit Associations' found across the globe.

Chit fund business is regulated under the Central Act of *Chit Funds Act, 1982* and the Rules framed under this Act by the various State Governments for this purpose. Central Government has not framed any Rules of operation for them. Thus, Registration and Regulation of Chit funds are carried out by *State Governments* under the Rules framed by them. Functionally, Chit funds are included in the definition of Non-Banking Financial Companies by RBI under the sub-head *miscellaneous non-banking company* (MNBC). But RBI has not laid out any separate regulatory framework for them.

Official Definition: As per the Chit Funds Act 1982, chit means 'a transaction whether called *chit, chit fund, chitty, kuri* or by *any other name* by or under which a person enters into an agreement with a specified number of persons that every one of them shall subscribe a certain sum of money (or a certain quantity of *grain* instead) by way of periodical installments over a definite period and that each such subscriber shall, in his turn, as determined by lot or by auction or by tender or in such other manner as may be specified in the chit agreement, be entitled to the prize amount'. A transaction is not a chit, if in such transaction—

(i) Some alone, but not all, of the subscribers get the prize amount without any liability to pay future subscriptions; or

(ii) All the subscribers get the chit amount by turns, with a liability to pay future subscriptions.

Q. 56 Discuss the challenges faced by the public sector banks in the light of the emerging business opportunities in the banking sector.

Ans. Once India started banking sector reforms in the early 1990s, the banking industry saw multi-dimensional growth where new private banks were given licences, foreign banks allowed entry, universal banking became possible etc. The hitherto closed banking sector with almost complete state monopoly (via the public sector banks—PSBs) was faced with multiple challenges. Private sector banks started entering the sector with state-of-

the-art technology, making it more difficult for the PSBs to complete. Another challenging task for PSBs in the near future will be related to their human resource management. The market in the financial sector and especially in banking, is seeing growth driven by new products and services that include opportunities in:

(i) credit cards, consumer finance and wealth management on the *retail side,* and
(ii) fee-based income and investment banking on the *wholesale side*.

These require new skills in sales and marketing, credit and operations. Furthermore, given the demographic shifts resulting from changes in the age profile and household income, consumers will increasingly demand enhanced institutional capabilities and levels, of service from banks. The PSBs need to fundamentally strengthen institutional skill levels especially in sales and marketing, service operations, risk management, and overall organisational performance.

The following steps (suggested by the RBI and experts) may help PSBs in handling these challenges:

(i) use of technology to reduce the gap created by shortage of staff and improving overall manpower efficiency.
(ii) a pool of talent for occupying leadership positions may be built up by banks by training and preparing promising officers to assume future leadership roles.

The challenges are going to be even tougher as the RBI has recently announced releasing some fresh licences for setting up new banks in the country.

Q. 57 Cite the reasons fer the state of under-developed corporate bond markets in India and suggest measures for its development.

Ans. Measures taken towards different segments of the finncial sector reforms since early 1990s have given visible results—in terms of market features and depth the Indian equity market today ranks among the best in the world; the government securities market has also evolved over the years and expanded. In contrast, the corporate bond market has not shown such a synergy and has remained a laggard, both in terms of market participation and structure. Emerging economies like Mexico, Russia, Poland, Brazil and Indonesia have more vibrant corporate bond markets in comparision to India.

Experts, together with the *Economic Survey 2010–11,* have cited several reasons for the under-development of the corporate bond market in India:

(i) Banks loans being the popular and predominant mode of raising long-term capital;
(ii) Participation of FIIs is limited ;
(iii) Due of lack of investor confidence, pensions and insurance companies as well as household are limited participants; and
(iv) Crowding out of fund/investible capital by government bonds.

Non-bank finance companies are the main issuers and very small amounts of finance are raised by companies/corporates directly. The corporate bond market as a result, is only about 14 per cent of the total bond market, while on the other hand, liquidity in the market and investment in the infrastructure sector remain constrained. With the intervention of the *Patil Committee* recommendations, the corporate bond market is slowly evolving. With bank finance drying up for long-term infrastructure projects in view of asset liability problems (faced by the banking system), further development of a deep and vibrant corporate bond market is the need

of the hour (also suggested by the *World Bank*, recently).

Following steps may be taken for the promotion and development of corporate bond market in India:

(i) Clearing/settlement on DvP (Delivery versus Payment) basis; market making with primary dealers; enabling Credit Default Swap; guaranteeing of corporate bonds by banks; and relaxing norms on short selling of government bonds (all fall under RBI's preview).

(ii) Relaxing norms for use of shelf prospectus (requires amendment to Section 60 of Companies Act by the MCA).

(iii) Putting corporate bonds under SARFAESI (Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest) Act (so that recovery becomes fullproof and investor's confidence comes in).

(iv) Arrangement for a comprehensive bond data base.

(v) Lowering the stamp duties on the bond and making them uniform across states (Stamp Act needs to be amended by the Department of Revenue).

Q. 58 'Finance Commission (FC) and Planning Commission (PC) were working together for better development.' Elucidate.

Ans. The Constitution provides for a Finance Commission (FC) to promote fiscal federalism and ensure decentralised ways of development. But the Parliament gave it only the power to suggest the distribution of the Union's tax revenue. Meanwhile, the extra-constitutional body, the Planning commission (PC) started playing a more proactive role in the area of developmental issues and allocation of funds. It was the fourth Finance commission (headed by P.V. Rajamannar) which, for the first time, suggested a cooperative approach between PC and FC. in the last few years, academicians and the experts have been suggesting the same thing.

It was in 2002 that the government, for the first time, announced such an idea. (The then Finance Minister Mr. Jaswant Singh suggested this while announcing the setting up of the 12th FC)—*the PC will be playing more or less a role of callaborator to the FC.* Mr. Som Pal was made a common member to both the bodies (after the UPA came to power, he resigned from the FC).

Experts appreciated the above governmental step as in the process of development; the FC has been left on the margins of the development process and the PC was playing a more important role. It is better they work in tandem since both are committed to economic development. The recent view of decentralised planning, coalition government and requirement of greater fiscal federalism together demand a collaborative approach between these two bodies. By doing so, there is no doubt that a greater developmental purpose will be served.

Q. 59 Briefly describe the National Mission for Sustainable Agriculture.

Ans. Climate change has enormous implications for the natural resources and livelihood of the people. Various studies indicate that the key sectors in India such as the agriculture, water, natural ecosystem, biodiversity and health are vulnerable to climate change. This is happening precisely at a time when it is confronted with huge development imperatives. The Indian Network for Climate Change Assessment (INCCA) released a report in November 2010 on assessment of the impact of climate change on key sectors and regions of India in the 2030s—agriculture being one among the four key sectors. The report warns of impacts such as sea-level rise, increase in cyclonic intensity, *reduced crop yield in rainfed crops, stress on livestock,*

reduction in milk productivity, increased flooding, and spread of malaria. This called for urgency of action in reducing vulnerability to adverse impacts of climate change. India announced a National Action Plan on Climate Change (NAPCC) in June 2008 to realise it, which includes eight National Missions.

The National Mission for Sustainable Agriculture (NMSA) is among the eight national missions which seeks to address issues regarding 'sustainable agriculture' in the context of risks associated with climate change. Major functions of the mission have been defined as given below:

(i) devising appropriate adaptation and mitigation strategies for ensuring food security,

(ii) enhancing livelihood opportunities, and contributing to economic stability,

(iii) mainstreaming the adaptation and mitigation measures in R&D activities,

(iv) absorption of improved technology and best practices,

(v) creation of physical and financial infrastructure and institutional framework,

(vi) facilitating access to information and promoting capacity building,

(vii) promoting dryland agriculture by developing drought- and pest-resistant crop varieties, and

(viii) expanding its coverage to rainfed areas for integrating farming systems with livestock and fisheries.

Under the aegis of the central government, the state governments are also preparing their State Action Plans aimed at creating institutional and programme-oriented capacities to address climate change. These, together with the National Missions, will enhance climate change-related actions in the public and private domains.

Q. 60 Write a note on the recent steps taken by the government in the direction of fiscal consolidation.

Ans. After the IMF cautioned about the economy's fiscal parameters and the condition put by it concerning the immediate fiscal consolidation, the Union government in mid 1990s looked concerned about the matter. After a longer time of deliberations, ultimately an Act was passed by the Parliament in 2003—the Fiscal Responsibility and Budget Management (FRBM) Act. All political parties voted in favour of this Act. This should be considered the most important legislation in India in the direction of fiscal consolidation which envisages:

(i) Revenue deficit to be cut by 0.5 per cent of GDP per year.

(ii) Fiscal deficit to be cut by 0.3 per cent of GDP per year.

(iii) Fiscal deficit must be brought down to less than 3 per cent of the GDP by 2007–08 and revenue deficit to zero by that time (UPA government did it in 2008–09).

Further, the government did set stiffer targets; the revenue deficit down from 3.6 per cent to 2.5 per cent of the GDP by March 2005. other than the FRBM Act, the government is also committed on the following fronts:

(i) Increasing *tax revenue*—imposing new taxes (service tax, transaction tax, etc.) besides broadening the tax base (income tax) as well as trying for better tax compliance and evasionless tax regime.

(ii) Cutting down *revenue expenditure*—controlling interest burden by lesser borrowings, rationalising subsidies, right-sizing the government etc.

(iii) Encouraging states to adopt a uniform VAT so that the state government's revenue could be increased and cascading effect of tax could be restricted.

(iv) Saving state governments from bankruptcy by proposing for them a share in the service tax and the custom duties.

A committee (task force) headed by Mr. Kelkar handed over its report to the government concerning the feasibility of the FRBM Act. Meanwhile, some populist tendencies have been seen among the states as many have gone for promising free electicity to the farmers; such sops are surely detrimental to the attempts of fiscal consolidation, as states are the real culprit in fiscal deficit at present.

Note: The Model Answers have been prepared by consulting a restricted list of references only to make them relevant and useful for the competitive examinations conducted by the various government bodies. Following main references have been consulted: various volumes of ***Economic Survey;*** *various volumes of* ***India*** reference manual; last three volumes of the ***India Development Report.*** Ministerial sources, websites of ***RBI*** and the **Planning Commission.**

ECONOMIC SURVEY

- Introduction
- Highlights of the Economic Survey 2014–15
- A Brief View
- Recent Growth Record
- Aggregate Demand
- Factor Shares in GVA
- Public Finance
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- External Sector
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INTRODUCTION

The *Economic Survey 2014–15* is different from its predecessors. In the words of Survey itself, it has been inspired by the World Economic Outlook of the IMF—departing *structurally* from its predecessors presenting its output in *two volumes*. **Volume 1** discusses the outlook and prospects as well as presents a number of analytical chapters addressing topical policy concerns. Volume 2 describes recent developments in all the major sectors of the economy and contains all the statistical tables and data. In a sense, Volume 1 is forward-looking but gaining from the perspective provided by the recent past which is the subject of Volume 2.

The survey begins with a famous quote from J. M. Keynes—'it is necessary to distinguish the important from the urgent'. This has been done to fulfil the aim of providing the new government a better insight into the issues, concerns and the policy choices. The *broad themes* of the survey are "creating opportunity and reducing vulnerability." Growth is the prerequisite for achieving many economic and indeed other objectives. Maximising the benefits of growth will, of course, require complementary public actions, but without growth, possibilities across the income spectrum shrink. Increasingly, the debate on reducing poverty and vulnerability more generally is less about 'whether' and more about 'how best' direct government support can complement broader economic growth. *Growth versus distribution* is, as it always should have been, a false choice.

Volume 1 begins with a chapter on the macroeconomic outlook and prospects for the Indian economy which sets the context for brief discussions of the policy issues focused on 'creating opportunity and reducing vulnerability.' These issues are then elaborated in the following nine chapters.

Growth requires macroeconomic and hence fiscal stability. A re-visiting of the fiscal framework is also necessary because this is the first full budget of the government and because of the reported recommendations of the Fourteenth Finance Commission that could decisively shape centre-state fiscal relations. This is followed by a chapter on 'wiping every tear from every eye' where the focus is on how support is best provided and the *role that technology* can play in this regard. Volume 1 covers several burning issues—

- The state of stalled projects and their implications for private and public investment going forward;
- A brief diagnosis of the banking system and its implications for reforming it;
- The role of railways in driving future Indian growth;
- *Make in India* initiative, shedding light on the debate between manufacturing and services and suggesting alternative ways of thinking about transformational sectors;
- The need a *single market* in agriculture;
- Climate change issue linking with the carbon tax issue;
- The *dramatic re-shaping* of Centre-State fiscal relations due to the acceptance to the recommendations of the recommendations of the *14th Finance Commission*.

The survey places a premium on new ideas or new perspectives both of an academic and policy nature. The limitations of time and resources mean that new ideas may not pass the most rigorous standards of the academy. But the approach is to find new data or present old data in a new form, to make connections, and to draw insights wherever possible, all with the aim of shedding light on policy. The aim is to provoke and stimulate debate and discussion, thereby enriching the process of policymaking, and hopefully, improving its outcome. The survey also aims to be readable, rising to the challenge of making dry economics as

accessible as an op-ed (or perhaps a blog) without fully sacrificing the rigor of a more serious tome. 'The discipline may be dismal but, dear reader, it should not be dreary', the survey appeals at the end.

HIGHLIGHTS OF THE ECONOMIC SURVEY 2014–15

A synoptic view of the *Economic Survey 2014–15*, Volume 2 is presented below.

A BRIEF VIEW

While comparing economic performance of different countries in 2014–15, one of the redeeming features has been, the *emergence* of India among the few large economies with propitious economic outlook, amidst the mood of pessimism and uncertainties that engulf a number of advanced and emerging economies (severe recession). Brighter prospects in India owe mainly to the fact that the economy stands largely *relieved of the vulnerabilities* associated with—

(i) an economic slowdown,
(ii) persistent inflation,
(iii) elevated fiscal deficit,
(iv) slackening domestic demand,
(v) external account imbalances, and
(vi) oscillating value of the rupee in 2011–12 and 2012–13.

From the macroeconomic perspective, the worst is clearly behind us. The latest indicators, emerging from the recently revised estimates of national income brought out by the CSO, point to the fact that the revival of growth had started in 2013–14 and attained further vigour in 2014–15.

Issues like the steep decline in oil prices, plentiful flow of funds from the rest of the world, and potential impact of the reform initiatives of the new government at the centre along with its commitment to calibrated fiscal management and consolidation bode well for the growth prospects and the overall macroeconomic situation.

Encouraged by the greater macro-economic stability and the reformist intent and actions of the government, coupled with improved business sentiments in the country, institutions like the IMF and the World Bank have presented an optimistic growth outlook for India for the year 2015 and beyond. The possible headwinds to such promising prospects, however, emanate from ***factors*** like (external and domestic)—

(i) Inadequate support from the global economy saddled with subdued demand conditions, particularly in Europe and Japan;
(ii) Recent slowdown in China;
(iii) Possible spill-overs of below normal agricultural growth; and
(iv) Challenges relating to the massive requirements of skill creation and infrastructural upgradation.

The encouraging results from the Advance Estimates for 2014–15 suggest that though the global sluggishness has partly fed into the lacklustre growth in foreign trade; yet this downward pressure has been compensated by strong domestic demand, keeping the growth momentum going.

RECENT GROWTH RECORD

Before analysing the recent macroeconomic trends, it may be mentioned that the Central Statistics Office (CSO) has recently revised the national accounts aggregates by shifting to the new base of 2011–12 from the earlier base of 2004–05 (for details see *Chapter 1* of the book). Given the provisional and preliminary nature of the available information that may take time to stabilize and the fact that information for growth-related parameters is available only for three years on the revised base, it becomes difficult to objectively analyse the broad macroeconomic trends on a

longer term horizon. The new set of information also cannot be compared with the information and analysis based on the 2004–05 series.

The economic scenario presented by the new series (with 2011–12 as base year) reveals that there was perceptible improvement in some of the macro-aggregates of the economy in 2013–14, which got strengthened in 2014–15.

- Economic growth, measured by growth in gross domestic product (GDP) at constant market prices, estimated at 5.1 per cent and 6.9 per cent respectively during 2012–13 and 2013–14, was higher than the corresponding figures of 4.7 per cent and 5.0 per cent released under the 2004–05 series in May 2014.
- That this high growth occurred in a year when the both the savings and investment to GDP ratios were lower than the average of a number of years and when the level of imports (that are generally positively associated with GDP) actually declined by 8.4 per cent in real terms, is somewhat puzzling.
- One of the reasons why the real GDP growth rate for 2013–14 appears to be strong is the lower GDP level in 2011–12 and 2012–13 along with lower GDP deflators than were thought hitherto.

