Contents

SOME BASIC CONCEPTS OF MACROECONOMICS:

The economic wealth, or well-being, of a country does not necessarily depend on the mere possession of resources (Otherwise Africa or Jharkhand/ Odisha would have become richest country / states); the point is how the available resources are used in generating new products or a flow of production and how, as a consequence, income and wealth are generated from that process.

In our modern economic setting this production of goods or flow of production arises out of production of commodities – goods and services by millions of enterprises large and small. But what happens to these commodities after being produced? Each producer of commodities intends to sell her output. hence, they are sold to consumer of goods or services. Say, farmer may sell his wheat produce baker. This baker may use this wheat to produce bread. Baker wants this bread to be sold to the consumer.

The consumer may, in turn, be an individual or an enterprise/company and the good or service purchased by that entity might be for final use or for use in further production(In the above example, Bread can be bought by the retailer for making , say, new type of cake or say cream bun). When it is used in further production it often loses its characteristic as that specific good and is transformed through a productive process into another good. Thus a farmer producing cotton sells it to a spinning mill where the raw cotton undergoes transformation to yarn; the yarn is, in turn, sold to a textile mill where, through the productive process, it is transformed into cloth; the cloth is, in turn, transformed through another productive process into an article of clothing which is then ready to be sold finally to the consumers for final use. Such an item that is meant for final use and will not pass through any more stages of production or transformations is called a **final good.**

Final goods: These goods do not undergo any further transformation in the production process. Final goods can be of two types consumption goods and capital goods.

1. Consumption Goods: Goods which are consumed by the ultimate consumers or meet the immediate need of the consumer are called consumption goods. Services are included in consumption goods only.

2. Capital Goods:

A particular good will be capital in nature only if it possess the following three characteristics:

(i) It is a produced durable output of a man made process

(ii) It again acts as an input for further production process

(iii) While acting as an input, it does not get transformed or consumed

Some commodities like television sets, automobiles or home computers, although they are for ultimate consumption, have one characteristic in common with capital goods – they are also durable. That is, they are not extinguished by immediate or even short period consumption; they have a relatively long life as compared to articles such as food or even clothing. They also undergo wear and tear with gradual use and often need repairs and replacements of parts, i.e., like machines they also need to be preserved, maintained and renewed. That is why we call these goods consumer durables.

Intermediate goods

These are semi-finished goods which have been produced by a process but cannot be used as it is and need to go through further production process to be converted into a final good. For example cotton cloth or wheat. The wheat flour can be used for making cake or cotton cloth can be used to make new T-shirts etc.

Concepts of stocks and flows

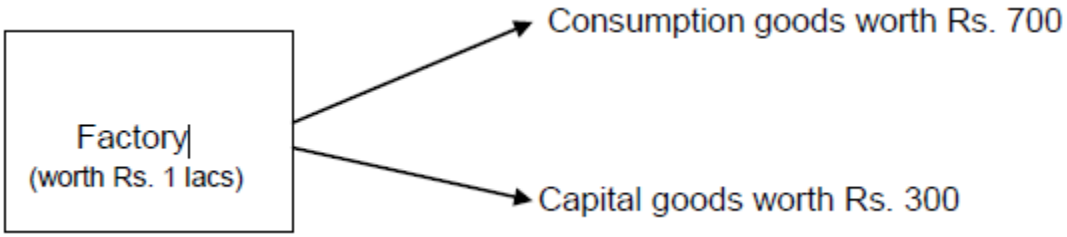
Income, or output, or profits are concepts that make sense only when a time period is specified. These are called flows because they occur in a period of time (say, in last one month or one year etc). Therefore we need to delineate a time period to get a quantitative measure of these. Since a lot of accounting is done annually in an economy, many of these are expressed annually like annual profits or production. **Flows** are defined over a period of time.

In contrast, capital goods or consumer durables once produced do not wear out or get consumed in a delineated time period (say, at 5pm). In fact capital goods continue to serve us through different cycles of production. The buildings or machines in a factory are there irrespective of the specific time period. There can be addition to, or deduction from, these if a new machine is added or a machine falls in disuse and is not replaced. These are called stocks. ***Stocks*** *are defined at a particular point of time*.

That part of our final output that comprises of capital goods constitutes gross investment of an economy. These may be machines, tools and implements; buildings, office spaces, storehouses or infrastructure like roads, bridges,etc.

So, investment in a country is not measured as money put in a business or any economic activity but it is basically that portion of the final output (GDP) which consists of capital goods.

Consider the following diagram:



Suppose there is only one factory (capital good) in a country is producing consumption goods worth Rs. 700 and capital goods worth Rs. 300 in a particular year (say 2015-16) in an economy. This means that the GDP will be Rs. 1000 (which is the total production of both consumption and capital goods) and the gross investment in the economy will be Rs. 300 or (Rs 300/Rs1000) 30%, as investment is measured as the percentage of **output** which consists of capital goods.

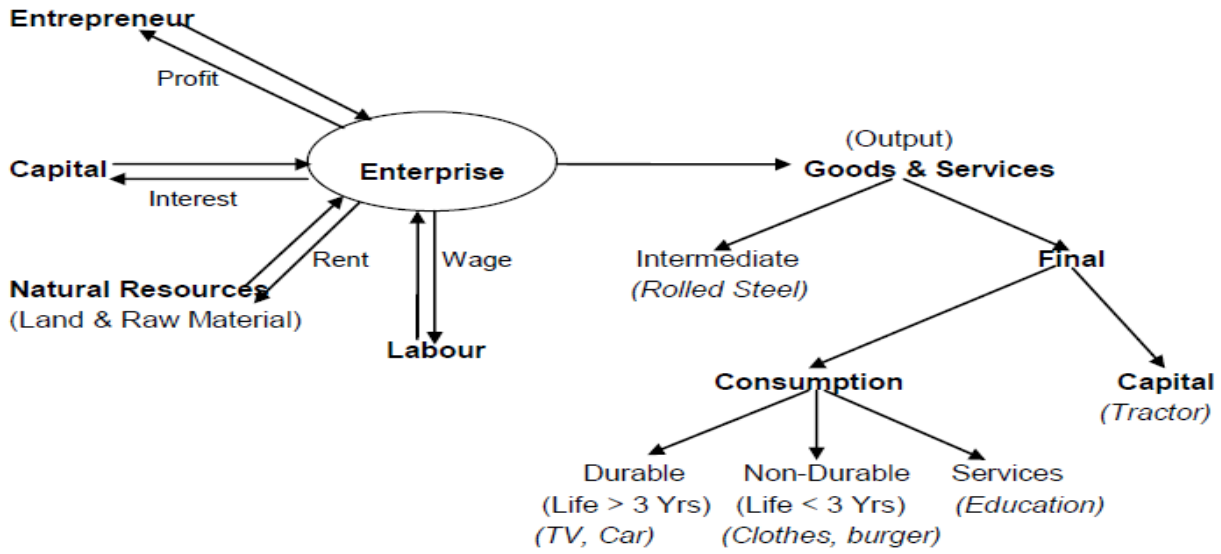
But all the capital goods produced in a year do not constitute an addition to the capital stock already existing. A significant part of current output of capital goods goes in maintaining or replacing part of the existing stock of capital goods because of wear and tear. Hence, this replaced capital asset needs to be deleted from the existing capital. This deletion, which is made from the value of gross investment in order to accommodate regular wear and tear of capital, is called depreciation.