The *Table 1* captures these effects separately based on the new and old series.

AGGREGATE DEMAND

The Indian economy underwent serious demand and supply constraints in recent years. With the firming up of growth in 2013–14, the final consumption expenditure in the economy (expressed at constant prices) also got strengthened. ***Important features*** regarding aggreagte demand in the economy have been as given below:

- There was a downward pressure on aggregate demand due to the steep decline in the rate of capital formation, constraining domestic absorption (consumption plus investment) to grow by only 2.8 per cent in 2013–14. Despite this, a growth close to 7 per cent was achieved in 2013–14 on the back of the robust 7.3 per cent growth in exports of goods and services and 8.4 per cent downslide in imports.
- The decline in the rate of gross fixed capital formation (GFCF) during 2013–14 was much less pronounced than in the overall investment rate (gross capital formation-GCF), because the other two components of GCF, viz. changes in stock and valuables, declined significantly. The correction in the stock of inventories is an ongoing process that is determined by the demand and supply conditions and is not, in a big way, related to the capital base of the economy.
- Likewise, valuables, i.e. the accumulation of gold, silver, and other precious metals, do not add much to the productive base either. Hence the decline in these items in 2013–14, though in accounting sense leads to a moderation in investment, need not be read much into. However, the almost five percentage point reduction in the rate of fixed investment from 2011–12 to 2014–15 would need to be reversed for growth to be sustained and augmented.
- Contrary to the long-term trends in consumption, the average propensity to consume increased visibly during the last three years (2012–15), mainly on account of higher growth in government consumption expenditure. This is expected to partially provide the required demand impetus to growth.

- The demand side of the GDP presented mixed signals in 2014–15—
  - (i) The increasing trends in consumption have gradually firmed up, with both private and government consumption growing in strength.
  - (ii) The fixed capital formation in the economy has picked up growth but lost share in aggregate demand.
  - (iii) There is hardly any support to growth from exports.
- The deceleration in imports owes substantially to the sharp decline in international oil prices in the current year that compressed the oil import bill. Hence one cautious conclusion could be that the ongoing growth revival is predominantly domestic consumption-driven.
- Comparison of the growth rates and ratios of GFCF to GDP among countries conveys that India operates at the *lowest* incremental capital output ratios (ICOR-based on GFCF) among the BRICS countries (and Indonesia). Given an average fixed investment rate of **30.5** per cent for 2012–13 and 2013–14, and given the average GDP growth of 6 per cent for these years, the ICOR works out to 5.1. With growth improving to 7.4 per cent in 2014–15 and with the ratio of GFCF declining slightly (despite acceleration in the rate of growth of GFCF), the ICOR for India may have declined further.
- From the past trends in the **saving rate** (gross domestic savings as percentage of GDP) available from the pre-revised series, it is observed that it reached its historical peak in 2007–08 (**36.8** per cent) and then remained volatile, with a general downward movement. While private corporate savings steadily declined, household savings witnessed realignment in favour of accumulation of physical assets at the cost of financial savings. Indications of compositional changes in savings can be seen from the data for three years based on the new series.

FACTOR SHARES IN GVA

In line with the *income approach* to GDP, the GVA (Gross Value Added) at basic prices in a year can be expressed as the sum of the compensation of employees (CE), operating surplus (OS)/mixed income of the self-employed (MI), consumption of fixed capital (CFC) and taxes net of subsidies on production. The CE is the composite value of wages and salaries paid in the sector, including the social contributions made by the employer, representing the income share of employees in the GVA. In the organized sector, OS is the difference between net value added and compensation of employees. As a result of the existence of unincorporated enterprises and household industries in the unorganized sector, which either do not maintain accounts or are wholly managed by self-employed workers, net value added (NVA) cannot be separated as income of labour and entrepreneurship. This necessitated the introduction of an item called mixed income of selfemployed to complete the account.

In the *agricultural sector*, CE represents only the share of wages to hired labour and hence the total returns to farmers working on their own fields/ fields hired by them, becomes part of MI. Hence, it is difficult to relate the employment share in agriculture to CE in agriculture. The presence of a large unorganized segment in *manufacturing* and certain services also makes it difficult to establish correspondence between their employment shares and the CE to GVA ratios. It may be noted that the employment share of the construction sector is higher than its GVA share, and the same gets reflected in the sector's CE to GVA ratio. Apart from agriculture, construction is the only sector whose employment share is higher than GVA

share. As per the AE for 2014–15, the growth in construction is gradually picking up, which should auger well for employment generation.

Among *service-sector* activities, two sectors with comparatively lower presence of the unorganised segment include financial, real estate, and business services and community, social, and personal services. Consistent with the contrast in their GVA and employment shares, the ratio of CE to GVA is also vastly different in these sectors. Community, social, and personal services have a majority government presence.

During 2012–13 to 2013–14, the average growth in **per capita income**, i.e., 4.3 per cent as per the new series, is much higher than the corresponding growth of 2.4 per cent presented by the old series.

PUBLIC FINANCE

The public finance sector has seen sveral changes in the past few years:

- In 2013–14, *proactive policy decisions* of the government with firm commitment to the policy of fiscal rectitude improved the year-end performance of the fiscal deficit target set for year. The first nine months of 2014–15 witnessed some major policy reforms—
  - (i) Change in the subsidy regime;
  - (ii) The modified direct benefit transfer scheme has been launched;
  - (iii) The new domestic gas pricing policy has been approved; and
  - (iv) Diesel prices have been deregulated.
  - (v) An Expenditure Management Commission has been constituted to lookintovariousaspectsofexpenditure reforms to achieve the goal of fiscal consolidation. It will review the allocative and operational efficiencies of government expenditure to achieve maximum output.
- The fiscal deficit for 2013–14 (PE) worked out at 4.5 per cent of GDP as opposed to the Budget Estimate (BE) of 4.8 per cent. Fiscal deficit and revenue deficit were budgeted at Rs. 5,31,177 crore (**4.1** per cent of GDP) and Rs. 3, 78,348 crore (**2.9** per cent of GDP) respectively in 2014–15.
- The BE for 2014–15 aimed at achieving *tax to GDP* and *non-debt receipt to GDP* ratios of 10.6 per cent and 9.8 per cent, respectively as against a 13.9 per cent total expenditure to GDP ratio. The envisaged growth for *gross tax revenue* was 17.7 per cent over the Revised Estimates (RE) for 2013–14 and 19.8 per cent over the Provisional Actuals (PA) 2013–14. Total expenditure was estimated to increase by 12.9 per cent and 14.8 per cent in BE 2014–15 over RE 2013–14 and PA 2013–14 respectively.
- On the expenditure side of Union Government accounts, the notable trends during April–December 2014 include a shortfall in growth in Plan and non-Plan expenditure vis-à-vis the corresponding period of the previous year**.** Major subsidies during April–December 2014 have increased by 12.5 per cent compared to April-December 2013 due to increase in food subsidy (Rs. 21,807 crore) and fertilizer subsidy (Rs. 6620 crore). A significant positive outcome in 2014–15 so far is a decline in petroleum subsidy by ' 4908 crore compared to the corresponding period in 2013–14 due to fuel pricing reforms and fall in the global prices of petroleum products.
- Fiscal deficit at 100.2 per cent of BE in 2014–15 (April–December) is much

higher than the five-year-average of 77.7 per cent. The revenue deficit for April-December 2014 is estimated at 106.2 per cent of BE and is significantly higher than the five-year -average of 81.4 per cent.

PRICES AND MONETARY MANAGEMENT

Prices and monetary management did show the following picture:

- Headline inflation (WPI with the base year 2004–05=100) which remained persistently high at around 6–9 per cent during 2011–13 *moderated* to an average of 3.4 per cent in 2014–15(April-December) on the back of lower food and fuel prices.
- During the first quarter of 2014–15, WPI headline inflation was at 5.8 per cent mainly because *food and fuel prices* continued to be high. In the second and third quarters of 2014–15, WPI inflation declined to 3.9 per cent and 0.5 per cent respectively. WPI headline inflation declined by 0.4 per cent in January 2015 as compared to January 2014.
- Retail inflation (CPI-C with the base year 2010=100) had remained stubbornly sticky around 9–10 per cent during 2012–13 and 2013–14. Like the WPI inflation, CPI inflation has also *moderated* significantly since the second quarter of 2014–15, with moderation in inflation observed in all the three major subgroups: food and beverages, and tobacco; fuel and light; and others. The CPI (combined) inflation declined to 5.1 per cent in January 2015.

The decline in inflation during the year turned out to be much faster than was anticipated in the initial months of the year due to the *following external and global factors*—

(i) Global factors, namely persistent decline in crude prices, soft global prices of tradables, particularly edible oils and even coal, helped moderate headline inflation.

(ii) The tight monetary policy was helpful in keeping the demand pressures contained, creating a buffer against any external shock, and keeping volatility in the value of the rupee under check.

(iii) During the last one year, the rupee remained relatively stable vis-à-vis the major currencies, which too had sobering influence on inflation.

(iv) Moderation in wage rate growth reduced demand pressures on proteinbased items.

(v) Base effect also contributed to the decline in headline inflation.

MONETARY DEVELOPMENTS

The RBI kept policy rates unchanged during the year till January 2015. With the easing of inflationary conditions, the RBI has signalled softening of the monetary policy stance by cutting policy repo rates by 25 basis points to 7.75 percent in January 2015. Subsequently, the RBI also reduced the statutory liquidity ratio (SLR) by 50 basis points from 22.0 per cent of net demand and time liabilities (NDTL) to 21.5 per cent. The RBI adopted the new CPI-C as the measure of the nominal anchor for policy communication from April 2014.

With a view to ensuring flexibility, transparency, and predictability in liquidity management operations, the RBI revised its liquidity management framework (LMF) in September 2014. Liquidity conditions have remained broadly balanced during 2014–15 so far, except transient *tight conditions*. The revised liquidity management framework helped the weighted average cut-off rates in the *14-day term*

repo auctions as well as in the overnight variable rate repo auctions to remain close to the repo rate.

EXTERNAL SECTOR

The situations on the external front have been mixed over the last few years due to fluctuations in the external factors, of late traits of recovery have been visible:

- After a turbulent initial phase in 2013–14, the outcome for the year as a whole was robust owing to the policies that were put in place to correct the extraordinary situation. A continuance of the robust external sector outcome through the year 2014–15 facilitated the lifting of restrictions on gold and, in tandem with lower international prices of crude petroleum, helped usher in reform in diesel pricing. The lack of full pass-through of global crude petroleum prices to domestic diesel prices was a major factor in the elevated levels of *twin deficits*. Going forward, the robustness of the external outcome is on a sustainable reform anchor.
- Over the **last ten years**, India's merchandise trade (on customs basis) increased manifold from US$ 195.1 billion in 2004–05 to US$ 764.6 billion in 2013–14 helping India's share in global exports and imports improve from **0.8** per cent and **1.0** per cent respectively in 2004 to 1.7 per cent and **2.5** per cent in 2013. Its ranking amongst the leading exporters and importers improved from 30 and 23 in 2004 to 19 and **12** respectively in 2013.
- After growing by 4.7 per cent in 2013–14, India's merchandise exports growth moderated to 2.4 per cent to reach US$ 265 billion in 2014–15 (April-January). During 2013–14, India's merchandise imports contracted by 8.3 per cent to US$ 450.2 billion.
- The value of petroleum, oil, and lubricants (**POL**) imports, which accounted for **36.6** per cent of India's total imports in 2013–14, declined by 7.9 per cent in 2014–15 (April-January) as a result of decline in the price of international crude petroleum products. The growth in imports of POL was 5.9 per cent and 0.4 per cent respectively in 2012–13 and 2013–14. Given the less than adequate pass-through, the level of POL imports continued to be elevated till the first quarter of the 2014–15. There was moderation in international crude oil prices (Brent) from US$109.8 per barrel in the first quarter of 2014–15 to US$ 76.0 per barrel in the third quarter which resulted in the value of POL imports declining by 7.9 per cent in 2014–15 (April–January).
- The share **of gold and silver** imports in India's total imports was 11.4 per cent in 2012–13 and 7.4 per cent in 2013–14. Gold and silver imports that declined by 9.6 per cent and 40.4 per cent respectively in 2012–13 and 2013–14 grew by 8.0 per cent in 2014–15 (April-January).
- **Capital goods** imports declined continuously from 2011. Non-POL and non-gold and silver imports, which largely reflect the imports needed for industrial activity, grew by 7.8 per cent in 2014–15 (April–January), after registering a decline of 0.7 per cent and 6.9 per cent respectively in 2012–13 and 2013–14.
- **Manufactured goods** constituted the bulk of exports—over **63** per cent in recent years—followed by crude and petroleum products (including coal)

with 20 per cent share and agriculture and allied products with 13.7 per cent share. After crossing US $ 300 billion in 2011–12, there has been significant deceleration in growth rates of exports which is somewhat a global phenomenon as global trade volumes have not picked up significantly since the 2011 *Eurozone crisis*.

- Growth in exports of petroleum and agriculture and allied products which were in positive territory for the last four years turned negative in 2014–15 (April-January). *Gems and jewellery* exports which exhibited a declining trend in 2012–13 and 2013–14, continued to decline in 2014–15 (April-January). Similarly, the decline in *electronic goods* exports since 2012–13 continued in 2014–15. During 2014–15 (April-January), some sectors like transport equipment; machinery and instruments; manufactures of metals; and ready-made garments registered positive growth in exports. Marine products and leather and leather manufactures recorded relatively higher growth in 2012–13, 2013–14, and 2014–15 (April-January).
- There has been significant *market diversification* in India's trade in recent years—a process that has helped cope with the sluggish global demand, which owes to a great extent to the weakness in the Eurozone.
- **Region-wise**, India's export shares to Europe and America have declined over the years from 23.6 per cent and 20.1 per cent respectively in 2004–05 to 18.6 per cent and 17.2 per cent respectively in 2013–14. Conversely, shares of India's exports to Asia and Africa have increased from 47.9 per cent and 6.7 per cent respectively in 2004–05 to 49.4 per cent and 9.9 per cent respectively in 2013–14.
- In 2014–15 (April-January), **trade deficit** increased marginally by 1.6 per cent to US$ 118.4 billion as against US$ 116.5 billion in 2013–14(April-January). Lower growth of exports (2.4 per cent) and imports (2.2 per cent) in 2014–15 (April–January) has resulted in a marginal increase of US $ 1.9 billion in the trade deficit.

Balance of Payment

- The widening of the current account deficit (CAD) in 2011–12 and 2012–13 owed to elevated levels of imports and its financing had implications in terms of larger outgo as investment income in the invisibles account. As a proportion of the level of CAD, such outgo rose from 28.2 per cent in 2007–08 to 72.6 per cent in 2013–14. One of the important considerations for reduction in CAD was that even with its full financing, the levels of CAD have a cascading impact through investment income outgo.
- In the first half of 2014–15, India's external-sector position was benign and comfortable. Two important developments were:
  - (i) lower trade deficit along with moderate growth in invisibles that resulted in lower CAD and
  - (ii) surge in capital inflows, enabled by higher portfolio investment, foreign direct investment (FDI), and external commercial borrowings (ECB).
- Capital inflows were in excess of the financing requirement of the CAD and resulted in accretion in foreign exchange reserves. The CAD was placed at US $ 17.9 billion in 2014–15 (April–September) as against US $ 26.9 billion in the same

period of 2013–14. As a proportion of GDP, the CAD declined from 3.1 per cent in the first half of 2013–14 to 1.9 per cent in the first half of 2014–15.

- Among the major economies with a CAD, India is the **second largest** foreign exchange reserve holder after Brazil. India's foreign exchange reserves at US$ 330.2 billion as on 6 February 2015 mainly comprised foreign currency assets amounting to US$ 305.0 billion, accounting for about 92.5 per cent of the total.
- With increase in reserves in the first half of 2014–15, all reserve-based traditional external sector vulnerability indicators have improved. For instance, the ratio of short-term external debt to reserves declined from 29.3 per cent at end-March 2014 to 27.5 per cent as at end-September 2014 and the *reserve cover* for imports also increased from 7.8 months at end-March 2014 to 8.1 months as at end-September 2014.
- The rupee-US dollar exchange rate has remained *broadly stable* during the year thanks to the huge inflow of FDI and foreign institutional investment (FII) in the equity and bond markets. Due to the weak economic outlook in Europe and Japan, the rupee has appreciated against the euro and yen since September 2014 in tandem with cross-currency movements of the euro and yen vis-à-vis the US dollar.

External Debt

The external debt stock of India increased by US$ 13.7 billion (3.1 per cent) to US$ 455.9 billion at end-September 2014 over the end-March 2014 level. The rise in external debt was on account of higher long-term debt particularly commercial borrowings and non-resident Indian (NRI) deposits.

The maturity profile of India's external debt indicates the dominance of long-term borrowings. At end-September 2014, long-term debt accounted for **81.1** per cent of the total external debt as against 79.8 per cent at end-March 2014. India's external debt has remained within manageable limits as indicated by the *external debt to GDP ratio* of 23.5 per cent and *debt service ratio* of 5.9 per cent in 2013–14.

The prudent external debt management policy of the Government of India has helped maintain a comfortable external debt position.

OUTLOOK FOR 2015–16

- The outlook of the economy for the year 2015–16 has been outlined by the survey in the following way:
- The *macroeconomic situation* in India has improved significantly during the current year. The release of the new series of national accounts revealed that the economy has been performing much better than what was being depicted earlier. The steady acceleration in services and manufacturing growth in the face of subdued global demand conditions point to the strengthening of domestic demand. Most of the buoyancy in domestic demand can be traced to consumption.
- *Investment* activity, which is slowly picking up, needs to be grounded on a stronger footing. The savings-investment dynamics will be crucial for the growth to strengthen further in the coming years, in addition to reversal of the subdued export performance being currently witnessed. The key will be the response of savings to improved price and financial market stability, and of investment, particularly

in the crucial infrastructure sector, to reform efforts of the Government that are underway.

- On the *supply side*, there are concerns about tentative growth patterns in construction and mining activities that need to be addressed to. This is particularly important in view of the strong intersectoral linkages that these sectors have. The farm sector suffered from a relatively poor monsoon, but there are no indications of its spillover to be next year. The improving rate of value addition in the economy, represented by the ratio of value added to output, and the falling incremental capital output ratio indicate better resource use in production.
- On the *global front*, the United States radiates confidence and strength, while some other structurally important economies like China, Russia, Euro area and Japan face uncertain prospects, thereby affecting global growth and investment outlook. The sharp decline in oil prices has provided an incentive for overall global growth and stability. At the same time, it has diminished fortunes of oil exporting countries that can influence economic activity adversely.

In the light of the government's commitment to reforms, along with the improvements in the price and external sector scenarios including the possibility of international oil prices remaining generally benign, the outlook for domestic macroeconomic parameters is generally optimistic, notwithstanding the uncertainties that could also arise from an increase in the interest rates in the United States and situation prevailing in Greece within Euro-zone. Given the above, and assuming normal monsoons better prospects in the world economy that could provide impetus to higher exports for Indian products and services, a growth of around 8.5 per cent is in the realm of possibility in 2015–16.

SECTORAL DEVELOPMENTS

AGRICULTURE

During the Tenth Plan, the contribution of agriculture and allied sectors to the GDP (at 2004–05 prices) of the country was 19 per cent and it declined to 15.2 per cent during the Eleventh Plan. This is in accordance with the typical past pattern of structural transformation of the economies in transition. Agriculture and allied sectors registered a growth of 2.5 per cent in the Ninth Plan, 2.4 per cent in Tenth Plan, and 4.1 per cent in the Eleventh Plan.

For the year 2013–14, total foodgrain production has been estimated at 265.6 million tonnes, which is higher by 8.5 million tonnes than the previous year's production and 22.1 million tonnes than the average production of foodgrains during the last five years. As per the second AE released by the Ministry of Agriculture on 18 February 2015, total production of foodgrains during 2014–15 is estimated at **257.1** million tonnes.

The *Survey* highlights the following **challenges** and **policy recommendations** for the Indian agriculture—

(i) Agriculture and food sectors need huge investment in research, education, extension, irrigation, fertilizers, and laboratories to test soil, water, and commodities, and warehousing and cold storage. Rationalization of subsidies and better targeting of subsidies would generate part of the resources for public investment.

(ii) There are wide differences in yields between states. Even the best of states have much lower yield in different

crops when compared to the best in the world. This provides ample opportunity to increase production by bridging the yield gap to the extent feasible within the climatic zone.

(iii) Providing irrigation can improve yield substantially, as vast cropped area is still unirrigated. For a shift in production function, investment in basic research would be necessary.

(iv) Recommendations of the Shanta Kumar Committee provide useful suggestions for the future road-map of food policy. Every effort should be made to bring states on board for creating a national common market for agricultural commodities.

(v) Distortions emerging from various policies, including exempting user charges for electricity and water should be removed.

(vi) For providing efficient advance price discovery to farmers and enabling them to hedge price risk, the Forward Markets Commission should be strengthened and empowered to regulate the market more effectively.

Industrial, Corporate, and Infrastructure Performance

The major characteristics have been as given below:

- As per recently released national accounts data, with 2011–12 as the base year, industrial growth was much better in 2012–13 and 2013–14 at 2.4 per cent and 4.5 per cent respectively than earlier estimated, with 2004–05 as the base year. The declining trend was attributed to moderation in domestic demand, inflationary pressures, increase in input costs, and slowdown in the world economy. Further, the 1.4 per cent growth in GCF in industry in 2013–14 implies that recovery in industrial growth had commenced last year.
- The *industrial growth* picture as per the IIP suggests that industrial production which had slowed down since 2011–12, reversed the trend in 2014–15. In terms of use-based classificationof the IIP, basic goods and capital goods witnessed marked improvement in growth during April–December 2014–15. While the growth in intermediate goods remained sluggish, consumer goods contracted in April–December 2014–15, particularly due to contraction in the consumer durables sector.
- Growth in *infrastructure*, based on an index of eight core industries, has improved slightly to 4.4 per cent during April–December 2014–15 as compared to 4.1 per cent in the same period in 2013–14. The performance of coal, electricity, and cement has shown marked improvement, steel and refinery products have grown marginally by 1.6 per cent and 0.2 per cent, while crude oil, gas, and fertilizers have seen negative growth. In the transport sector, growth in the first nine months of 2014–15 has improved in railway freight (5.1 per cent), domestic air passenger traffic (7.1 per cent), international passenger traffic (10.3 per cent), international cargo (8.3 per cent), domestic cargo (19.3 per cent), and cargo throughput at major and non-major ports (6.8 per cent)as compared to the same period in the 2013–14.
- The performance of *listed manufacturing companies* (Ltd. firms) in the private sector in terms of growth of sales and net profit appeared to turn around in Q1 2014–15. However, the performance in Q2 2014–15

dampened expectations of sustained improvement. There is no discernible improvement in capacity utilisation in the first two quarters of 2014–15, as per the RBI's twenty-seventh round of the Order Books, Inventories, and Capacity Utilization Survey.

- Of the total 246 central infrastructure projects costing Rs. 1,000 crore and above, 124 are delayed with respect to the latest schedule and 24 have reported additional delays vis-à-vis the date of completion reported in the previous month *(Flash Report for October 2014, Ministry of Statistics and Programme Implementation)*.
- All the other major industrial sectors except mining have witnessed slowdown in the growth of credit in 2014–15 as compared to 2013–14. The growth of credit flow to the manufacturing sector at 13.3 per cent in 2014–15 is lower than the growth of 25.4 per cent in 2013–14. Chemicals, food processing, and textiles have seen a sharp decline in growth of credit in 2014–15.
- During April–November 2014–15, total FDI inflows (including equity inflows, reinvested earnings, and other capital) were US$ 27.4 billion, while FDI equity inflows were US$ 18.9 billion. Cumulative FDI inflows from April 2000 to November 2014 were US$ 350.9 billion. Services, construction, telecommunications, computer software and hardware, drugs and pharmaceuticals, automobile industry, chemicals, and power have attracted a disproportionately high share of total inflows.

SERVICES SECTOR

The performance of the services sector has been as given below:

- The services sector of India remains the *major driver* of economic growth contributing **72.4** per cent of GDP growth in 2014–15. Services-sector growth has increased from 8.0 per cent in 2012–13 to 9.1 per cent in 2013–14 and further to 10.6 per cent in 2014–15.
- This is mainly due to growth acceleration in financial, real estate, and professional services to 13.7 per cent from 7.9 per cent and public administration, defence, and other services to 9.0 per cent from 7.9 per cent in the previous year. Growth in trade, hotels, transport, communication, and related services was 8.4 per cent in 2014–15 compared to 11.1 per cent in 2013–14.
- Data available for the beginning months of 2015 indicates pick-up in the services sector with expansion in business activity as indicated by services PMI data. This growth momentum is expected to continue in 2015–16.
- The services sector is also the *dominant sector* in most of the states of India with a more than 40 per cent share in the gross state domestic product (GSDP) in 2013–14 for almost all states. This sector has made substantial contribution to FDI inflows, exports, and employment.
- During the last twelve years, with a compound annual growth average (CAGR) of 8.7 per cent, India had the **second fastest** growing services sector, just below China's 10.7 per cent. In commercial services exports, India had the highest CAGR of 20 per cent during this period.
- India's share in global exports of commercial services increased to 3.2 per cent in 2013 from 1.2 per cent in 2000.

Its ranking among the leading exporters in 2013 was **sixth**.

- In the first half of 2014–15, services exports grew by 3.7 per cent to US$ 75.9 billion and import of services grew by 5.0 per cent to US$ 39.9 billion, resulting in net services growth of only 2.4 per cent. The services value-added content in exports has also been rising.
- India is very active in the services negotiations in the World Trade Organization (WTO) and has recently provided more liberal offers to least developed countries.
- Among the sub-sectors, computer and related services with a share of 3.3 per cent in India's GDP grew by 14.4 per cent in 2013–14. The contribution of tourism to total income and employment of the country during 2012–13 was 6.9 per cent and 12.5 per cent respectively. In 2014, foreign tourist arrivals and foreign exchange earnings increased by 7.1 per cent and 6.6 per cent respectively.

Banking and Insurance

Banking and insurance sector did show the following trends:

- Asset quality of banks showed some signs of stress during the year. The gross non-performing advances (NPAs) of scheduled commercial banks (SCB) as a percentage of the total gross advances increased to 4.5 per cent in September 2014 from 4.1 per cent in March 2014. Stressed advances increased to 10.7 per cent of the total advances from 10.0 per cent between March and September 2014. RBI has taken a number of steps to resolve the NPA issue.
- The growth of aggregate deposits of SCBs decelerated during 2014–15 till December mainly due to base effect, i.e., high accretion to NRI deposits last year during September-November and lower deposit mobilisation during this year. The growth in non-food credit also decelerated.
- To achieve the objective of financial inclusion, the *Pradhan Mantri Jan-Dhan Yojana (PMJDY)* was launched on 28 August 2014. The Yojana envisages universal access to banking facilities with at least one basic banking account for every household. The scheme is expected to provide a big push to the Direct Transfer Benefit scheme.
- The year 2014–15 saw other reform initiatives in the banking and insurance sector, which include allowing banks to raise capital from the market to meet capital adequacy norms by diluting the government's stake up to 52 per cent and notifying of an ordinance to enhance the foreign equity cap in the insurance sector.
- Equity markets continued to do well during the year. The benchmark indices BSE Sensex and Nifty showed a general upward trend in the current year. A number of steps such as improvement in corporate governance norms and establishment of foreign portfolio investor (FPI) regulation framework were taken by the Securities and Exchange Board of India (SEBI) to improve functioning of both primary and secondary markets.

HUMAN DEVELOPMENT

India's social sector performance has been outlined by the Survey in the following way:

- India is projected to be the youngest nation in the world by 2020. While this

provides great opportunities, it also poses challenges before the nation. India's total fertility rate (TFR) has been steadily declining and is currently at 2.3 although state-wise disparities exist.

- As per Sample Registration System (SRS) data for 2013, there has been a gradual decline in the share of population in the age group 0–14 from 41.2 to 38.1 per cent during 1971 to 1981 and from 36.3 to 28.4 percent during 1991 to 2013, whereas the economically active population (15-59 years) has increased from 53.4 to 56.3 per cent during 1971 to 1981 and from 57.7 to 63.3 per cent during 1991 to 2013. Of concern is the secular decline in the child sex ratio (CSR).
- A new scheme, *Beti Bachao Beti Padhao,* for promoting survival, protection, and education of the girl child was launched in January 2015. It aims to address the declining CSR through a mass campaign targeted at changing social mindset and creating greater awareness.
- In 2020 the average age of India's population at around 29 years is expected to be among the lowest in the world. Consequently, while the global economy is expected to witness a shortage of young population of around 56 million by 2020, India will be the only country with a youth surplus of 47 million. These young people need to be healthy, suitably educated, and appropriately skilled to contribute optimally to the economy

Educational Challenges are outlined as—

- While only 73 per cent literacy has been achieved (Census 2011), there is marked improvement in female literacy. Male literacy at 80.9 per cent is still higher than female literacy at 64.6 per cent but the latter increased by 10.9 percentage points compared to the 5.6 percentage points for the former.
- Total enrolment in primary schools has declined in 2013–14 while upper primary enrolment has grown. This is in line with the demographic changes in the age structure. However, the overall standard of the education system is well below global standards.
- The single most significant finding of the Annual Status of Education Report (**ASER**) is that learning levels across the country, whether in public or private schools, have not improved. Clearly, the policy prescription lies in shifting attention away from inputs to outcomes and focus on building quality education and skill development infrastructure. The Padhe Bharat Badhe Bharat initiative to create a base for reading, writing, and math fluency is a good step in this direction.

Skilling generation faces the following challenges—

- As per the *Labour Bureau Report 2014,* the current size of India's formally skilled workforce is small, approximately 2 per cent; this number compares poorly with smaller countries like South Korea and Japan which report figures of 96 and 80 per cent respectively. At all-India level, around 6.8 per cent of persons aged 15 years and above are reported to have received/are receiving vocational training.
- As per the *National Skill Development Corporation (NSDC),* for the period between 2013 and 2022 there is an incremental requirement of 120 million skilled persons in the non-farm sector. A dedicated *Department of Skill Development and Entrepreneurship* has been created for

focused attention to skill development. Besides, skilling of rural youth has now been re-focused and reprioritised towards building the capacity of poor rural youth. New programmes have also been started for bringing minorities into mainstream development.

Employment generation has been sluggish and faces the following challenges—

- A cause for concern is deceleration in the CAGR of employment during 2004–05 to 2011–12 to 0.5 per cent from 2.8 per cent during 1999–2000 to 2004–05 as against CAGRs of 2.9 per cent and 0.4 per cent in the labour force respectively for the same two periods.
- During 1999–2000 to 2004–05, employment on usual status (US) basis increased by 59.9 million persons from 398.0 million to 457.9 million as against the increase in labour force by 62.0 million persons from 407.0 million to 469.0 million.
- After a period of slow progress during 2004–05 to 2009-10, employment generation picked up during 2009–10 to 2011–12, adding 13.9 million persons to the workforce, but not keeping pace with the increase in labour force (14.9 million persons).
- A major impediment to the pace of quality employment generation in India is the *small share of manufacturing* in total employment.
- However, data from the 68th Round of the National Sample Survey (NSS) indicates a revival in employment growth in manufacturing from 11 per cent in 2009-10 to 12.6 per cent in 2011–12. Promoting growth of micro, small, and medium enterprises (MSME) is critical from this perspective.

Labour Reforms is a critical area with a 'multiplicity of labour laws' and difficulty in their compliance has been an impediment to industrial development. In a major initiative for bringing compliance in the system and ensuring ease of doing business, a set of labour reform measures has been put forth by the government.

Challenges of the Health sector have been there. The Swachh Bharat Mission (Gramin) launched in October 2014, aims at attaining an *Open Defecation Free India* by October 2, 2019. Besides, *Mission Indradhanush* launched in December 2014 will cover all children by 2020 who are either unvaccinated or are partially vaccinated against seven vaccine-preventable diseases. The erstwhile Department of AYUSH (Ayurveda,Yoga and Naturopathy, Unani, Siddhi, and Homoeopathy) has now been elevated to a full-fledged Ministry.

The latest estimates of **poverty** are available for the year 2011–12. These estimates have been made following the Tendulkar Committee methodology using household consumption expenditure survey data. For 2011–12, the percentage of persons living below the poverty line is estimated as 25.7 percent in rural areas, 13.7 percent in urban areas, and 21.9 percent for the country as a whole

India's **Human Development in International perspective** has been weak. The Human Development Report (HDR) 2014 presents the Human Development Index (HDI)—values and ranks—for 187 countries. India's HDI value for 2013 is 0.586, ranking it **135** out of 187 countries and territories, the lowest among the BRICS countries with Russia at 57, Brazil at 79, China at 91, and South Africa at118, and slightly ahead of Bangladesh and Pakistan.

India also ranks low with respect to the *Gender Development Index (GDI)*. The GDI value

for India is 0.828 and it is ranked 132 among 148 nations. In comparison, Bangladesh and China are ranked higher.