So new addition to capital stock in an economy is measured by net investment or new capital formation, which is expressed as

Net Investment = Gross investment – Depreciation

This is how economists define investment. This must not be confused with the commonplace notion of investment which implies using money to buy physical or financial assets. Thus use of the term investment to denote purchase of shares or property or even having an insurance policy has nothing to do with how economists define investment. Investment for us is always capital formation, a gross or net addition to capital stock.

Private Sector: The four inputs that an enterprise requires to produce output (goods and services) are called the four "factors of production" or the "inputs of production". These four factors of production are the following (as shown in the figure):



The four factors/inputs of production combining together to produce output and the classification of output (goods and services) into consumption and capital goods.

Enterprise

1. Entrepreneur: The person who takes the risk and starts a new business. This person puts in initial money in the enterprise and in return expects "**Profit**". *The entrepreneur is a human being and he belongs to the household sector.*

2. Capital: In today's world, capital can be physical, financial or intellectual. But from an economic point of view, only the physical capital goods are considered as capital. So capital includes the building, machinery, equipments etc. The return for the capital is called "**Interest**".

3. Natural Resources: Natural resources include land and raw materials which are naturally available and are not produced through manmade processes. The return for the natural resources is called "**Rent**".

4. Labour: It is the human labour which may be physical or mental i.e. it can be unskilled, semi-skilled or skilled. When a human being provides his labour to the enterprise, in return he/she expects **wages**. *The labour (who is providing the labour services) is a human being and belongs to the household sector.*

CIRCULAR FLOW OF INCOME AND METHODS OF CALCULATING NATIONAL INCOME

In its simplest version, the economy is modeled as consisting only of households and firms. Money flows to workers in the form of wages, and money flows back to firms in exchange for products.

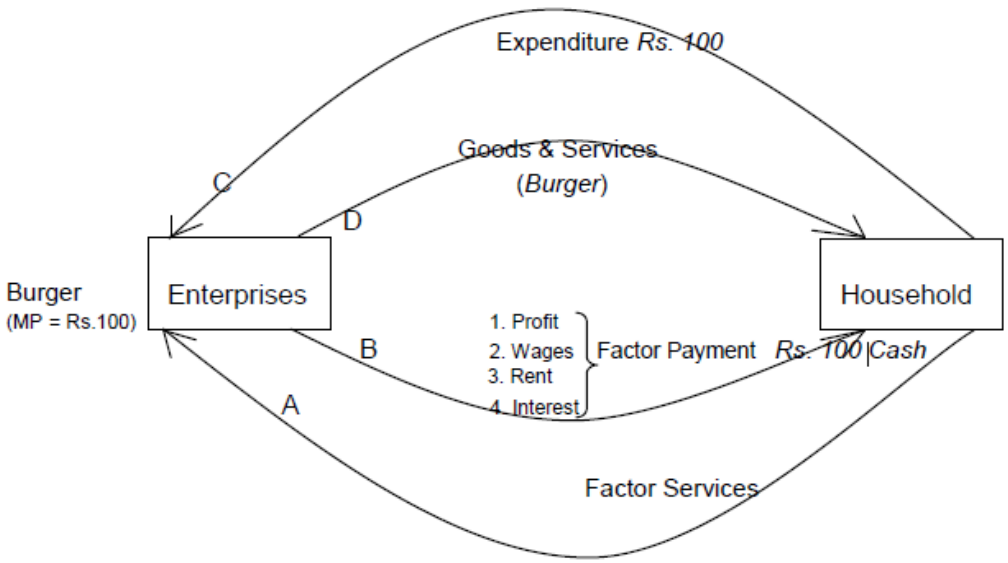
Most, if not all, people go to work daily to earn a living. The money that is earned is used to purchase goods and services from businesses such as food, clothes, rent, basic commodities, entertainment services, health and wellness products, etc. The income earned daily flows back to businesses continuously in a cycle known as the circular flow of income.

Businesses and companies manufacture goods or provide services to consumers. To increase sales and profits, these companies use factors of production - labor, capital, and land - to run their operations and grow their businesses. In return for their services, the hired labor is given a wage or salary, known as income. The income received is used by households and individuals to purchase the goods and services produced by these businesses. The businesses use the proceeds from the sales to produce more products and pay workers for their labor

Simply put, the firms' demand for factors of production to run the production process creates payments to the public. In turn, the public's demand for goods and services creates payments to the firms and enables the sale of the products they produce.

So the social act of consumption and production are intricately linked and, in fact, there is a circular causation here. The process of production in an economy generates factor payments for those involved in production and generates goods and services as the outcome of the production process. The incomes so generated create the capacity to purchase the final consumption goods and thus enable their sale by the business enterprises, the basic object of their production. The capital

goods which are also generated in the production process also enable their producers to earn income – wages, profits etc. in a similar manner. The capital goods add to, or maintain, the capital stock of an economy and thus make production of other commodities possible.



The value of the burger i.e. Rs. 100 is called the Gross Domestic Product (GDP) of the country for that year. Since the amount of money representing the aggregate value of goods and services, is moving in circular way, if we want to estimate the aggregate value of goods and services (GDP) produced during a year, we can measure the annual value of flows at any of the lines indicated in the diagram. For example, if we measure the GDP by the aggregate value of spending that the firms receive for the final goods and services which they produce (by line C) then this method is called the expenditure method. If we measure the flow at D by measuring the aggregate value of final goods and services produced by all the firms, then it is called product method (value added). If we measure the total factor payments at B then it is called the income method. Thus we can measure
the aggregate output (GDP) in three ways.

Gross Domestic Product (GDP)

The total final value of goods and services produced within the domestic boundary of a country in a specified time period (generally a financial year) is called Gross Domestic Product. GDP can be calculated by three methods:

1. **The Product or Value Added Method**

In this method we calculate the aggregate annual value of goods and services produced and to arrive at this we add up the value of all goods and services produced by all the firms in an economy. Let us take an example:

Farmer	Rs. 50	+	Rs. 50 (consumed)	=	Rs. 100 wheat produced
Baker	Purchase	+	Value Addition	=	Rs. 200 bread produced

GDP = Value addition by Baker + Value addition by Farmer

= (Rs. 200 - Rs. 50) + (Rs. 100)

= Rs. 150 + Rs. 100

= Rs. 250

Value addition by the farmer is Rs. 100. Value addition does not depend on whether the farmer is selling the wheat in the market or consuming himself. *Value addition is basically "the value/price that somebody's work will fetch in the market" and it includes profit also.*

By the standard definition, GDP should be equal to the final value of all goods and services produced in the economy. So we can cross check the above example.