Fostering Inclusive Growth has been among the major policy planks of the government. Few strong steps taken in this regard are:

- The *PMJDY* launched in August 2014 and the *RuPay Card*, which is a payment solution, are important new measures for financial inclusion.
- Besides, the government has restructured a number of ongoing programmes based on field experience to make them need based. To facilitate coordinated functioning of various social infrastructure and human development programmes, the *Sansad Adarsh Gram Yojna (SAGY)* has been launched which will be implemented through convergence of existing programmes.
- Another scheme launched is the *Vanbandhu Kalyan Yojna* that will be implemented in one block of each of the ten states having Schedule V areas. Given the multiple schemes implemented to foster inclusive growth, the role of *Panchayati Raj institutions* is critical and there is need to strengthen the panchayats and urban local governments.
- RBI data on social services shows that there was a consistent rise in absolute social-sector expenditure by the general government (centre–state) even in the time of the 2008–09 global crisis and 2011–12 Euro area crisis.
- A unique feature of India is the *lag in demographic transition* between different states. Due to the substantial fertility decline in the south during the last two decades, the south is ahead in the demographic transition compared to the north. For instance, the projected average age of population in 2020 of 29 years has already been surpassed in some states like Kerala (33 years), Goa (32.3), Tamil Nadu (31.3), Himachal Pradesh (30.4), Punjab (29.9), Andhra Pradesh (29.3) and West Bengal (29.1).

Climate Change and Sustainable Development

The year 2015 is likely to be a momentous year with the world set to witness new agreements on climate change and sustainable development. This will determine the course for international development and environmental policy agenda for the global community for the next fifteen years—

- The negotiations under the United Nations Framework Convention on Climate Change (UNFCCC) are expected to result in a global agreement by December 2015, applicable to all countries to take action on climate change from 2020. Simultaneously, the governments are due to agree to a new post-2015 development agenda including a set of sustainable development goals (SDGs), replacing the Millennium Development Goals, which are coming to an end in 2015.
- The latest scientific findings of the **IPCC AR5** have estimated the following:
  - (i) To remain below 2°C, the world can emit only about 2900 giga-tonne (Gt) of CO_2 from all sources from the industrial revolution till 2100.
  - (ii) Till 2011, the world has already emitted 1900 Gt of CO_2 and consumed around two-third of this budget. This means that out of the budget of 2900 Gt, only 1000 Gt remains to be used between now and 2100.

(iii) The key issue therefore for designing emission reduction commitment is how we should allocate this remaining sparse carbon budget between countries in a manner which is both fair and achievable.

(iv) There are substantial variations in total and per capita emissions of different countries. In terms of absolute CO_2 emissions in 2013, China, the USA, and EU hold the first three positions respectively with India a distant fourth. However, in terms of per capita CO2 emissions in 2013, countries like India, Brazil, and South Africa fall in the bottom 100 among 196 countries.

As a responsible country India has on its own chalked out policies on sustainable development and climate change:

- India was one of the early adopters of a National Action Plan on Climate Change (NAPCC).
- It is now revisiting National Missions under the NAPCC in the light with a view to undertaking additional interventions in areas like greenhouse gas (GHG) mitigation in power generation, other renewable energy technology programmes, and disaster management and exploring possibilities of new missions on wind energy, health, and waste to energy.
- Efforts are also under way by the government to build India's institutional capacity for mobilizing climate change finance. A *National Adaptation Fund* with an initial corpus of Rs. 100 crore has been set up to support adaptation actions to combat the challenges of climate change in sectors like agriculture, water, and forestry.
- Other recent key initiatives include scaling up of the *Solar Mission* **fivefold** from 20,000 megawatts to 100,000 megawatts requiring an additional investment of US$ 100 billion, development of 100 *Smart Cities* with integrated policies for sustainable development, and preparations for developing a *National Air Quality Index* and a *National Air Quality Scheme.*

The challenge for India is manifold. India is at the threshold of an *urban flare-up*. As population increases, demand for every key service will increase five-to seven fold. These trends combined with the current challenges of poverty eradication, food and energy security, urban waste management, and water scarcity will put further pressure on our limited resources which will add to greater energy needs and cause a parallel increase in emission if decoupling does not take place.

At the same time, hidden in this challenge are great opportunities. Unlike many countries, India has a young population and therefore can reap the fruits of demographic dividend. With more than half of the India of 2030 yet to be built, we have an opportunity to avoid excessive dependence on fossil fuel-based energy systems and carbon lock-ins that many industrialised countries face today. A conscious policy framework which takes into account both developmental needs and environmental considerations could help turn the challenges into opportunities.

The sum up, as we put our acts together towards a post-2015 global agreement on climate change, it is absolutely critical to ensure that—

(i) the new agreement is comprehensive, balanced, equitable, and pragmatic.

(ii) it should address the genuine requirements of developing countries like India by providing them equitable carbon and

development space to achieve sustainable development and eradicate poverty.

(iii) to achieve this, adherence to the principles and provisions of the UNFCCC is the key.

(iv) importantly, global climate action rests heavily on the means of implementation, especially on finance and technology, which needs to be addressed adequately in the agreement.

As India's Prime Minister said in the UN General Assembly in September 2014, 'We should be honest in shouldering our responsibilities in meeting the challenges. The world community has agreed on a beautiful balance of collective action—common but differentiated responsibilities. That should form the basis of continued action.'

RAILWAY BUDGET 2015–16

- ⇨ Railway Budget 2015–16
- ⇨ Highlights of the Railway Budget 2015–16
- ⇨ Four Goals to Transform Over Next Five Years
- ⇨ Execution Strategy
- ⇨ Thrust Areas of Action Plan
- ⇨ Station Re-Development
- ⇨ Capacity Augmentation
- ⇨ Financial Performance of 2014–15
- ⇨ Budget Estimates for 2015–16
- ⇨ Conclusion

RAILWAY BUDGET 2015–16

The Railway Budget 2015–16 is considered in its own league. It should be noted that the *Economic Survey 2014–15* made a strong point to enhance public investment in the sector and linked it to the *Make in India*. Not only this, the proposed expansion of the 'manufacturing sector' to enhance employability in the economy has been directly linked to the railways by the document. The Survey projected a big push in the economy through expansion, better services, safety, and upgradation of the railways, as the GoI was able to promote the similar impact with the 'road sector' in 1999 onwards. These inputs of the Survey seems being taken by the new budget.It is encouraging to see that the Budget has envisaged an investment of Rs. 8.5 lakh crore in next five years that would be mobilised from sources such as multilateral development banks and pension funds. Also commendable is the strategy for leveraging partnership with the states, PSUs, private sector and other stakeholders towards gaining access to long-term financing & technology, improving last mile connectivity, expanding fleet of rolling stock and building railway infrastructure and modernizing station development.Besides putting thrust on better passenger amenities and safety, the budget has targeted operating ratio at 88.5 per cent for 2015–16 as compared with 91.8 per cent in 2014–15, and the *best* in last 9 years. Lower operating ratio would help in generating higher internal resources for meeting various requirements. Other notable measures include those meant for improving speed of 9 railway corridors and enhancing average speed of freight trains; improved cleanliness; greater connectivity to North-Eastern region and coastal areas; 1330 per cent increase in railway electrification; setting up of transport logistics corporation of India towards expanding freight handling capacity and provide end-to-end logistic solutions; green initiatives including setting up of 1,000 MW solar plants on railway/private land.

HIGHLIGHTS OF THE RAILWAY BUDGET 2015–16

THRUST AREAS

1. IR to become prime mover of economy once again
2. Resource mobilisation for higher Investments
3. Decongestion of heavy haul routes and speeding up of trains: emphasis on gauge conversion, doubling, tripling and electrification
4. Project delivery
5. Passenger Amenities.
6. Safety
7. Transparency & system improvement.
8. Railways to continue to be the preferred mode of transport for the masses.
9. Sustainability.

FOUR GOALS TO TRANSFORM OVER NEXT FIVE YEARS

(a) *To deliver a sustained and measurable improvement in customer experience.*

(b) *To make rail a safer means of travel.*

(c) *To expand Bhartiya Rail's capacity substantially and modernise infrastructure.:* increase daily passenger carrying capacity from 21million to 30 million: increase track length by 20 per cent from 1,14,000 km to 1,38,000 km: grow our annual freight carrying capacity from 1 billion to 1.5 billion tonnes.

(d) *Finally, to make Bhartiya Rail financially self-sustainable.* Generate large surpluses from operations not only to service

Proposed Investment Plan (2015–2016)

Item	Amount (Rs. in Crore)
Network Decongestion (including DFC, Electrification, Doubling including electrification and traffic facilities_	1,99,320
Network Expansuion (including electrification)	19,300
Safety (Track renewal, bridge works, ROB, RUB and Signalling & Telecom)	39,000
Information Technology / Research	5,000
Rolling Stock (Locomotives, coaches wagons - production & maintenance)	1,02,000
Passenger Amenities	12,500
High Speed Rail & Elevated corridor	65,000
Station redevelopment and logistic parks	1,00,000
Others	13,200
Total	**8,56,020**

the debt needed to fund our capacity expansion, but also to invest on an on-going basis to replace our depreciating assets.

EXECUTION STRATEGY

The five drivers for executin are as given below:

(a) **Adopting a medium-term perspective:** The *White Paper*, *Budget 2015–16* & a *Vision-2030* document were presented together. Budget proposals to mark beginning of a Five Year Action Plan to transform the Railways—

(b) **Building Partnerships**: This will require partnering with key stakeholders: States, PSU's, partner with multilateral and bi-lateral organisations & other governments to gain access to long term financing and technology from overseas, the private sector to improve last mile connectivity, expand fleet of rolling stock and modernise our station infrastructure.

(c) **Leveraging additional resources:** IR (Indian Railways) envisages investment of Rs. 8.5 lakh crore in next five years to be mobilised from multiple sources to cater to funding i.e., multilateral development banks, pension funds.

(d) **Revamping management practices, systems, processes, and re-tooling of human resources:**

- Targeted operating ratio for 2015–16 at 88.5 per cent against 91.8 per cent in 2014–15—best in the last 9 years.
- IR to speed up decision making, tighten accountability, improve management information systems: training and development of human resource.

(e) **To set standards for governance and transparency**

THRUST AREAS OF ACTION PLAN

The Budget has emphasised 11 thrust areas of its 'Action Plan' to improve the 'quality of journeys' by train—

Cleanliness: Swachh Rail, Swachh Bharat, new department for cleanliness, integrated cleaning by engaging professional agencies and training our staff, 'waste to energy' conversion plants, new

toilets covering 650 additional stations compared to 120 stations last year. Bio-toilets.

Bed linen: NIFT to design; online booking of disposable bed rolls.

Help-line: 24X7 helpline number 138; toll-free number 182 for security related complaints.

Ticketing: operation five minutes for issuing unreserved tickets, hot buttons, coin vending machines, single destination teller, concessional e-tickets for differently abled travelers, developing a multi-lingual e-portal, crediting of refunds through banks, unreserved tickets on smart phones, proliferation of automatic ticket vending machines with smart cards and currency options, integrated ticketing system on the lines of rail-cum-road tickets, defence travel system developed for elimination of Warrants .

Catering: e-catering to select meals from an array of choices. Ordering food through IRCTC website at the time of booking of tickets; integrating best food chains into this project; setting up of base kitchens in specified divisions to be run by reputed agencies for serving quality food; expansion of water vending machines.

Leveraging technology: Hand-held terminals to Travelling Ticket Examiners (TTEs) for verification of passengers and downloading charts; possibility of extending facility of SMS on mobiles as a valid proof of travel for PRS tickets; integrated customer portal as a single interface to access different services; Introduction of a centrally managed Railway Display Network in over 2000 stations in next two years; 'SMS Alert' service to inform passengers in advance of the updated arrival/departure time of trains at starting or destination stations.

Surveillance: surveillance cameras provided on a pilot basis in selected mainline coaches and ladies' compartments of suburban coaches without intruding into privacy.

Entertainment: project for introducing on-board entertainment on select Shatabdi trains on license fee basis launched; mobile phone charging facilities to be provided in general class coaches & increased in sleeper class coaches.

Station facilities: 200 more stations to come under Adarsh Station scheme; Wi-Fi to be provided at B category stations ; facility of self-operated lockers to be made available at stations; provision of concierge services through IRCTC at major stations; online booking of wheel chair on payment basis for senior citizens, patients and the differently-abled passengers through IRCTC on select stations.

Train capacity: capacity in identified trains be augmented to run with 26 coaches; more general class coaches be added in identified trains;

Comfortable travel: NID approached to design user friendly ladders for climbing upper berths; increasing quota of lower berths for senior citizens; TTEs be instructed to help senior citizens, pregnant women and differently-abled persons in obtaining lower berths; middle bay of coaches to be reserved for women and senior citizen; NID to develop ergonomically designed seats; introduction of train sets; provision of Rs. 120 crore for lifts and escalator which is 76 per cent higher; newly manufactured coaches will be braille enabled; building wider entrances for the ease of differently-abled passengers; allocation for passenger amenities up by 67 per cent Y-O-Y (year-on-year). Corporate houses & MPs to be requested to invest in improving passenger amenities at railway stations through CSR & MPLAD funds; divisional committees in each Railway to be chaired by Members of Parliament.

STATION RE-DEVELOPMENT

- Station redevelopment policy to be revamped and processes simplified by inviting open bids;

- present stations be available for development on 'as is where is' basis, to exploit the space and air rights on concession basis;
- Zonal and divisional offices be empowered for quicker decision making;
- Land will not be sold;
- Development of 10 satellite railway terminals in major cities with twin purpose of decongesting the city and providing service to the suburban passengers.

CAPACITY AUGMENTATION

Several capacity augmentation plans have been announced—

Network Expansion

- Decongesting networks with basket of traffic generating projects priority; priority to last mile connectivity projects; fast track sanctioned works on 7,000 kms of double/third/fourth lines and commission 1,200 km in 2015–16 at an investment of Rs. 8,686 crore, 84 per cent higher Y-O-Y.
- Commissioning 800 km of gauge conversion targeted in current fiscal.
- 77 projects covering 9,400 km of doubling/tripling/quadrupling works along with electrification, covering almost all states, at a cost of Rs. 96,182 crore which is over 2,700 per cent higher in terms of amount sanctioned.
- Traffic facility works a top priority with outlay of Rs. 2,374 crore.
- In the Northeast states, Meghalaya brought on the Railway map of India and direct connectivity to Delhi provided. Barak Valley to be connected on BG .
- Award of 750 km of civil contracts and 1300 km of system contracts in 2015–16 on Dedicated Freight Corridor; 55 km section of Eastern DFC to be completed in the current year. Preliminary Engineering cum Traffic Survey (PETS) for four other DFCs in progress.
- Acceleration of pace of Railway electrification: 6,608 route kilometers sanctioned for 2015–16, an increase of 1330 per cent over the previous year.

Expansion of Freight Handling Capacity

- Transport Logistics Corporation of India *(TRANSLOC),* to be set up for developing common user facilities with handling and value-added services to provide end-to-end logistics solution at select Railway terminals through Public Private Partnerships.
- For the benefit of our farmers, a state-of-the-art Perishable Cargo centre under completion at the Azadpur Mandi with a scientific banana-ripening centre; air cargo sector to be developed to facilitate and integrate the movement of air cargo between ICDs and the gateway airports.
- Policy for Private Freight Terminals (PFT) to be revised.
- Automatic Freight Rebate Scheme for traffic to be expanded
- Long haul freight operations to be used extensively; construction of long loop lines to be expedited. Distributed power system for multi-loco haulage to be accelerated.

Improving Train Speed

- Speed of 9 railway corridors to be increased from existing 110 and 130 kmph to 160 and 200 kmph respectively so that inter-metro journeys like Delhi-

Kolkotta and Delhi–Mumbai can be completed overnight.

- Average speed of freight trains in empty and loaded conditions, will be enhanced to 100 kmph for empty freight trains and 75 kmph for loaded trains; loading density on all major freight bearing routes to be upgraded to 22.82 tonne axle loads.

BULLET TRAIN

- Feasibility study for High Speed Rail between Mumbai–Ahmadabad is in advanced stage and report expected by the mid of this year. For other high speed routes on the diamond quadrilateral, studies are being commissioned.

UPGRADING MANUFACTURING CAPABILITY

- Creation of job opportunities by upgrading the manufacturing capability.
- Functioning of Indian Railways Production Units and Workshops would be reviewed to provide them a cutting edge; measures for technological upgradation and enhancing productivity be undertaken to make them self-sustaining.

SAFETY

- Action plan being prepared for areas where accidents occur: five-year corporate safety plan by June 2015 indicating annual quantifiable targets; Pending recommendations made by High Level Safety Review Committee headed by *Dr. Kakodkar Committee* to be examined by April 2015.
- RDSO to develop a suitable device with reliable power supply system based on theft-proof panels/batteries in consultation with Indian Space Research Organization, using geo-spatial technology for providing audio-visual warning to road users at unmanned level crossings; radio based signal design project been taken up with IIT Kanpur for warnings at unmanned level crossing.
- 970 ROB/RUBs and other safety-related works to eliminate 3438 level crossings at a total Railway expense of Rs. 6,581 crore have been sanctioned which is 2600 per cent higher than the previous year covering most states.
- Train Protection Warning System and Train Collision Avoidance System to be installed on select routes at the earliest.
- Modern track structure consisting of sleepers and heavier rails being used while carrying out primary track renewals. Better welding techniques being promoted; digital type machines to replace analogue type machines.

TECHNOLOGY UPGRADATION

- Constituting an innovation council called '*Kayakalp*' for business re-engineering and introducing a spirit of innovation in Railways.
- Technology portal being constituted to invite innovative technological solutions.
- Strengthening of RDSO into an organization of excellence for applied research; four Railway Research Centers to be set up in select universities for fundamental research; *'Malaviya Chair'* for Railway Technology at IIT (BHU), Varanasi to be set up.
- Consortium of Ministry of Railways, Ministry of Human Resource Development, Ministry of Science And Technology and Industries on to take up identified Railway projects for research.

- IT vision to be unveiled: information on latest berth availability station navigation system, bar coded/RFID tracking of parcels and freight wagons, automated parcel warehouses. Integration of train control and asset management applications.
- Mechanize integrated track maintenance.

Partnerships for Development

- PPP cell to be revamped to make it result oriented.
- Projects for rail connectivity to many ports and mines being developed under participative models; simplification of procedures and consistency of policy to be ensured.
- 'Foreign Rail Technology Cooperation scheme' to be launched.
- MUTP III for Mumbai to be taken up.
- Joint ventures (JVs) to be set up with States for focused project development, resource mobilisation, land acquisition, project implementation and monitoring of critical rail projects.
- JVs to be set up with major public sector customers for meeting requirements of new lines.

Improvements to Management Processes and Systems

- Delegate, de-centralise, de-regulate and simplify to be the new mantra.
- Systems audit to be conducted for review of all processes and procedures.
- Global benchmarks for key operating and maintenance activities.
- Improve appraisal mechanism for the selection of projects and introduce simulation tools for project planning and decision-making; introducing EPC system of contracting.
- Constitution of a working group to modify present system of accounting, to ensure tracking of expenditure to desired outcomes.
- Train operations to be audited.
- Paperless working in material management system to be expanded; Vendors to be integrated through Vendor Interface Management System to provide single window interface to vendors.

Resource Mobilisation

- Plan Budget up by 52 per cent from Rs. 65,798 crore to Rs. 1,00,011 crore in 2015–16. Support from the Central Government 41.6 per cent of the Plan and Internal generation 17.8 per cent; setting up of a Financing Cell in the Railway Board.
- Setting up an infrastructure fund, a holding company and a JV with an existing NBFC of a PSU with IRFC, for raising long term debt from domestic as well as overseas sources, including multilateral and bilateral financial institutions. Monetisation of assets rather than selling them.
- Digitized mapping of land records and responsibility fixing for encroachments.
- New strategy to tap latent advertising potential, including offering stations and trains for corporate branding.
- Coastal Connectivity Program. Railways in partnership with ports will deliver rail connectivity to Nargol, Chharra, Dighi, Rewas and Tuna.
- Projects worth Rs. 2,500 crore through BOT/Annuity route. These include Wardha- Nagpur 3rd line, Kazipet-

Vijaywada 3rd line, Bhadrak–Nargundi 3rd line and Bhuj–Nalia Gauge Conversion.

- Scrap disposal policy to be reviewed for speedier scrap disposal.

Human Resources

- Human Resource Audit to be undertaken. Focused Human Resource strategy to raise employee productivity in line with global standards. Separate accounting head for HRD. ERP based Human Resource Management System.
- Special training module on soft skills for frontline staff so that our customers feel welcomed. Training in yoga.
- Setting up a full-fledged University during 2015–16.
- Improved delivery of health services to employees: Upgradation of four holiday homes.

Energy and Sustainability

- Environment Directorate to be constituted in Railway Board to give increased focus and thrust on environment management.
- Detailed energy audit for energy saving.
- Procure power through the bidding process at economical tariff from generating companies, power exchanges, and bilateral arrangements. Initiative likely to save at least Rs. 3,000 crore in next few years.
- Solar Power as part of the Solar Mission of Railways. 1,000 MW solar plants will be set up by the developers on Railway/ private land and Railway buildings with subsidy/viability gap funding support of Ministry of Non-Renewable Energy in next five years.
- Water conservation mission including water audit and expansion of water harvesting systems.
- Accreditation for environment management to be extended.
- 100 DEMUs to be enabled for dual fuel, i.e., CNG and diesel. Locomotives running on LNG are also currently under development.
- Noise levels of locos to be at par with international norms; concerns related to wildlife to be addressed.
- in Indian Railways necessary for our ecological sustenance mainly due to efficiencies of fuel consumption.

Transparency and Governance Initiatives

- System of on-line applications introduced for two categories of recruitment as a pilot project to be extended.
- All possible solutions be explored to address menace of corruption.
- E-procurement value chain being expanded.
- Constituting a mechanism for making regulations, setting performance standards, determining tariffs and adjudicating disputes among licensees/ private partners and the Ministry, subject to review in appeal.

Social Initiatives

- Infrastructure like stations and training centers to be made available for skill development. Indian Railways personnel and their services also available for this national cause.
- Promotion of products made by Self Help Groups, consisting mainly of women and youth on the model of Konkan Railway.

TOURISM

- Incredible Rail for Incredible India to be launched; Promotion of training of auto-rickshaw and taxi-operators as tourist-guides on the model of Konkan Railway.
- Coaches in select trains connecting major tourist destinations to travel agencies may be offered on a revenue sharing model.
- IRCTC to work on promoting the Gandhi circuit to attract tourists to mark the occasion of 100 years of the return of Mahatma Gandhi to India from South Africa; IRCTC will work on Kisan Yatra, a special travel scheme for farmers for farming & marketing technique centres.

FINANCIAL PERFORMANCE OF 2014–15

- Net reduction in Gross Traffic Receipts by Rs 917 crore compared to the BE of Rs 1,60,165 crore.
- Growth in Ordinary Working Expenses (O.W.E) scaled down to 11.7 per cent as against BE of 15.5 per cent Y-O-Y. Taking into account the likely savings accruing from drop in prices of HSD (high speed diesel) for traction partly offset by higher requirements under certain heads for maintenance, safety and cleanliness activities, the budgeted O.W.E. of Rs. 1,12,649 crore decreased in the RE 2014–15 to Rs. 1,08,970 crore i.e. by Rs. 3,679 crore.
- Appropriation to the Pension Fund has been increased to Rs. 29,540 crore in RE. Internal resource generation also improved and accordingly the appropriation to DRF has been scaled up to Rs. 7,975 crore in RE from the BE 2014–15 provision of Rs 7,050 crore. After taking into account the above, 'Excess' of receipts over expenditure stands at Rs. 7,278 crore in RE 2014–15 reflecting better financial management. Plan size for 2014–15 increased from Rs. 65,445 crore in the B. to Rs. 65,798 crore in the Revised Estimates, i.e., by Rs. 353 crore with higher provisions under internal resource component and market borrowings for rolling stock requirement.

BUDGET ESTIMATES FOR 2015–16

- The intention is to capture increased revenues and ensure appropriate investments so as to decongest the system and enhance line-capacity.
- Passenger earnings growth pegged at 16.7 per cent and target budgeted at Rs. 50,175 crore.
- Freight traffic is pegged at an all time high incremental traffic of 85 million tonnes, anticipating a healthier growth in the core sector of economy; Goods earnings proposed at Rs. 1,21,423 crore which includes rationalisation of rates, commodity classification and distance slabs.
- Other coaching and sundries are projected at Rs. 4,612 crore and Rs. 7,318 crore.
- Gross Traffic Receipts estimated at Rs. 1,83,578 crore , a growth of 15.3 per cent.
- Ordinary Working Expenses proposed to grow at 9.6 per cent over RE 2014–15. Traction fuel bill anticipated to shrink further.
- Higher provisions made for safety maintenance and cleanliness. Lease charges, interest component of the current and previous market borrowings, at a growth of 21 per cent.
- Appropriation to Pension Fund proposed at Rs. 35,260 crore and appropriation to DRF at Rs. 8,100 crore. Appropriation

of Rs. 7,616 crore proposed to be made to Capital Fund for payment of principal component of lease charges to IRFC.

PLAN OUTLAY 2015–16

- Gross budgetary support of Rs. 40,000 crore for the Railway's annual Plan. Rs. 1,645.60 crore has also been provided as Railway's share of diesel cess from the Central Road Fund. Market borrowing under EBR projected at Rs. 17,655 crore, an increase of about 46.5 per cent. Balance Plan outlay includes Rs. 17,793 crore from Internal Resources and Rs. 5781 crore from PPP. Significantly, we are allocating large amounts towards Doubling, Traffic Facilities, Electrification and Passenger Amenities.
- Given the huge shelf of project and ensuring proper funds flow for the same with a view to completing them on target, a new financing approach to expand EBR has been projected. This EBR, presently named EBR (Institutional Finance) would be based on institutional investments in railway projects through Railway/ PSUs. This element is projected at Rs. 17,136 crore and is aimed at accelerating completion of capacity augmentation projects. Works proposed to be financed through this mode are listed in the Budget documents.
- Plan Outlay is Rs. 1,00,011 crore, an increase of 52 per cent over RE 2014–15. It is anticipated that the Plan size will get higher once resources from institutional bodies are formalized during the course of the ensuing financial year.

CONCLUSION

- Complete the review of speed restrictions soon.
- All critical initiatives to be pursued in mission mode under designated senior officials in the Ministry of Railways as Mission Directors; similar structure replicated in all zonal railways.

UNION BUDGET 2015–16

- ⇨ Union Budget 2015–16
- ⇨ Highlights of the Union Budget 2015–16
- ⇨ State of Economy
- ⇨ Budget Estimates
- ⇨ Tax Proposals

UNION BUDGET 2015–16

The Union Budget 2015–16 is the first full budget of the new government. The stock markets closed in green on Budget Day for the first time in four years. Indian corporate sector welcomed the budget with most calling it a *pro-reform* and a *positive budget*. Even though people were expecting the Government to reduce their tax burden but the finance minister did not touch the income tax slabs. However, the budget provided for extra deductions—individuals can now save tax upto close to Rs. 4,50,000 a year if they plan well.

The budget said that the fiscal deficit target of 3 per cent of GDP will now be reached in three years as against two years stated earlier—this is important for investments to continue as public investment is needed to boost growth. Talking about the *policy paralysis* of the past, the finance minister said that the current government has worked hard over the past 9 months to bring the investor sentiment back. He said that the budget shows exactly that resolve. Experts have called the budget going for a kind of preparation to boost growth in the comming years. Naturally enough, the budget shows the impact of the economic slowdown of the past over three years.

HIGHLIGHTS OF THE UNION BUDGET 2015–16

INTRODUCTION

- Credibility of Indian economy has been re-established in the last nine months.
- Indian economy about to take-off on a fast growth trajectory.
- Most growth forecasts have upgraded Indian economic growth while downgrading global economic growth.
- Economically empowered states are equal partners to Indian economic growth.
- Round the clock, round the year Government to pursue accelerated growth, enhanced investment for the benefit of all Indians.
- After inheriting an economy with sentiments of 'doom and gloom' with adverse macroeconomic indicators, nine months have seen at turn around, making India fastest growing large economy in the World with a real GDP growth expected to be 7.4 per cent (New Series).
- Stock market: Second best performing in 2014.
- Macro-economic stability and conditions for sustainable poverty alleviation, job creation and durable double digit economic growth have been achieved.
- Restored the trust of the people on the Government by delivering on different areas.

THREE KEY ACHIEVEMENTS

- Financial Inclusion: 12.5 crores families financially mainstreamed in 100 days.
- Transparent Coal Block auctions to augment resources of the States.
- Swachh Bharat is not only a programme to improve hygiene and cleanliness but has become a movement to regenerate India.
- Game changing reforms on the anvil:
- Goods and Service Tax (GST)
- Jan Dhan, Aadhar and Mobile (JAM) - for direct benefit transfer.

STATE OF THE ECONOMY

INFLATION

- Inflation declined—a structural shift
- CPI inflation projected at 5 per cent by the end of the year, consequently, easing of monetary policy.

- Monetary Policy Framework Agreement with RBI, to keep inflation below 6 per cent .
- GDP growth in 2015–16, projected to be between 8 to 8.5 per cent .

Amrut Mahotsav–The year 2022, 75th year of Independence

Vision for 'Team India' led by PM

- Housing for all - 2 crore houses in Urban areas and 4 crore houses in Rural areas.
- Basic facility of 24x7 power, clean drinking water, a toilet and road connectivity.
- At least one member has access to means for livelihood.
- Substantial reduction in poverty.
- Electrification of the remaining 20,000 villages including off-grid Solar Power- by 2020.
- Connecting each of the 1,78,000 un-connected habitation.
- Providing medical services in each village and city.
- Ensure a Senior Secondary School within 5 km reach of every child, while improving quality of education and learning outcomes.
- To strengthen rural economy: increase irrigated area, improve the efficiency of existing irrigation systems, and ensure value addition and reasonable price for farm produce.
- Ensure communication connectivity to all villages.
- To make India, the manufacturing hub of the world through skill India and the Make in India programmes.
- Encourage and grow the spirit of entrepreneurship: to turn youth into job creators.
- Development of Eastern and North Eastern regions on par with the rest of the country.

Major Challenges Ahead

- Five major challenges: Agricultural income under stress, increasing investment in infrastructure, decline in manufacturing, resource crunch in view of higher devolution in taxes to states, maintaining fiscal discipline.
- To meet these challenges public sector needs to step in to catalyse investment, make in india programme to create jobs in manufacturing, continue support to programmes with important national priorities such as agriculture, education, health, MGNREGA, rural infrastructure including roads.
- Challenge of maintaining fiscal deficit of 4.1 per cent of GDP met in 2014–15, despite lower nominal GDP growth due to lower inflation and consequent sub-dued tax buoyancy.

Fiscal Roadmap

- Government firm on journey to achieve fiscal target of 3 per cent of GDP.
- Realistic figures shown in fiscal account without showing exaggerated revenue projections.
- With improved economy, pressure to accelerate fiscal consolidation too has decreased.
- Accordingly, journey for fiscal deficit target of 3 per cent will be achieved in 3 years rather than 2 years. The fiscal deficit targets are 3.9 per cent , 3.5 per cent and 3.0 per cent in FY 2015–16, 2016–17 & 2017–18 respectively.
- Additional fiscal space will go to funding infrastructure investment.

- Need to view public finances from a National perspective and not just the perspective of the Central Government. Aggregate public expenditure of the Governments, as a whole can be expected to rise substantially.
- Disinvestment to include both disinvestment in loss making units, and some strategic disinvestment.

GOOD GOVERNANCE

- Need to cut subsidy leakages, not subsidies themselves. To achieve this, government committed to the process of rationalising subsidies.
- Direct Transfer of Benefits to be extended further with a view to increase the number of beneficiaries from 1 crore to 10.3 crore.

AGRICULTURE

- Major steps take to address the two major factors critical to agricultural production, that of soil and water.
- 'Paramparagat Krishi Vikas Yojana' to be fully supported.
- 'Pradhanmantri Gram Sinchai Yojana' to provide 'Per Drop More Crop'.
- Rs. 5,300 crore to support micro-irrigation, watershed development and the 'Pradhan Mantri Krishi Sinchai Yojana'. States urged to chip in.
- Rs. 25,000 crore in 2015–16 to the corpus of Rural Infrastructure Development Fund (RIDF) set up in NABARD; Rs. 15,000 crore for Long Term Rural Credit Fund; Rs. 45,000 crore for Short Term Co-operative Rural Credit Refinance Fund; and Rs. 15,000 crore for Short Term RRB Refinance Fund.
- Target of Rs. 8.5 lakh crore of agricultural credit during the year 2015–16.
- Focus on improving the quality and effectiveness of activities under MGNREGA.
- Need to create a National Agriculture Market for the benefit farmers, which will also have the incidental benefit of moderating price rises. Government to work with the states, in NITI, for the creation of a Unified National Agriculture Market.