GDP = Final value of all goods produced

= Final value of wheat + Final value of bread

= Rs. 50 + Rs. 200

= Rs. 250 *(which is same as above calculated from value added method)*

Out of the Rs. 100 wheat produced by the farmer, only Rs 50 consumed by the farmer is final good. The wheat that the farmer sold to the baker worth Rs. 50 is an intermediate good and not final good.

2. **Expenditure Method**

An alternative way to calculate GDP is by looking at the expenditure side of all the sectors. Whatever goods and services are produced in the economy are ultimately purchased by the four sectors of the economy i.e. household sector, government sector, private sector and external sector. So if we add the expenditures done by these four sectors on the purchase of final goods and services produced by the firms within the domestic boundary then it shall be equal to the GDP of the country.

The household sector spends only on the consumption goods (denoted by C')

The private sector spends only on capital goods (investment) barring some exceptions when firms buys consumables to treat their guest or for their employees (denoted by I')

The government sector purchase both capital and consumption goods (denoted by G')

The external sector also purchases both consumption and capital goods from our economy which is basically called the exports from India (denoted by X).

$$GDP = C' + I' + G' + X$$

$$= C - Cm + I - Im + G - Gm + X$$

$$= C + I + G + X - (Cm + Im + Gm)$$

$$= C + I + G + X - M$$

$$GDP = C + I + G + X - M$$

C', I' and G' are all expenditure on **domestically produced** final goods as we are trying to calculate GDP. And C, I and G are expenditure by the three sectors **on domestic and imported both** final goods.

3. **Income Method**

It has already been stated in the beginning that the sum of the final goods produced in the economy must be equal to the income received by all the four factors of production i.e. wages, rents, interests and profits. This follows from the simple idea that the revenues earned by all the firms put together must be distributed to those who has contributed in the production process which are basically the four factors of production entrepreneurship, labour, capital and natural resources.

GDP = Profit earned by all the firms + Interest received by all the capital deployed + Rent received for the natural resources + Wages earned by all the labourers

GDP = Profit + Interest + Rent + Wages

Macroeconomic variables

Gross Domestic Product (GDP) measures the aggregate/total production of final goods and services taking place within the domestic (geographical boundary) economy of the country during a year. But it may be possible that the foreign nationals working within India have contributed in that GDP production.

So, now we are interested in measuring the output/earnings made by Indian residents only whether in India or abroad which is termed as Gross National Product (GNP). GNP is that income or product which accrues to the economic agents who are **residents** of the country. *(i.e. income earned by the Non Resident Indians (NRIs) will not be part of India's GNP).*

To calculate GNP, we add the factor income of Indians from abroad in GDP and subtract the contribution of foreigners in India's GDP.

Gross National Product (GNP) = GDP + Factor income earned by the domestic factors of production employed in the rest of the world - Factor income earned by the factors of production of the rest of the world employed in the domestic economy

GNP = GDP + Net factor income from abroad (NFIA)

Factor income is basically the income earned by the four factors of production i.e. profit, rent, interest and wages but it does not include the transfer incomes/payments. Hence GNP is the sum of GDP and factor income and it does not include transfer payments from the rest of the world (for example remittances).

National Disposable Income = National Income + Transfer payments

Gross Domestic Product (GDP) + NFIA = Gross National Product (GNP)

Gross Domestic Product (GDP) - Depreciation = Net Domestic Product (NDP)

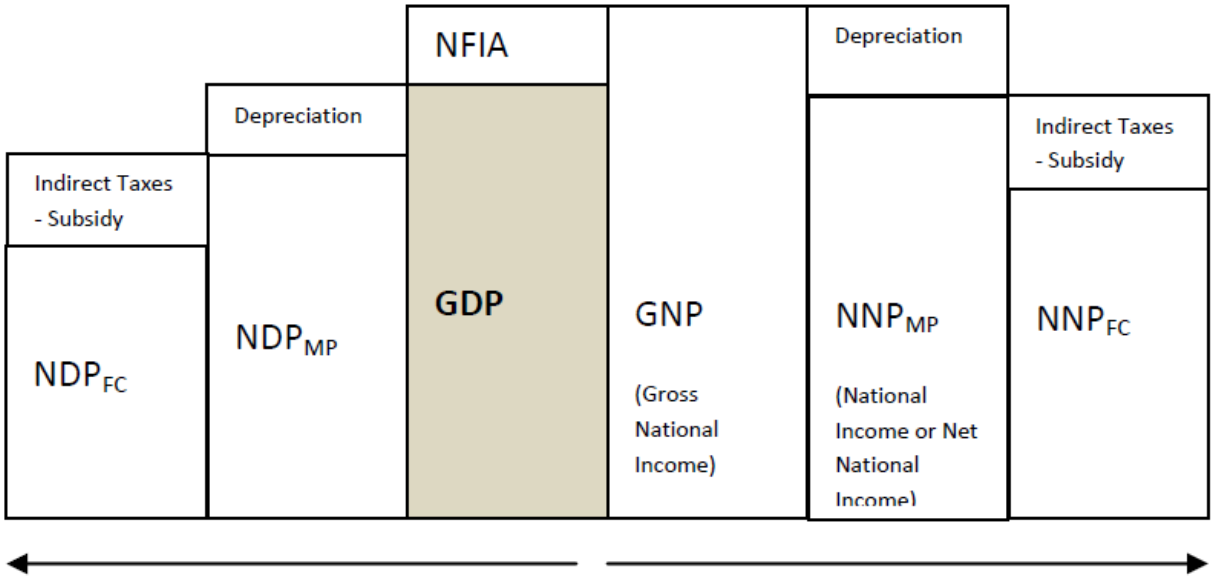
Gross National Product (GNP) - Depreciation = Net National Product (NNP)

"Gross National Product (GNP) is also called Gross National Income and Net National Product (NNP) is also called Net National Income or just National Income."

Market Price = Factor Cost + (Indirect Taxes- Subsidies)

*In India now (**since January 2015 onwards**) we calculate GDP at Market Prices rather than at Factor Cost. The way we are calculating GDP at MP and FC, similarly NDP can also be calculated at MP and FC and GNP and NNP can also be measured at MP and FC.*

The figure below presents a diagrammatic representation of the relations between the various macroeconomic variables.