FUNDING THE UNFUNDED

- Micro Units Development Refinance Agency (MUDRA) Bank, with a corpus of Rs. 20,000 crores, and credit guarantee corpus of Rs. 3,000 crores to be created.
- In lending, priority will be given to SC/ST enterprises.
- MUDRA Bank will be responsible for refinancing all micro-finance institutions which are in the business of lending to such small entities of business through a Pradhan Mantri Mudra Yojana.
- A Trade Receivables discounting System (TReDS) which will be an electronic platform for facilitating financing of trade receivables of MSMEs to be established.
- Comprehensive Bankruptcy Code of global standards to be brought in fiscal 2015–16 towards ease of doing business.
- Postal network with 1,54,000 points of presence spread across villages to be used for increasing access of the people to the formal financial system.
- NBFCs registered with RBI and having asset size of Rs. 500 crore and above may be considered for notifications as 'Financial Institution' in terms of the SARFAESI Act, 2002.

From Jan Dhan to Jan Suraksha

- Government to work towards creating a functional social security system for all Indians, specially the poor and the under-privileged.
- Pradhan Mantri Suraksha Bima Yojna to cover accidental death risk of Rs. 2 lakh for a premium of just Rs. 12 per year.
- Atal Pension Yojana to provide a defined pension, depending on the contribution and the period of contribution. Government to contribute 50 per cent of the beneficiaries' premium limited to Rs. 1,000 each year, for five years, in the new accounts opened before December 31, 2015.
- Pradhan Mantri Jeevan Jyoti Bima Yojana to cover both natural and accidental death risk of Rs. 2 lakh at premium of Rs. 330 per year for the age group of 18–50.
- A new scheme for providing physical aids and assisted living devices for senior citizens, living below the poeverty line.
- Unclaimed deposits of about Rs. 3,000 crores in the PPF, and approximately Rs. 6,000 crores in the EPF corpus. The amounts to be appropriated to a corpus, which will be used to subsidise the premiums on these social security schemes through creation of a Senior Citizen Welfare Fund in the Finance Bill.
- Government committed to the on-going schemes for welfare of SCs, STs and Women.

INFRASTRUCTURE

- Sharp increase in outlays of roads and railways. Capital expenditure of public sector units to also go up.
- National Investment and Infrastructure Fund (NIIF), to be established with an annual flow of Rs. 20,000 crores to it.
- Tax free infrastructure bonds for the projects in the rail, road and irrigation sectors.
- PPP mode of infrastructure development to be revisited and revitalised.
- Atal Innovation Mission (AIM) to be established in NITI to provide Innovation Promotion Platform involving academicians, and drawing upon national and international experiences to foster a culture of innovation , research and development. A sum of Rs. 150 crore will be earmarked.
- Concerns of IT industries for a more liberal system of raising global capital, incubation facilities in our centres of excellence, funding for seed capital and growth, and ease of doing business etc. would be addressed for creating hundreds of billion dollars in value.
- (SETU) Self-Employment and Talent Utilization) to be established as Techno-financial, incubation and facilitation programme to support all aspects of start-up business. Rs. 1,000 crore to be set aside as initial amount in **NITI**.
- Ports in public sector will be encouraged, to corporatise, and become companies under the Companies Act to attract investment and leverage the huge land resources.
- An expert committee to examine the possibility and prepare a draft legislation where the need for multiple prior permission can be replaced by a pre-existing regulatory mechanism. This will

facilitate India becoming an investment destination.

- 5 new Ultra Mega Power Projects, each of 4,000 MW, in the Plug-and-Play mode.

Financial Market

- *Public Debt Management Agency* (PDMA) bringing both external and domestic borrowings under one roof to be set up this year.
- Enabling legislation, amending the Government Securities Act and the RBI Act included in the Finance Bill, 2015.
- Forward Markets commission to be merged with SEBI.
- Section-6 of FEMA to be amended through Finance Bill to provide control on capital flows as equity will be exercised by government in consultation with RBI.
- Proposal to create a Task Force to establish sector-neutral financial redressal agency that will address grievance against all financial service providers.
- India Financial Code to be introduced soon in Parliament for consideration.
- Vision of putting in place a direct tax regime, which is internationally competitive on rates, without exemptions.
- Government to bring enabling legislation to allow employee to opt for EPF or New Pension Scheme. For employee's below a certain threshold of monthly income, contribution to EPF to be option, without affecting employees' contribution.

Monetising Gold

- Gold monetisation scheme to allow the depositors of gold to earn interest in their metal accounts and the jewellers to obtain loans in their metal account to be introduced.
- Sovereign Gold Bond, as an alternative to purchasing metal gold scheme to be developed.
- Commence work on developing an Indian gold coin, which will carry the Ashok Chakra on its face.

Investment

- Foreign investments in Alternate Investment Funds to be allowed.
- Distinction between different types of foreign investments, especially between foreign portfolio investments and foreign direct investments to be done away with. Replacement with composite caps.
- A project development company to facilitate setting up manufacturing hubs in CMLV countries, namely, Cambodia, Myanmar, Laos and Vietnam.

Safe India

- Rs. 1,000 crores to the Nirbhaya Fund.

Tourism

- Resources to be provided to start work along landscape restoration, signage and interpretation centres, parking, access for the differently abled , visitors' amenities, including securities and toilets, illumination and plans for benefiting communities around them at various heritage sites.
- Visas on arrival to be increased to 150 countries in stages.

Green India

- Target of renewable energy capacity revised to 1,75,000 MW till 2022, comprising 1,00,000 MW Solar, 60,000 MW Wind, 10,000 MW Biomass and 5,000 MW Small Hydro.

- A need for procurement law to contain malfeasance in public procurement.
- Proposal to introduce a public Contracts (resolution of disputes) Bill to streamline the institutional arrangements for resolution of such disputes.
- Proposal to introduce a regulatory reform Bill that will bring about a cogency of approach across various sectors of infrastructure.

Skill India

- Less than 5 per cent of our potential work force gets formal skill training to be employable. A national skill mission to consolidate skill initiatives spread accross several ministries to be launched.
- Deen Dayal Upadhyay Gramin Kaushal Yojana to enhance the employability of rural youth.
- A Committee for 100th birth celebration of Shri Deen Dayalji Upadhyay to be announced soon.
- A student Financial Aid Authority to administer and monitor the front-end all scholarship as well Educational Loan Schemes, through the Pradhan Mantri Vidya Lakshmi Karyakram.
- An IIT to be set up in Karnataka and Indian School of Mines, Dhanbad to be upgraded in to a full-fledged IIT.
- New All India Institute of Medical Science (AIIMS) to be set up in J&K, Punjab, Tamil Nadu, Himachal Pradesh and Assam. Another AIIMS like institutions to be set up in Bihar.
- A post graduate institute of Horticulture Research & Education is to be set up in Amritsar.
- 3 new National Institute of Pharmaceuticals Education and Research in Maharashtra, Rajasthan & Chattisgarh and one institute of Science and Education Research is to be set up in Nagaland & Orissa each.
- An autonomous Bank Board Bureau to be set up to improve the governance of public sector bank.
- The National Optical Fibre Network Programme (NOFNP) to be further speeded up by allowing willing states to execute on reimbursement of cost basis.
- Special assistance to Bihar & West Bengal to be provided as in the case of Andhra Pradesh.
- Government is committed to comply with all the legal commitments made to AP & Telengana at the time of their re-organisation.
- Inspite of large increase in devolution to state sufficient fund allocated to education, health, rural development, housing, urban development, women and child development, water resources & cleaning of Ganga.
- Part of Delhi-Mumbai Industrial Corridor (DMIC); Ahmedabad-Dhaulera Investment region and Shendra-Bidkin Industrial Park are now in a position to start work on basic infrastructure.
- Made in India and the Buy and the make in India policy are being carefully pursued to achieve greater self-sufficiency in the area of defence equipment including air-craft.
- The first phase of GIFT to become a reality very soon. Appropriate regulations to be issued in March.

BUDGET ESTIMATES

- Non-Plan expenditure estimates for the Financial Year are estimated at Rs. 13,12,200 crore.
- Plan expenditure is estimated to be Rs. 4,65,277 crore, which is very near to the R.E. of 2014–15.
- Total Expenditure has accordingly been estimated at Rs. 17,77,477 crore.
- The requirements for expenditure on Defence, Internal Security and other necessary expenditures are adequately provided.
- Gross Tax receipts are estimated to be Rs. 14,49,490 crore.
- Devolution to the states is estimated to be Rs. 5,23,958.
- Share of Central Government will be Rs. 9,19,842.
- Non Tax Revenues for the next fiscal are estimated to be Rs. 2,21,733 crore.
- Fiscal deficit will be 3.9 per cent of GDP and Revenue Deficit will be 2.8 per cent of GDP.

TAX PROPOSALS

- Objective of stable taxation policy and a non-adversarial tax administration.
- Fight against the scourge of black money to be taken forward.
- Efforts on various fronts to implement GST from next year.
- No change in rate of personal income tax.
- Proposal to reduce corporate tax from 30 per cent to 25 per cent over the next four years, starting from next financial year.
- Rationalisation and removal of various tax exemptions and incentives to reduce tax disputes and improve administration.
- Exemption to individual tax payers to continue to facilitate savings.
- Broad themes :
- Measures to curb black money;
- Job creation through revival of growth and investment and promotion of domestic manufacturing—'Make in India';
- Improve ease of doing business - Minimum Government and maximum governance;
- Improve quality of life and public health—Swachh Bharat;
- Benefit to middle class tax-payers; and
- Stand alone proposals to maximise benefit to the economy.

BLACK MONEY

- Generation of black money and its concealment to be dealt with effectively and forcefully.
- Investigation into cases of undisclosed foreign assets has been given highest priority in the last nine months.
- Major breakthrough with Swiss authorities, who have agreed to:
- Provide information in respect of cases independently investigated by IT department;
- Confirm genuineness of bank accounts and provide non-banking information;
- Provide such information in time-bound manner; and
- Commence talks for automatic exchange of information.
- New structure of electronic filing of statements by reporting entities to ensure seamless integration of data for more effective enforcement.

- Bill for a comprehensive new law to deal with black money parked abroad to be introduced in the current session.
- Key features of new law on black money:
- Evasion of tax in relation to foreign assets to have a punishment of rigorous imprisonment upto 10 years, be non-compoundable, have a penalty rate of 300 per cent and the offender will not be permitted to approach the Settlement Commission.
- Non-filing of return/filing of return with inadequate disclosures to have a punishment of rigorous imprisonment upto 7 years.
- Undisclosed income from any foreign assets to be taxable at the maximum marginal rate.
- Mandatory filing of return in respect of foreign asset.
- Entities, banks, financial institutions including individuals all liable for prosecution and penalty.
- Concealment of income/evasion of income in relation to a foreign asset to be made a predicate offence under PML Act, 2002.
- PML Act, 2002 and FEMA to be amended to enable administration of new Act on black money.
- Benami Transactions (Prohibition) Bill to curb domestic black money to be introduced in the current session of Parliament.
- Acceptance or re-payment of an advance of Rs. 20,000 or more in cash for purchase of immovable property to be prohibited.
- PAN being made mandatory for any purchase or sale exceeding Rupees 1 lakh.
- Third party reporting entities would be required to furnish information about foreign currency sales and cross border transactions.
- Provision to tackle splitting of reportable transactions.
- Leverage of technology by CBDT and CBEC to access information from either's data bases.

Make in India

- Revival of growth and investment and promotion of domestic manufacturing for job creation.
- Tax 'pass through' to be allowed to both category I and category II alternative investment funds.
- Rationalisation of capital gains regime for the sponsors exiting at the time of listing of the units of **REITs** and **InvITs**.
- Rental income of REITs from their own assets to have pass through facility.
- Permanent Establishment (PE) norm to be modified to encourage fund managers to relocate to India.
- General Anti Avoidance Rule (GAAR) to be deferred by two years.
- GAAR to apply to investments made on or after 01.04.2017, when implemented.
- Additional investment allowance (@ 15 per cent) and additional depreciation (@35 per cent) to new manufacturing units set up during the period April 1, 2015 to March 31, 2020 in notified backward areas of Andhra Pradesh and Telangana.
- Rate of Income-tax on royalty and fees for technical services reduced from 25 per cent to 10 per cent to facilitate technology inflow.
- Benefit of deduction for employment of new regular workmen to all business entities and eligibility threshold reduced.

- Basic Custom duty on certain inputs, raw materials, inter mediates and components in 22 items, reduced to minimise the impact of duty inversion.
- All goods, except populated printed circuit boards for use in manufacture of ITA bound items, exempted from SAD.
- SAD reduced on import of certain inputs and raw materials.
- Excise duty on chassis for ambulance reduced from 24 per cent to 12.5 per cent .
- Balance of 50 per cent of additional depreciation @ 20 per cent for new plant and machinery installed and used for less than six months by a manufacturing unit or a unit engaged in generation and distribution of power is to be allowed immediately in the next year.

Ease of doing business–Minimum Government Maximum Governance

- Simplification of tax procedures.
- Monetary limit for a case to be heard by a single member bench of ITAT increase from Rs. 5 lakh to Rs. 15 lakh.
- Penalty provision in indirect taxes are being rationalised to encourage compliance and early dispute resolution.
- Central excise/Service tax assesses to be allowed to use digitally signed invoices and maintain record electronically.
- Wealth-tax replaced with additional surcharge of 2 per cent on super rich with a taxable income of over Rs. 1 crore annually.
- Provision of indirect transfers in the Income-tax Act suitably cleaned up.
- Applicability of indirect transfer provisions to dividends paid by foreign companies to their shareholders to be addressed through a clarificatory circular.
- Domestic transfer pricing threshold limit increased from Rs. 5 crore to Rs. 20 crore.
- MAT rationalised for FIIs and members of an AOP.
- Tax Administration Reform Commission (TARC) recommendations to be appropriately implemented during the course of the year.
- Education cess and the Secondary and Higher education cess to be subsumed in Central Excise Duty.
- Specific rates of central excise duty in case of certain other commodities revised.
- Excise levy on cigarettes and the compounded levy scheme applicable to pan masala, gutkha and other tobacco products also changed.
- Excise duty on footwear with leather uppers and having retail price of more than Rs. 1,000 per pair reduced to 6 per cent .
- Online central excise and service tax registration to be done in two working days.
- Time limit for taking CENVAT credit on inputs and input services increased from 6 months to 1 year.
- Service-tax plus education cesses increased from 12.36 per cent to 14 per cent to facilitate transition to GST.
- Donation made to National Fund for Control of Drug Abuse (NFCDA) to be eligible for 100 per cent deduction u/s 80G of Income-tax Act.
- Seized cash can be adjusted towards assessees tax liability.

SWACHH BHARAT

- 100 per cent deduction for contributions, other than by way of CSR contribution, to Swachh Bharat Kosh and Clean Ganga Fund.
- Clean energy cess increased from Rs. 100 to Rs. 200 per metric tonne of coal, etc. to finance clean environment initiatives.
- Excise duty on sacks and bags of polymers of ethylene other than for industrial use increased from 12 per cent to 15 per cent .
- Enabling provision to levy Swachh Bharat cess at a rate of 2 per cent or less on all or certain services, if need arises.
- Services by common affluent treatment plant exempt from service-tax.
- Concessions on custom and excise duty available to electrically operated vehicles and hybrid vehicles extended upto March 31, 2016.

BENEFITS TO MIDDLE CLASS TAX-PAYERS

- Limit of deduction of health insurance premium increased from Rs. 15,000 to Rs. 25,000, for senior citizens limit increased from Rs. 20,000 to Rs. 30,000.
- Senior citizens above the age of 80 years, who are not covered by health insurance, to be allowed deduction of Rs. 30,000 towards medical expenditures.
- Deduction limit of Rs. 60,000 with respect to specified decease of serious nature enhanced to Rs. 80,000 in case of senior citizen.
- Additional deduction of Rs. 25,000 allowed for differently abled persons.
- Limit on deduction on account of contribution to a pension fund and the new pension scheme increased from Rs. 1 lakh to Rs. 1.5 lakh.
- Additional deduction of Rs. 50,000 for contribution to the new pension scheme u/s 80CCD.
- Payments to the beneficiaries including interest payment on deposit in Sukanya Samriddhi scheme to be fully exempt.
- Service-tax exemption on Varishtha Bima Yojana.
- Concession to individual tax-payers despite inadequate fiscal space.
- Lot to look forward to as fiscal capacity improves.
- Conversion of existing excise duty on petrol and diesel to the extent of Rs. 4 per litre into Road Cess to fund investment.
- Service Tax exemption extended to certain pre cold storage services in relation to fruits and vegetables so as to incentivise value addition in crucial sector.
- Negative List under service-tax is being slightly pruned to widen the tax base.
- Yoga to be included within the ambit of charitable purpose under Section 2(15) of the Income-tax Act.
- To mitigate the problem being faced by many genuine charitable institutions, it is proposed to modify the ceiling on receipts from activities in the nature of trade, commerce or business to 20 per cent of the total receipts from the existing ceiling of Rs. 25 lakh.
- Most provisions of Direct Taxes Code have already been included in the Income-tax Act, therefore, no great merit in going ahead with the Direct Taxes Code as it exists today.
- Direct tax proposals to result in revenue loss of Rs. 8,315 crore, whereas the proposals in indirect taxes are expected to yield Rs. 23,383 crore. Thus, the net

impact of all tax proposals would be revenue gain of Rs. 15,068 crore.

OTHERS

- Increase in basic custom duty:
- Metallergical coke from 2.5 per cent to 5 per cent .
- Tariff rate on iron and steel and articles of iron and steel increased from 10 per cent to 15 per cent .
- Tariff rate on commercial vehicle increased from 10 per cent to 40 per cent .
- Basic custom duty on digital still image video camera with certain specification reduced to nil.
- Excise duty on rails for manufacture of railway or tram way track construction material exempted retrospectively from March 17, 2012 to February 2, 2014, if not CENVAT credit of duty paid on such rails is availed.
- Service-tax to be levied on service provided by way of access to amusement facility, entertainment events or concerts, pageants, non recoganised sporting events etc.
- Service-tax exemption:
- Services of pre-conditioning, pre-cooling, ripening etc. of fruits and vegetables.
- Life insurance service provided by way of Varishtha Pension Bima Yojana.
- All ambulance services provided to patients.
- Admission to museum, zoo, national park, wile life sanctuary and tiger reserve.
- Transport of goods for export by road from factory to land customs station.
- Enabling provision made to exclude all services provided by the government or local authority to a business entity from the negative list.
- Service-tax exemption to construction, erection, commissioning or installation of original works pertaining to an airport or port withdrawn.
- Transportation of agricultural produce to remain exempt from service-tax.
- Artificial heart exempt from basic custom duty of 5 per cent and CVD.
- Excise duty exemption for captively consumed intermediate compound coming into existance during the manufacture of agarbathi.

CENSUS 2011

- Introduction
- Census of India 2011
- New Features
- Caste-based Census
- Census Data
- Highlights of The Census 2011
- Diagrammatic Highlights of The Census

INTRODUCTION

The Indian Census is a credible source of statistical information on different characteristics of the citizens since 1872. This was conducted at different points of time in different parts of the country. It was in 1881 that a Census was taken for the entire country simultaneously. Since then, Census has been conducted every ten years, without a break. The Census provides a snapshot of the country's population and housing at a given point of time. The Office of the Registrar General and Census Commissioner, India, under the Union Ministry of Home Affairs is the ***nodal authority*** for conducting decennial Census in the country. Census 2011 is the 15th National Census of the country since 1872 and the 7th after Independence.

The Indian Censuses have throughout evoked interest worldwide but have become of greater interest since 2001 when the country population crossed one billion marks. Taking count of the large size of the population, especially when it is continuing to grow made 2011 Census another challenge. Like in the past censuses, the census organisation undertook publicity by various means to create awareness amongst the public for participating in the Census.

Census provides detailed and authentic information on demography, economic activity, literacy and education, housing & household amenities, urbanisation, fertility and mortality, Scheduled Castes and Scheduled Tribes, language, religion, migration, disability and many other socio-cultural and demographic data. This information helps the Central and State Governments in planning and formulation of various policies. Besides, the delimitation or reservation of constituencies—Parliamentary/ Assembly/Panchayats and other local bodies—are also based on demographic data.

According to ***Article 246*** of the Constitution of India, population Census is a Union Subject. But, the State Governments provide administrative support in conducting the Census process.

The Office of the Registrar General and Census Commissioner, headed by the Registrar General and Census Commissioner, plans and implements Census. There are field offices, headed by Directors of Census Operations, in all the States and Union Territories (except Dadra and Nagar Haveli and Union Territory of Daman and Diu, which are attached to the office at Gujarat). Directors of Census Operations are responsible for the conduct of Census in their respective jurisdiction.

CENSUS OF INDIA 2011

The ***provisional figures*** of Census 2011 were released by the Ministry of Home Affairs on March 31, 2011. The **final data** were released in March 2011–still some data are to come. Census 2011 was conducted in two phases.

The first phase, called the ***House Listing*** or Housing Census was conducted between April and September last year across the country, depending on the convenience of different States/UTs. The second phase, ***Population Enumeration***, began simultaneously all over the country from February 9, 2011 and continued up to February 28, 2011.

NEW FEATURES

This Census has incorporated some ***new categories*** for the first time for the purpose of acquiring comprehensive and better data. The new categories are as follows:

- **Gender**: New category 'Other' introduced in addition to Male and Female.
- **Date of Birth**: a new question introduced along with **Age**.
- **Current Marital Status**: Separate codes Assigned for Separated and Divorced.

- New filter **Question on SC/ST** Introduced— "Is this person SC/ST?"
- **Disability**: Household Schedule of Census 2011 attempts to collect information on eight types of disabilities as against five included in the Household Schedule of Census of India 2001. The information is being collected on disabilities namely, disability 'In Seeing', 'In Hearing', 'In Speech', 'In Movement', 'Mental retardation', 'Mental Illness', 'Any Other' and 'Multiple Disability'.
- **Literacy Status** for "Other" sex added in addition to existing Male and Female.
- New Codes under Status of **Attendance in Educational Institutions** introduced for Not Attending, viz., (i) Attended before and (ii) Never attended.
- **Work**: Marginal workers have been classified into two categories viz., (i) worked for 3 months or more but less than 6 months (ii) worked for less than 3 months. The definition of 'Main worker' remains the same.
- A separate code-5 has been included under **Non-economic** activity for renters.
- **Migration**: Provision to specify the present name of the Village/Town of the Birth Place as well as the Place of Last Residence introduced.
- **Name** of the Institutional Household is also being recorded.

Census 2011, for the ***first time***, has taken a new initiative to *sensitise school students* about census operations. The Census Organization implemented ***"Census in School'*** programme across the country. This was specifically designed for the active participation of children in ensuring authenticity of census data of their families.The programme covered about 60 to 80 schools in each of the 640 districts in the country.

A ***mascot*** of an enumerator was also created for Census 2011 to make the process more people-friendly with the objective of helping people to relate with the Census process and elucidate the key role of enumerators in the process.

CASTE-BASED CENSUS

Following demands from several ruling coalition leaders and many opposition parties this was decided to include caste-based informations to be collected during the Census. Information on caste was last collected during British Raj in 1931. During the early census, people often exaggerated their caste status to garner social status and it is expected that people downgrade it now in the expectation of gaining government benefits.

There is only *one instance* of a caste-count in post-Independent India. It was conducted in Kerala in 1968 by the Communist government under E. M. S. Namboodiripad to assess the social and economic backwardness of various lower castes. The census was termed Socio-Economic Survey of 1968 and the results were published in the Gazetteer of Kerala, 1971.

CENSUS DATA

According to provisional results, India's population grew to 1.21 billion. The absolute number of children in the 0–6 age group recorded decline from 163 million in the 2001 census to 158 million in 2011.

Number of Administrative Units in Census 2011

- State/Union Territories: 35
- Districts: 640
- Sub-districts: 5,924
- Towns: 7,938
- Villages: 6.41 Lakh

The cost of Census 2011 has been estimated at Rs. 22,000 million, which works out to a per

person cost of Rs. 18.19. A total of 2.7 million functionaries worked in the process with the census schedules in 16 languages—a total of 340 million schedules were printed.

National Population Register (NPR)

A milestone of Census 2011 is the creation of National Population Register (NPR). The National Population Register (NPR) will build up a comprehensive identity database of usual residents of the country. It would have the ***biometric data*** and ***UID Number*** of every person (15 years and above). National Identity Cards will be given in a phased manner to all usual residents by the Office of the Registrar General and Census Commissioner, India. The NPR is being introduced for the ***first time*** in the country.

National Population Policy 2000

The National Population Policy, 2000 (NPP 2000) affirms the commitment of the Government towards voluntary and informed choice and consent of citizens while availing of reproductive health care services, and continuation of the target free approach in administering family planning services. The NPP 2000 provides a policy framework for advancing goals and prioritizing strategies during the next decade, to meet the reproductive and child health needs of the people of India, and to achieve net replacement levels (TFR) by 2010. It is based upon the need to simultaneously address issues of child survival, maternal health, and contraception, while increasing outreach and coverage of a comprehensive package of reproductive and child health services by government, industry and the voluntary non-government sector, working in partnership.

The ***immediate objective*** of the NPP 2000 is to address the unmet needs for contraception, health care infrastructure, and health personnel, and to provide integrated service delivery forbasic reproductive and child health care. The ***medium-term objective*** is to bring the TFR (Total Fertility Rate) to replacement level (i.e., 2.1) by 2010, through vigorous implementation of inter-sectoral operational strategies. The ***long-term objective*** is to achieve a stable population by 2045, at a level consistent with the requirements of sustainable economic growth, social development, and environmental protection.

In pursuance of these objectives, the following **National Socio-Demographic Goals** were set by the Government of India to be achieved in each case by 2010 (***one year before the next Census***):

- Address the unmet needs for basic reproduc-tive and child health services, supplies and infrastructure.
- Make school education up to age 14 free and compulsory, and reduce drop outs at primary and secondary school levels to below 20 per cent for both boys and girls.
- Reduce infant mortality rate to below 30 per 1,000 live births.
- Reduce maternal mortality ratio to below 100 per 100,000 live births.
- Achieve universal immunization of children against all vaccine preventable diseases.
- Promote delayed marriage for girls, not earlier than age 18 and preferably after 20 years of age.
- Achieve 80 per cent institutional deliveries and 100 per cent deliveries by trained persons.
- Achieve universal access to information/counseling, and services for fertility regulation and contraception with a wide basket of choices.
- Achieve 100 per cent registration of births, deaths, marriage and pregnancy.
- Contain the spread of Acquired Immunodeficiency Syndrome (AIDS),

and promote greater integration between the management of reproductive tract infections (RTI) and sexually transmitted infections (STI) and the National AIDS Control Organisation.

- Prevent and control communicable diseases.
- Integrate Indian Systems of Medicine (ISM) in the provision of reproductive and child health services, and in reaching out to households.
- Promote vigorously the small family norm to achieve replacement levels of TFR.
- Bring about convergence in implementation of related social sector programs so that family welfare becomes a people centred programme.

Population growth in India continue to be high due to so may *inter-related* and *independent* factors. The factors may be seen as follows:

- The large size of the population in the reproductive age-group (estimated contribution 58 per cent). An addition of 417.2 million between 1991 and **2016** is anticipated despite substantial reductions in family size in several states, including those which have already achieved replacement levels of TFR. This momentum of increase in population will continue for some more years because high TFRs in the past have resulted in a large proportion of the population being currently in their reproductive years. It is imperative that the the reproductive age group adopts without further delay or exception the *"small family norm"*, for the reason that about 45 per cent of population increase is contributed by births above two children per family.
- *Higher fertility* due to unmet need for contraception (estimated contribution 20 per cent). India has 168 million eligible couples, of which just 44 per cent are currently effectively protected. Urgent steps are currently required to make contraception more widely available, accessible, and affordable. Around 74 per cent of the population lives in rural areas, in about 5.5 lakh villages, many with poor communications and transport. Reproductive health and basic health infrastructure and services often do not reach the villages, and, accordingly, vast numbers of people cannot avail of these services.
- High wanted fertility due to the *high infant mortality rate* (IMR) (estimated contribution about 20 per cent). Repeated child births are seen as an insurance against multiple infant (and child) deaths and accordingly, high infant mortality stymies all efforts at reducing TFR.
- Over 50 per cent of girls marry below the age of 18, the minimum legal age of marriage, resulting in a typical reproductive pattern of *"too early, too frequent, too many"*. Around 33 per cent births occur at intervals of less than 24 months, which also results in high IMR.

HIGHLIGHTS OF THE CENSUS 2011

The major **highlights** of the Census 2011 are as under:

- The **population** of the country is 1210.19 million of which 623.72 million (51.54 per cent) are males and 586.46 million (48.46 per cent) are females.
- The population of India has increased by more than ***181 million*** during the decade 2001–11.
- Decadal growth rate of the population (2001–2011) has been 17.64 per cent (**i.e., 1.76 per cent per year**); males 17.19 and females 18.12.

- 2001–2011 is the ***first decade*** (with the exception of 1911–1921) which has actually added lesser population compared to the previous decade.
- Uttar Pradesh (199.8 million) is the **most populous** State in the country followed by Maharashtra with 112.3 million.
- The per centage decadal growth rates of the six most populous States have ***declined*** during 2001–2011 compared to 1991–2001:
  - Uttar Pradesh (25.85 per cent to 20.09 per cent)
  - Maharashtra (22.73 per cent to 15.99 per cent)
  - Bihar (28.62 per cent to 25.07 per cent)
  - West Bengal (17.77 per cent to 13.93 per cent)
  - Andhra Pradesh (14.59 per cent to 11.10 per cent)
  - Madhya Pradesh (24.26 per cent to 20.30 per cent)
- During 2001–2011, as many as 25 states/ UTs with a share of about 85 per cent of the country's population registered an annual growth rate of less than 2 per cent as compared to, 15 States/UTs with a share of about 42 per cent during the period 1991–2001.
- 15 States/UTs have grown by less than 1.5 per cent per annum during 2001–2011, while the number of such States/UTs was only 4 during the previous decade.
- The total number of children in the age-group 0–6 is 158.8 million (-5 million since 2001).
- Twenty States and Union Territories now have over one million children in the age group 0–6 years. On the other extreme, there are five States and Union Territories in the country that are yet to reach the one hundred thousand mark.
- Uttar Pradesh (29.7 million), Bihar (18.6 million), Maharashtra (12.8 million), Madhya Pradesh (10.5 million) and Rajasthan (10.5 million) constitute 52 per cent children in the age group of 0–6 years.
- Population (0–6 years) 2001–2011 registered minus (–) 3.08 per cent growth with minus (–) 2.42 for males and –3.80 for females
- The proportion of ***Child Population*** in the age group of 0–6 years to total population is ***13.0*** per cent while the corresponding figure in 2001 was 15.9 per cent. The decline has been to the extent of 2.9 points.
- Overall **sex ratio** at the national level has increased by 10 points to reach **943** at Census 2011 as against 933 in Census 2001. This is the ***highest*** sex ratio recorded since Census 1971 and a shade lower than 1961. Increase in sex ratio is observed in 29 States/UTs.
- Three major States (J&K, Bihar & Gujarat) have shown decline in sex ratio as compared to Census 2001.
- Kerala with 1084 has the **highest sex ratio** followed by Puducherry with 1037; Daman & Diu has the **lowest sex ratio** of 618.
- **Child sex ratio** (0–6 years) is 915. Increasing trend in the child sex ratio (0–6) seen in Punjab, Haryana, Himachal Pradesh, Gujarat, Tamil Nadu, Mizoram and A&N Islands. In all remaining 27 States/UTs, the child sex ratio show decline over Census 2001.
- Mizoram has the ***highest child sex ratio*** (0–6 years) of 971 followed by Meghalaya with 973. Haryana is at the bottom with ratio of 831 followed by Punjab with 848.