2014-KAS

If NDP of India is greater than NNP, it means that

(a) The level of production in the private sector has increased.

(b) The level of production in the public sector has increased.

(c) The net earnings from abroad are positive.

(d) The net earnings from abroad are negative.

Nominal and Real GDP

Real GDP growth measures growth in **quantity** only and nominal GDP measures growth in **value** (which includes quantity and price both).

One implicit assumption in all this discussion is that the prices of goods and services do not change during the period of our study. If prices change, then there may be difficulties in comparing GDPs. If we measure the GDP of a country in two

consecutive years and see that the figure for GDP of the latter year is twice that of the previous year, we may conclude that the volume of production of the country has doubled. But it is possible that only prices of all goods and services have doubled between the two years whereas the production has remained constant.

Therefore, in order to compare the GDP figures (and other macroeconomic variables) of different countries or to compare the GDP figures of the same country at different points of time, we cannot rely on GDPs evaluated at current market prices. For comparison we take the help of ***real GDP***.

Real GDP is calculated in a way such that the goods and services are evaluated at some **constant set of prices** (or **constant prices**). Since these prices remain fixed, if the Real GDP changes we can be sure that it is the volume of production which is undergoing changes.

Nominal GDP, on the other hand, is simply the value of GDP at the current prevailing prices. For example, suppose a country only produces bread. In the year 2000 it had produced 100 units of bread, price was Rs 10 per bread. GDP at current price was Rs 1,000. In 2001 the same country produced 110 units of bread at price Rs 15 per bread. Therefore nominal GDP in 2001 was Rs 1,650 (=110 × Rs 15). Real GDP in 2001 calculated at the price of the year 2000 (2000 will be called the base year) will be 110 × Rs 10 = Rs 1,100.

Notice that the ratio of nominal GDP to real GDP gives us an idea of how the prices have moved from the base year (the year whose prices are being used to calculate the real GDP) to the current year.

In the calculation of real and nominal

GDP of the current year, the volume of production is fixed. Therefore, if these measures differ it is only due to change in the price level between the base year and the current year. The ratio of nominal to real GDP is a well known index of prices.

This is called GDP Deflator. Thus if GDP stands for nominal GDP and gdp stands for real GDP then,

GDP deflator =GDP/gdp

Since **January 2015**, Central Statistical Office (CSO) has changed the base year for calculation of GDP to 2011-12. GDP deflator is published by CSO.

Before 2015, CSO was not using market prices to calculate GDP, rather it was using Factor Cost i.e. Market Price excluding indirect taxes and subsidies. Now, as per the global best practices and the IMF's World Economic Outlook projections based on GDP at market prices, India has changed its methodology of GDP calculation at market prices.

In India, **economic growth** is measured by **real GDP** i.e. GDP at **constant** Market Prices

To calculate GDP at market prices, first we calculate GDP at factor cost/basic prices and then we separately add the governments total indirect taxes including both GST and non GST revenue of Central and State governments.

Let us take an example:

Suppose there is a farmer who sold wheat in Rs. 100 which then was purchased by ITC which converted wheat into flour (Aashirwaad atta) and sold it in Rs. 500 to a restaurant. The restaurant converted flour into chapati and sold the chapati in Rs. 1000 to a customer in the restaurant. The customer in total paid Rs. 1100 (i.e. Rs. 1000 plus 10% tax)

If we have to calculate GDP at market price, first we will calculate GDP at factor cost/basic prices and then add separately the taxes.

$GDPMP = GVA_{\text{factor cost/basic prices}}$ + Indirect taxes – Subsidies

GVA by farmer (agriculture sector) = Rs. 100

GVA by ITC (Industrial sector) = Rs. 500 – Rs. 100 = Rs. 400

GVA by Restaurant (Service sector) =Rs. 1000 – Rs. 500 = Rs. 500

$GVA_{\text{factor cost/basic prices}}$ = Rs. 100 + Rs. 400 + Rs. 500 = Rs. 1000

Indirect taxes – subsidy = Rs. 100

GDPMP = Rs. 1100

As per the first advance estimates released by CSO in January 2019, the GDP of India at *current market prices* is going to be **Rs. 188.4 lakh crore for 2018-19** as against Rs. 167.7 lakh crore in 2017-18 showing a growth rate of 12.3 percent.

The GNP of India at current market prices is expected to be Rs. 186.4 lakh crore for 2018- 19.

Real GDP of India at constant market prices (2011-12) in the year 2018-19 is likely to attain a level of Rs. 139.5 lakh crore as against Rs. 130.1 lakh crore in 2017-18, showing a growth rate of 7.2 percent.

World Bank and IMF Classification of Countries

World Bank classifies the world's economies based on estimates of gross national income (GNI) per capita based on nominal exchange rate. The GNI per capita estimates are also used as input to the World Bank's operational classification of economies that determines lending eligibility. As per the July 2017 data, the following is the classification of world economies:

- High Income — $12,235 < GNI per capita
- Middle Income
  - Upper Middle — $3,956 < GNI per capita < $12,235
  - Lower Middle — $1,006 < GNI per capita < $3,955
- Low Income — GNI per capita < $1,005

India belongs to the "Lower Middle" group as its GNI per capita is $1940 in terms of nominal exchange rate. As per the PPP exchange rate, India's GNI per capita is $7060.

The World Economic Outlook (WEO, **IMF**) classifies the world into two major groups:

- Advanced economies
- Emerging market and developing economies

This above classification is based on three parameters:

- Per capita income *(using PPP exchange rate)*
- Export diversification
- Degree of integration into the global financial system

Government Budget

There is a constitutional requirement in India (Article 112) to present before the Parliament a statement of estimated receipts and expenditures of the government in respect of every financial year which runs from 1 April to 31 March. This 'Annual Financial Statement' constitutes the main budget document of the government.

Objectives of Government Budget

The government plays a very important role in increasing the welfare of the people. In order to do that the government intervenes in the economy in the following ways.

I. ***Allocation Function of Government Budget:***

Government provides certain goods and services which cannot be provided by the market mechanism i.e. by exchange between individual consumers and producers. Examples of such goods are national defence, roads, government administration etc. which are referred to as public goods.

II. ***Stabilisation Function of Government Budget:***

The intervention of the government whether to expand demand or reduce it constitutes the stabilisation function. For example: When there is no demand, govt can pump in money, say through MGNREGA. This will increase the demand in the economy. Similarly, by increasing the income tax rates, it can reduce the disposable income with the household. this will reduce the demand in the economy.

III. ***Redistribution Function of Government Budget:***

It is known that the total national income of the country goes to either the private sector, that is, firms and households (known as private income) or the government (known as public income). Out of private income, what finally reaches the households is known as personal income and the amount that can be spent is the personal disposable income. The government sector affects the personal disposable income of households by making transfers and collecting taxes. It is through this that the government can change the distribution of income and bring about a distribution that is considered 'fair' by society. This is the redistribution function.

Every budget gives three sets of figures. For example, the budget (Annual Financial Statement) presented in Feb 2016 for the year 2016-17 will contain the following figures:

- Budget Estimate (BE) for the next FY 2016-17
- Budget and Revised Estimate (RE) for the current FY 2015-16
- Actual figures for the preceding FY 2014-15

There can be three kinds of Budget presented by the government:

(i) Full Budget: It contains the government's estimate for expenditure and receipts for the entire financial year.

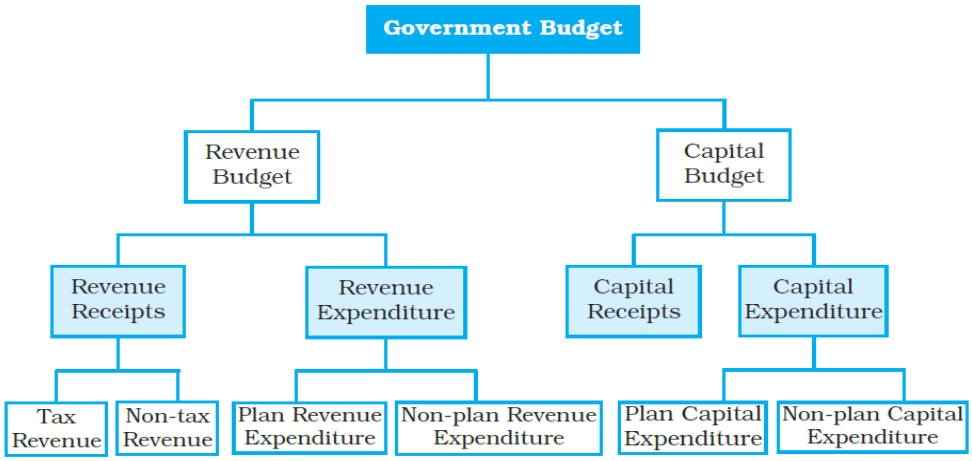
(ii) Interim Budget: During an election year, the ruling government may present an interim budget which is a complete set of accounts, including both expenditure and receipts but only for a part of the year. An Interim Budget gives the complete financial statement, very similar to a full Budget. When the new government will be formed, it shall prepare the full budget. There is no such constitutional obligation to prepare an interim budget, it is just an unwritten convention that political parties have developed.

(iii) Vote-on-Account: 'Vote on Account' deals only with the expenditure side of the government's budget. Through 'Vote on Account', the government obtains the vote of the Parliament for a sum sufficient to incur expenditure on various items for a part of the year. Normally, the 'Vote on Account' is taken for two months for a sum equivalent to one sixth of the estimated expenditure for the entire year under various demands for grants.

Classification of Receipts:

Revenue Receipts: Revenue receipts are those receipts that do not lead to a claim on the government. They are therefore termed non-redeemable. They are divided into tax and non-tax revenues. Tax revenues, an important component of revenue receipts, have for long been divided into direct taxes (personal income tax) and firms (corporation tax), and indirect taxes like excise taxes (duties levied on goods produced within the country), customs duties (taxes imposed on goods imported into and exported out of India) and service tax. Other direct taxes like wealth tax, gift tax and estate duty (now abolished) have never brought in large amount of revenue and thus have been referred to as 'paper taxes'. The redistribution objective is sought to be achieved through progressive income taxation, in which higher the income, higher is the tax rate. Firms are taxed on a proportional basis, where the tax rate is a particular proportion of profits. With respect to excise taxes, necessities of life are exempted or taxed at low rates, comforts and semi-luxuries are moderately taxed, and luxuries, tobacco and petroleum products are taxed heavily.

Non-tax revenue of the central government mainly consists of interest receipts on account of loans by the central government, dividends and profits on investments made by the government, fees and other receipts for services rendered by the government. Cash grants-in aid from foreign countries and international organisations are also included. The estimates of revenue receipts take into account the effects of tax proposals made in the Finance Bill.



The Components of the Government Budget

Capital Receipts: The government also receives money by way of loans or from the sale of its assets. Loans will have to be returned to the agencies from which they have been borrowed. Thus they create liability. Sale of government assets, like sale of shares in Public Sector Undertakings (PSUs) which is referred to as PSU disinvestment, reduce the total amount of financial assets of the government. All those receipts of the government which create liability or reduce financial assets are termed as capital receipts. When government takes fresh loans it will mean that in future these loans will have to be returned and interest will have to be paid on these loans. Similarly, when government sells an asset, then it means that in future its earnings from that asset, will disappear. Thus, these receipts can be debt creating or non-debt creating.

Classification of Expenditure

Revenue Expenditure

Revenue Expenditure is expenditure incurred for purposes other than the creation of physical or financial assets of the central government. It relates to those expenses incurred for the *normal functioning of the government departments and various services, interest payments on*

debt incurred by the government, and grants given to state governments and other parties (even though some of the grants may be meant for creation of assets).

Budget documents classify total expenditure into plan and non-plan expenditure. According to this classification, plan revenue expenditure relates to central Plans (the Five-Year Plans) and central assistance for State and Union Territory plans. Non-plan expenditure, the more important component of revenue expenditure, covers a vast range of general, economic and social services of the government. The main items of non-plan expenditure are interest payments , defence services, subsidies, salaries and pensions. Interest payments on market loans, external loans and from various reserve funds constitute the single largest component of non-plan revenue expenditure. Defence expenditure, is committed expenditure in the sense that given the national security concerns, there exists little scope for drastic reduction. Subsidies are an important policy instrument which aim at increasing welfare. Apart from

providing implicit subsidies through under-pricing of public goods and services like education and health, the government also extends subsidies explicitly on items such as exports, interest on loans, food and fertilisers.

(Recently, distinction between plan and non-plan expenditure has been removed by the central government.)

Capital Expenditure

There are expenditures of the government which *result in creation of physical or financial assets or reduction in financial liabilities.* This includes expenditure on the acquisition of land, building, machinery, equipment, investment in shares, and loans and advances by the central government to state and union territory governments, PSUs and other parties. Capital expenditure is also categorised as plan and non-

plan in the budget documents. Plan capital expenditure, like its revenue counterpart, relates to central plan and central assistance for state and union territory plans. Non-plan capital expenditure covers various general, social and economic services provided by the government.

The budget is not merely a statement of receipts and expenditures. Since Independence, with the launching of the Five-Year Plans, it has also become a significant national policy statement. The budget, it has been argued, reflects and shapes, and is, in turn, shaped by the country's economic life. Along with the budget, three policy statements are mandated by the Fiscal Responsibility and Budget Management Act, 2003 (FRBMA).