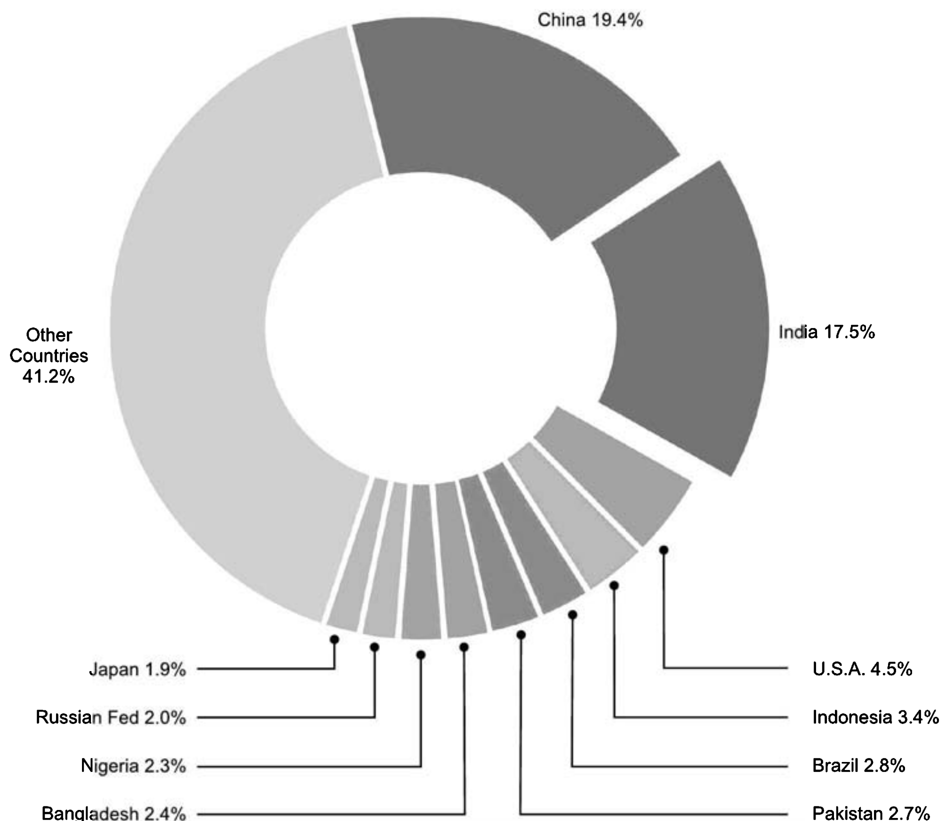
- **Literacy** rate has gone up from 64.83 per cent in 2001 to **74.04** per cent (*aged 7 and above*) in 2011 showing an increase of 9.21 per centage points. Percentage growth in literacy during 2001–2011 is 38.82; males: 31.98 per cent and females: 49.10 per cent .

THE WAY AHEAD

The Census also talks about the rising population and the solutions regarding checking it. The discussion takes recourse to the famous Theory of Demographic Transition. A country which has added a size of population equa to the 5th most populous country in the world (Brazil), the pressure on the resources may be just imagined in India! The speed with which India is adding population poses a big challenge in front of almost every kind of *planning* in the country. The immediacy to check the rising population has been highlighted by the Census. Without overall development in the living standards of the population, checking population will not be possible. This is why since the launching of the NPP–2000, the governments are trying to ***tag-in*** all the programmes focused at poverty alleviation, employment generation, healthcare, etc to realise the single goal—***let peoples' living standard improve***. The changed policy stance seems having an impact on the population growth rate—the country going for decreased rate of population growth rate in the decade gone by.

DIAGRAMMATIC HIGHLIGHTS OF THE CENSUS

INDIA in the WORLD: **India's population (1210.56 million) is almost equal to the**



combined population of USA, Indonesia, Brazil, Pakistan, Bangladesh and Japan (totalling 1214.3 million)! The absolute increase in India's population (181 million) during 2001–2011, is slightly lower than the population of Brazil, the fifth most populous country in the world!

Population of Selected Countries in 2010

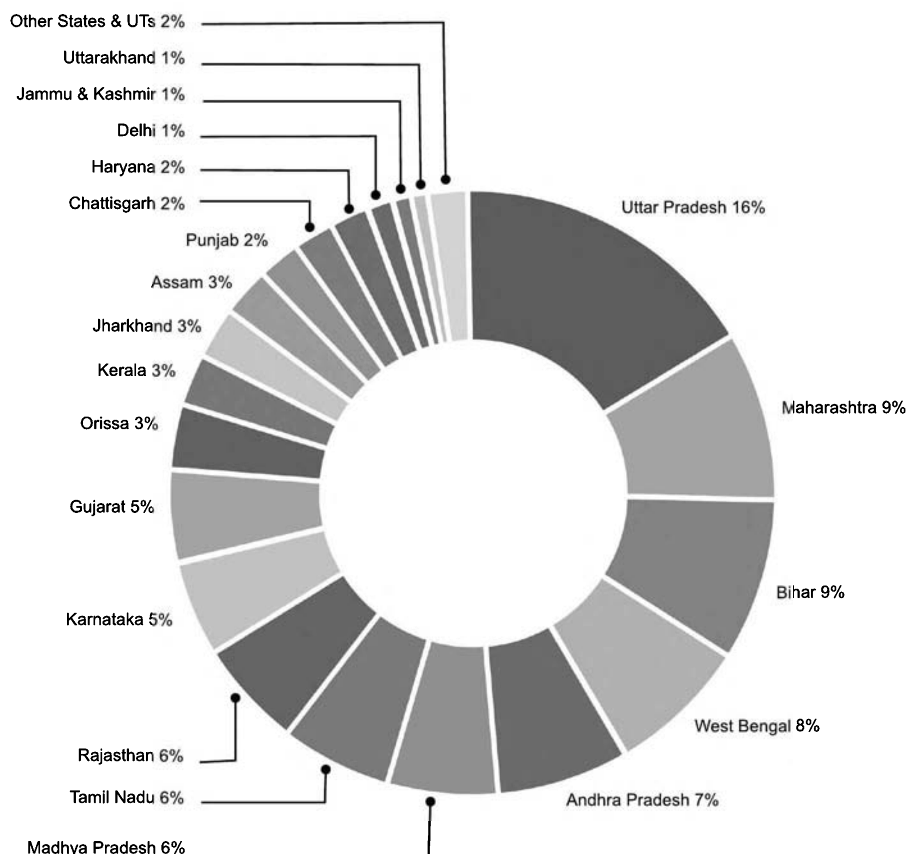
Sl. No	*Country*	*Reference date*	*Population (in millions)*	*Decadal change (in per cent)*
1	China	01.11.2010	1,341.0	5.43
2	India	01.03 2011	1,210.5	17.70
3	U.S.A	01.04.2010	308.7	7.26
4	Indonesia	31.05.2010	237.6	15.05
5	Brazil	01.08.2010	190.7	9.39
6	Pakistan	01.07.2010	184.8	24.78
7	Bangladesh	01.07.2010	164.4	16.76
8	Nigeria	01.07.2010	158.3	26.84
9	Russian Fed.	01.07.2010	140.4	-4.29
10	Japan	01.10.2010	128.1	1.1
	Other Countries	01.07.2010	2844.7	15.43
	World	01.07.2010	6908.7	12.97

Vital Statistics of the Indian Population (Census–2011)

1.	Total Population	–	1,210,569,573
2.	Density of Population	–	382 persons per sq. km.
3.	Highest Density	–	Bihar (1,106 ppsq. km)
4.	Lowest Density	–	Arunachal Pradesh (17 ppsq. km)
5.	Sex Ratio	–	943/1000
6.	Highest Sex Ratio	–	Kerala (1084/1000)
7.	Lowest Sex Ratio	–	Haryana (879/1000)
8.	Male Literacy	–	80.9 per cent
9.	Female Literacy	–	64.6 per cent
10.	Literacy Rate (Nat. Av.)	–	73.0 per cent
11.	Highest Lit. Rate	–	Kerala (94.0 per cent)
12.	Lowest Lit. Rate	–	Bihar (61.8 per cent)
13.	Highest Decadal Growth	–	Arunachal Pradesh (26 per cent)
14.	Lowest Decadal Growth	–	Nagaaland (–0.6 per cent)
15.	Urban Population	–	31.15 per cent
16.	Rural Population	–	68.85 per cent

State./ UT Coce	India/State/Union Territory*	Total Population			Population Density (Persons per sq. km)	Sex Ratio (No. of Female per 1000 Males)	Literacy Rate (%)			Percentage Deeadal Growth Rate	% share in total population of the country
	Name	Persons	Male	Female			Persons	Male	Female		
	India (Included 3 Sub-divisions of Senapati Distt. of Manipur)	1,210,569,573	623,121,843	587447730	382	943	73	80.9	64.6	17.7	100.00
1.	Jammu and Kashmir	12,541,302	6,640,662	5900640	124	889	67.2	76.8	56.4	23.6	1.04
2.	Himachal Pradesh	6,864,602	3,481,873	3382729	123	972	82.8	89.5	75.9	12.9	0.57
3.	Punjab	27,743,338	14,639,465	13103873	551	895	75.8	80.4	70.7	13.9	2.29
4.	Chandigarh*	1,055,450	580,663	474787	9258	818	86	90	81.2	17.2	0.09
5.	Uttarakhand	10,086,292	5,137,773	4948519	189	963	78.8	87.4	70	18.8	0.83
6.	Haryana	25,351,462	13,494,734	11856728	573	879	75.6	87.1	65.9	19.9	2.09
7.	NCT of Delhi*	16,787,941	8,987,326	7800615	11320	868	86.2	90.9	80.8	21.2	1.39
8.	Rajasthan	68,548,437	35,550,997	32997440	200	928	66.1	79.2	52.1	21.3	5.66
9.	Uttar Pradesh	199,812,341	104,480,510	95331831	829	912	67.7	77.3	57.2	20.2	16.51
10.	Bihar	104,099,452	54,278,157	49821295	1106	918	61.8	71.2	51.2	25.4	8.60
11.	Sikkim	610,577	323,070	287507	86	890	81.4	86.6	75.6	12.5	0.05
12.	Arunachal Pradesh	1,383,727	713,912	669815	17	938	65.4	72.6	57.7	26	0.11
13.	Nagaland	1,978,502	1,024,649	953853	119	931	79.6	87.8	76.1	–0.6	0.16
14.	Manipur	2,570,390	1,290,171	1280219	115	992	79.2	86.1	72.4	18.6	0.21
15.	Mizoram	1,097,206	555,339	541867	52	976	91.3	93.3	89.3	23.5	0.09
15.	Tripura	3,673,917	1,874,376	1799541	350	960	87.2	91.5	82.7	14.8	0.30
16.	Meghalaya	2,966,889	1,491,832	1475057	132	989	74.4	76	72.9	27.9	0.25
17.	Assam	31,205,576	15,939,443	15266133	398	958	72.2	77.8	66.3	17.1	2.58

18.	West Bengal	91,276,115	46,809,027	44467088	1028	950	76.3	81.7	70.5	13.8	7.54
19.	Jharkhand	32,988,138	16,930,315	16057819	414	948	66.4	76.8	55.4	22.4	2.73
20.	Odisha	41,974,218	21,212,136	20762082	270	979	72.9	81.6	64	14	3.47
21.	Chhattisgarh	25,545,198	12,832,895	12712303	189	991	70.3	80.3	60.2	22.6	2.11
22.	Madhya Pradesh	72,626,809	37,612,306	35014503	236	931	69.3	78.7	89.2	20.3	6.00
23.	Gujarat	60,439,692	31,491,260	28948432	308	919	78	85.8	69.7	19.3	4.99
24.	Daman & Diu*	243,247	150,301	92946	2191	618	87.1	91.5	79.5	53.8	0.02
25.	Dadra & Nagar Haveli*	343,709	193,760	149949	700	774	76.2	85.2	64.3	55.9	0.03
26.	Maharashtra	112,374,333	58,243,056	54131277	365	929	82.3	88.4	75.9	16	9.28
27.	Andhra Pradesh	84,580,777	42,442,146	42138631	308	993	67	74.9	59.1	11.6	6.99
28.	Karnataka	61,095,297	30,966,657	30128640	319	973	75.4	82.5	68.1	15.6	5.05
29.	Goa	1,458,545	739,140	719405	394	973	88.7	92.6	84.7	8.2	0.12
30.	Lakshadweep*	64,473	33,123	31350	2149	946	91.8	95.6	87.9	6.3	0.01
31.	Kerala	33,406,061	16,027,412	17378649	860	1084	94	96.1	92.1	4.9	2.76
32.	Tamil Nadu	72,147,030	36,137,975	36009055	555	996	80.1	86.8	73.4	15.6	5.96
33.	Puducherry*	1,247,953	612,511	635442	2547	1037	85.8	91.3	80.7	28.1	0.10
34.	Andaman & Nicobar Islands*	380,581	202,871	177710	46.137	876	86.6	90.3	82.4	6.9	0.0



Shares of States and UTs in Total Population

Sex Ratio of the Selected Countries

SI. No	*Country*	*2001*	*2011*
1	*2*	*2*	*3*
	World	**986**	**984**
1	China	944	926
2	India	933	943
3	U.S.A.	1,029	1,025
4	Indonesia	1,004	988
5	Brazil	1,025	1,042
6	Pakistan	938	943
7	Russian Fed.	1,140	1,167
8	Bangladesh	958	978
9	Japan	1,041	1,055
10	Nigeria	1.016	987

Sex Ratio: India & Neighbours

India among its neighbours 2001-2011

Countries	*2001*	*2011*
India	**933**	**943**
China	944	926
Pakistan	938	943
Bangladesh	958	978
Sri Lanka	1010	1034
Nepal	1005	1014
Afghanistan	930	931
Bhutan	919	897
Myanmar	1011	1048

India's Sex Ratio: 1901–2011

Census Year	*Sex ratio (Females per 1000 males)*
1	2
1901	972
1911	964
1921	955
1931	950
1941	945
1951	946
1961	941
1971	930
1981	934
1991	927
2001	933
2011	943

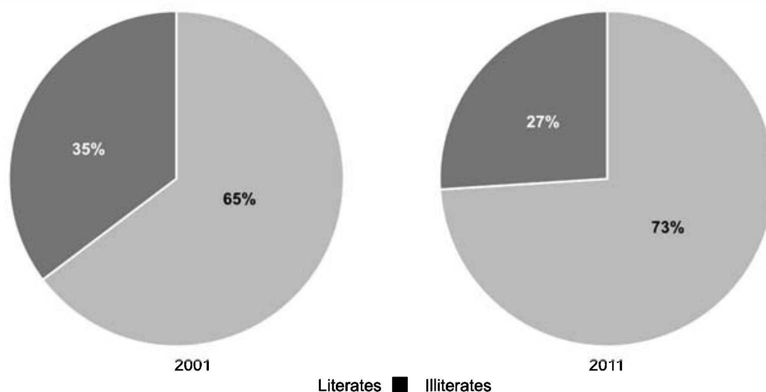
Sex Ratio of total population and child population in the age group 0-6 and above 7+ years: 2001-2011

State/ UT Code	*India/States/Union Territory#*	*Sex ratio (females per 1,000 males)*					
		Total population		*Child population in the age group 0-6*		*Population aged 7 and above*	
		2001	2011	2001	2011	2001	2011
1	2	3	4	5	6	7	8
	INDIA	**933**	**943**	**927**	**915**	**934**	**945**
01	Jammu & Kashmir	892	889	941	861	884	888
02	Himachal Pradesh	968	972	896	908	980	984
03	Punjab	876	895	798	848	888	899
04	Chandigarh#	777	818	845	867	767	813
05	Uttarakhand	962	963	908	886	973	976
06	Haryana	861	879	819	831	869	885
07	NCT of Delhi#	821	868	868	867	813	867
08	Rajasthan	921	928	909	884	923	935
09	Uttar Pradesh	898	912	916	900	894	910
10	Bihar	919	918	942	934	914	913
11	Sikkim	875	890	963	945	861	883
12	Arunachal Pradesh	893	938	964	961	878	916
13	Nagaland	900	931	964	946	890	931
14	Manipur	974	992	957	935	977	996
15	Mizoram	935	976	964	973	930	977

16	Tripura	948	960	966	952	945	963
17	Meghalaya	972	989	973	971	971	990
18	Assam	935	958	965	958	929	954
19	West Bengal	934	950	960	951	929	947
20	Jharkhand	941	948	965	944	935	949
21	Orissa	972	979	953	935	975	986
22	Chhattisgarh	989	991	975	964	992	995
23	Madhya Pradesh	919	931	932	912	916	933
24	Gujarat	920	919	883	887	927	924
25	Daman & Diu#	710	618	926	909	682	589
26	Dadra & Nagar Haveli#	812	774	979	923	779	753
27	Maharashtra	922	929	913	884	924	932
28	Andhra Pradesh	978	993	961	943	981	997
29	Karnataka	965	973	946	944	968	972
30	Goa	961	973	938	921	964	973
31	Lakshadweep#	948	946	959	908	946	952
32	Kerala	1,058	1,084	960	959	1,072	1,099
33	Tamil Nadu	978	996	942	946	993	1,000
34	Puducherry#	1,001	1,037	967	964	1,006	1,046
35	Andaman & Nicobar Islands#	846	876	957	965	831	867

Literacy Rate: 1951-2001

Census Year	*Persons*	*Males*	*Females*	*Male-Female gap in literacy rate*
1	2	3	4	5
1951	18.33	27.16	8.86	18.30
1961	28.3	40.4	15.35	25.05
1971	34.45	45.96	21.97	23.98
1981	43.57	56.38	29.76	26.62
1991	52.21	64.13	39.29	24.84
2001	64.83	75.26	53.67	21.59
2011	74.04	82.14	65.46	16.68



Shares of Literates & Illiterates: 2001-2011