- ✓ ***The Medium-term Fiscal Policy Statement*** sets a three year rolling target for specific fiscal indicators and examines whether revenue expenditure can be financed through revenue receipts on a sustainable basis and how productively capital receipts including market borrowings are being utilized.
- ✓ ***The Fiscal Policy Strategy Statement*** sets the priorities of the government in the fiscal area, examining current policies and justifying any deviation in important fiscal measures.
- ✓ ***The Macroeconomic Framework Statement*** assesses the prospects of the economy with respect to the GDP growth rate, fiscal balance of the central government and external balance.

Measures of Government Deficit

When a government spends more than it collects by way of revenue, it incurs a budget deficit6. There are various measures that capture government deficit and they have their own implications for the economy.

Revenue Deficit: The revenue deficit refers to the excess of government's revenue expenditure over revenue receipts

Revenue deficit = Revenue expenditure – Revenue receipts

Item 3 in Table 5.1 shows that revenue deficit in 2015-16 was 2.8 per cent of GDP. The revenue deficit includes only such transactions that affect the current income and expenditure of the government. When the government incurs a revenue deficit, it implies that the government is dissaving and is using up the savings of the other sectors of the economy to finance a part of its consumption expenditure. This situation means that the government will have to borrow not only to finance its investment but also its consumption requirements. This will lead to a buildup of stock of debt and interest liabilities and force the government, eventually, to cut expenditure. Since a major part of revenue expenditure is committed expenditure, it cannot be reduced. Often the government reduces productive capital expenditure or welfare expenditure. This would mean lower growth and adverse welfare implications.

Table 5.1: Receipts and Expenditures of the Central Government, 2015-16 (B.E.)

	(As per cent of GDP)
1. Revenue Receipts (a+b)	8.1
(a) Tax revenue (net of states' share)	6.5
(b) Non-tax revenue	1.6
2. Revenue Expenditure of which	10.9
(a) Interest payments	3.2
(b) Major subsidies	1.6
(c) Defence expenditure	1.1
3. Revenue Deficit (2–1)	2.8
4. Capital Receipts (a+b+c) of which	4.5
(a) Recovery of loans	0.1
(b) Other receipts (mainly PSU[1] disinvestment)	0.5
(c) Borrowings and other liabilities	3.9
5. Capital Expenditure	1.7
6. Total Expenditure [2+5=6(a)+6(b)]	12.6
(a) Plan expenditure	3.3
(b) Non-plan expenditure	9.3
7. Fiscal deficit [6-1-4(a)-4(b)] or [3+5-4(a)-4(b)]	3.9
8. Primary Deficit [7–2(a)]	0.7

Source: *Economic Survey*, 2015-16 [1] Public Sector Undertaking

Fiscal Deficit: Fiscal deficit is the difference between the government's total expenditure and its total receipts excluding borrowing

Gross fiscal deficit = Total expenditure – (Revenue receipts + Non-debt creating capital receipts)

Non-debt creating capital receipts are those receipts which are not borrowings and, therefore, do not give rise to debt. Examples are recovery of loans and the proceeds from the sale of PSUs. From Table 5.1 we can see that non-debt creating capital receipts equals 0.6 per cent of GDP, obtained by subtracting, borrowing and other liabilities from total capital receipts (4.5 – 3.9). The fiscal deficit, therefore turn out to be 3.9 per cent of GDP. The fiscal deficit will have to be financed through borrowing. Thus, it indicates the total borrowing requirements of the government from all sources. From the financing side

Gross fiscal deficit = (Net borrowing at home + Borrowing from RBI + Borrowing from abroad)

Net borrowing at home includes that directly borrowed from the public through debt instruments (for example, the various small savings schemes) and indirectly from commercial banks through Statutory Liquidity Ratio (SLR). The gross fiscal deficit is a key variable in judging the financial health of the public sector and the stability of the economy.

From the way gross fiscal deficit is measured as given above, it can be seen that revenue deficit is a part of fiscal deficit (Fiscal Deficit = Revenue Deficit + Capital Expenditure - non-debt creating capital receipts). A large share of revenue deficit in fiscal deficit indicated that a large part of borrowing is being used to meet its consumption expenditure needs rather than investment.

Fiscal Deficit of Central Government

2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	*2018-19
5.1%	5.8%	4.9%	4.5%	4.1%	3.9%	3.5%	3.5%	3.4%

Fiscal Deficit of State Governments

2014-15	2015-16	2016-17	2017-18	*2018-19
2.60%	3.10%	3.50%	3.10%	2.70%

Primary Deficit: We must note that the borrowing requirement of the government includes interest obligations on accumulated debt. The goal of measuring primary deficit is to focus on present fiscal imbalances. To obtain an estimate of borrowing on account of current expenditures exceeding revenues, we need to calculate what has been called the primary deficit. It is simply the fiscal deficit minus the interest payments

Gross primary deficit = Gross fiscal deficit – Net interest liabilities

Net interest liabilities consist of interest payments minus interest receipts by the government on net domestic lending.

2011-KAS

Fiscal deficit and primary deficit of the Central Government would have been equal in 2010 – 11, if revenue expenditure on

(1) Major subsidies were zero

(2) Defence expenditures were zero

(3) Recovery of loans were zero

(4) Interest payments were zero

Sources: Annual Financial Statement, Karnataka Budget Documents 2019-20; PRS.

Budget 2019-20 - Key figures (in Rs crore)

Items	2017-18 Actuals	2018-19 Budgeted	2018-19 Revised
Total Expenditure	**1,86,510**	**2,18,488**	**2,17,451**
A. Receipts (except borrowings)	1,47,140	1,66,600	1,66,101
B. Borrowings	25,122	47,134	46,126
Total Receipts (A+B)	**1,72,262**	**2,13,734**	**2,12,228**
Revenue Surplus	**4,517**	**106**	**194**
As % of GSDP	0.34%	0.01%	0.01%
Fiscal Deficit	**31,101**	**40,753**	**40,167**
As % of GSDP	2.37%	2.89%	2.85%
Primary Deficit	**17,171**	**24,544**	**24,571**
As % of GSDP	1.31%	1.74%	1.74%

Notes: BE is Budget Estimate; RE is Revised Estimate.
GSDP for 2019-20 is Rs 15,88,303 crore.

The State's fiscal consolidation efforts have continued to be effective with all the fiscal indicators contained within the stipulated limits of the Karnataka Fiscal Responsibility Act, 2002 (KFRA). The broad fiscal indicators continue to perform well and have largely been within the fiscal rules prescribed. Driven by various fiscal consolidation measures, Karnataka while enhancing its revenues has managed its expenditure well. In 2018-19, the State has estimated

(i) revenue surplus of Rs.106.06 crore,

(ii) Fiscal Deficit at 2.89% of GSDP and

(iii) outstanding debt at 19.64% of GSDP. Other important expenditure indicators such as proportion of State tax revenue in the revenue expenditure and non-development expenditure in aggregate disbursements place Karnataka in a better position.

Economic Survey- 2018-19

Fiscal Responsibility and Budget Management Act, 2003 (FRBMA)

In a multi-party parliamentary system, electoral concerns play an important role in determining expenditure policies. A legislative provision, it is argued, that is applicable to all governments – present and future – is likely to be effective in keeping deficits under control. The enactment of the FRBMA, in August 2003, marked a turning point in fiscal reforms, binding the government through an institutional framework to pursue a prudent fiscal policy. The central government must ensure intergenerational equity and long-term macro-economic stability by achieving sufficient revenue surplus, removing fiscal obstacles to monetary policy and effective debt management by limiting deficits and borrowing. The rules under the Act were notified with effect from July, 2004.

Main Features

1. The Act mandates the central government to take appropriate measures to reduce fiscal deficit to not more than 3 percent of GDP and to eliminate the revenue deficit by March 31, 20098 and thereafter build up adequate revenue surplus.

2. It requires the reduction in fiscal deficit by 0.3 per cent of GDP each year and the revenue deficit by 0.5 per cent. If this is not achieved through tax revenues, the necessary adjustment has to come from a reduction in expenditure.

3. The actual deficits may exceed the targets specified only on grounds of national security or natural calamity or such other exceptional grounds as the central government may specify.

4. The central government shall not borrow from the Reserve Bank of India except by way of advances to meet temporary excess of cash disbursements over cash receipts.

5. The Reserve Bank of India must not subscribe to the primary issues of central government securities from the year 2006-07.

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

7. The central government to lay before both Houses of Parliament three statements – Medium-term Fiscal Policy Statement, The Fiscal Policy Strategy Statement, The Macroeconomic Framework Statement along with the Annual Financial Statement.

8. Quarterly review of the trends in receipts and expenditure in relation to the

budget be placed before both Houses of Parliament.

The act applies to the central government. However, 26 states have already enacted fiscal responsibility legislations which have made the rule based fiscal reform programme of the government more broad based. Although the government has emphasised that the FRBMA is an important institutional mechanism to ensure fiscal prudence and support macroeconomic balance there have been fears that welfare expenditure may get reduced to meet the targets mandated by the Act.

FRBM Review Committee

In the last thirteen years since the FRBM act was enacted, the Indian economy has graduated to a middle income country. At the time of enactment of the FRBM, there was a general thinking that fiscal rules were better than discretion. However, since then the advanced countries have moved away from this but in India, the government has affirmed its faith in the fiscal policy principles set out in the FRBM. Therefore, there is support for retaining the basic operational framework designed in 2003 but to revamp it to incorporate the changing scenario in India and also with an eye for the future path of growth – the task that has been handed to the FRBM Review Committee.

India's TAX System

Taxes can be classified in several ways:

One way is to classify them in progressive, proportional and regressive way:

- Progressive Tax: Percentage of tax increases with increase in income
- Proportional Tax: Percentage of tax remains same/constant irrespective of income
- Regressive Tax: Percentage of tax decreases with increase in income

Another way of classification is Specific tax and Ad valorem tax:

- Specific tax is the tax which is fixed as per each unit of good or service rather than based on its value.
- Ad valorem tax is levied as a percentage of value of the item it is imposed on, and not on the item's quantity, size, weight or other such factor.

2014-KAS

. Which type of taxes help in reducing income disparities ?

(a) Neutral Taxes

(b) Proportionate Taxes

(c) Progressive Taxes

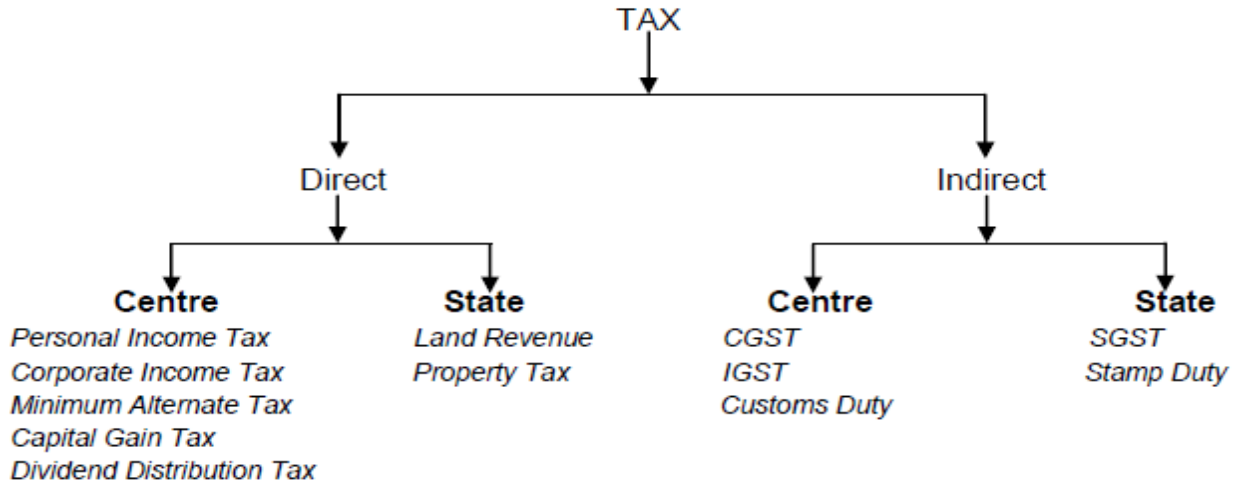
(d) Regressive Taxes

Another way of classification is production and consumption based tax. *(This classification is only for indirect taxes)*.

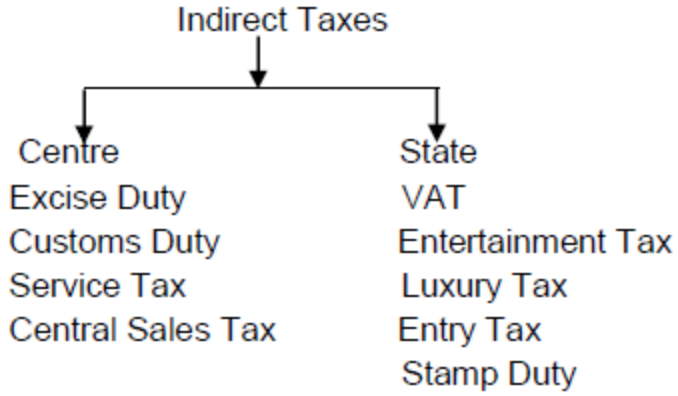
- Production tax (also called origin based tax) is levied where goods or services are produced.
- Consumption tax (also called destination tax) are levied where goods and services are consumed.

Another way of classification is direct and indirect taxes:

- Direct taxes are those which are paid directly by an individual or organization to the imposing entity i.e. the government. For example, a taxpayer pays direct taxes to the government for different purposes like income tax, property tax etc.
- An indirect tax is a tax collected by an intermediary (such as a retail store) from the person who bears the ultimate economic burden of the tax (such as the consumer). For example taxes levied on goods and services.



Before GST came into effect i.e. 1st July 2017, Indirect taxes were classified in the following ways:



GST: One Nation, One Tax, One Market

Goods and Service Tax (GST) is the single comprehensive indirect tax, operational from 1 July 2017, on supply of goods and services, right from the manufacturer/ service provider to the consumer. It is a destination based consumption tax with facility of Input Tax Credit in the supply chain. It is applicable throughout the country with one rate for one type of goods/service. It has amalgamated a large number of Central and State taxes and cesses. It has replaced large number of taxes on goods and services levied on production/ sale of goods or provision of service.

As there have been a number of intermediate goods/services, which were manufactured/provided in the economy, the pre GST tax regime imposed taxes not on the value added at each stage but on the total value of the commodity/service with minimal facility of utilisation of Input Tax Credit (ITC). The total value included taxes paid on intermediate goods/services.

This amounted to cascading of tax. Under GST, the tax is discharged at every stage of supply and the credit of tax paid at the previous stage is available for set off at the next stage of supply of goods and/or services. It is thus effectively a tax on value addition at each stage of supply. In view of our large and fast growing economy, it addresses to establish parity in taxation across the country, and extend principles of 'value- added taxation' to all goods and services.

It has replaced various types of taxes/cesses, levied by the Central and State/UT Governments. Some of the major taxes that were levied by Centre were Central Excise Duty, Service Tax, Central Sales Tax, Cesses like KKC and SBC. The major State taxes were VAT/Sales Tax, Entry Tax, Luxury Tax, Octroi, Entertainment Tax, Taxes on Advertisements, Taxes on Lottery /Betting/ Gambling, State Cesses on goods etc. These have been subsumed in GST.

Five petroleum products have been kept out of GST for the time being but with passage of time, they will get subsumed in GST. State Governments will continue to levy VAT on alcoholic liquor for human consumption.

Tobacco and tobacco products will attract both GST and Central Excise Duty. Under GST, there are 6 (six) standard rates applied i.e. 0%, 3%,5%, 12%,18% and 28% on supply of all goods and/or services across the country.

GST is the biggest tax reform in the country since independence and was rolled out on the mid-night of 30 June/1 July, 2017 during a special midnight session of the

Parliament. The 101th Constitution Amendment Act received assent of the President of India on 8 September, 2016. The amendment introduced Article 246A in the Constitution cross empowering Parliament and Legislatures of States to make laws with reference to Goods and Service Tax imposed by the Union and the States. Thereafter CGST Act, UTGST Act and SGST Acts were enacted for GST. GST has simplified the multiplicity of taxes on goods and services. The laws, procedures and rates of taxes across the country are standardised. It has facilitated the freedom of movement of goods and services and created a common market in the country. It is aimed at reducing the cost of business operations and cascading effect of various taxes on consumers. It has also reduced the overall cost of production, which will make Indian products/services more competitive in the domestic and international markets. It will also result into higher economic growth as GDP is expected to rise by about 2%. Compliance will also be easier as all tax payment related services like registration, returns, payments are available online through a common portal www.gst.gov.in. It has expanded the tax base, introduced higher transparency in the taxation system, reduced human interface between Taxpayer and Government and is furthering ease of doing business.

MONEY AND BANKING

Money is an important discovery that has made day to day transactions; valuing goods and services; as well as storing the wealth for future easier.

'Money is anything which is widely accepted in payment for goods or in discharge of other business obligations"

Evolution of Money: Money has evolved over a number of years through various stages. Let us discuss the different stages of evolution of money.

Barter system: In the primitive stage, people exchanged goods for goods without the use of money. Barter was extremely difficult method of trade. For example if you had cow and wanted sheep in exchange, you had to search an individual who not only had a sheep, but also who needed cow in exchange. If finally, you came across

such an individual then the question is how many sheep are equivalent to one cow? Hence, barter system had many deficiencies for easy transaction.

Commodity money: Later on the societies started using some commodities against which goods were exchanged. A commodity with a prescribed size and weight was adopted as money and everything else was measured in terms of that standard commodity. Varied commodities were used as commodity money in different countries. For example, cattle in Greece, sheep in Rome, teeth in China, etc. However, commodity money could not solve all the difficulties of barter.

Metallic money: Gradually, the precious metals like Gold, Silver, Bronze, etc., began to be used as money. The standard weight, fineness and general acceptability of these metals made them a very suitable medium of exchange. The coins minted out of these metals were of different denominations, easily divisible, portable and were convenient in making payments.

Commodity money: Later on the societies started using some commodities against which goods were exchanged. A commodity with a prescribed size and weight was adopted as money and everything else was measured in terms of that standard commodity. Varied commodities were used as commodity money in different countries. For example, cattle in Greece, sheep in Rome, teeth in China, etc. However, commodity money could not solve all the difficulties of barter.

Metallic money: Gradually, the precious metals like Gold, Silver, Bronze, etc., began to be used as money. The standard weight, fineness and general acceptability of these metals made them a very suitable medium of exchange. The coins minted out of these metals were of different denominations, easily divisible, portable and were convenient in making payments.

(personal identification number) for conducting transactions. Since it is done through electronic means, it is also called as e-money.

Functions of money

A) Primary or main functions: The important primary functions of money are:

I. Medium of exchange or means of payment: Money is used for selling and buying goods and making corresponding payments.

II. Measure of Value: The prices of all goods and services are expressed in terms of money only. This makes it easier to determine the value of goods and services with a common unit.

B) Secondary functions: The important secondary functions of money are:

i. Standard of deferred payments: Money eases the future transactions too. A borrower is under an obligation to pay a specified sum of money on a specified future date. Similarly, a person buys now agrees to pay a stated amount of money on a future date. Use of money facilitates such future payments.

ii. Store of value: Since the future value is assured, money has made it possible to save or store wealth for future and help in its accumulation.

iii. Transfer of value: The introduction of money has made the exchange of goods to distant places possible. The ease of transferring purchasing power from person to person and place too has expanded trade and commerce.

Banks

Banks play a vital role in the development of trade, commerce and other economic activities in a country. The Indian Banking Regulation Act of 1949 defined the term "Banking Company" as "any company which transacts the business of banking in India", and the term "banking" is defined as "**accepting**, for the purpose of lending or investment, of **deposit**s of money from the public, **repayable on demand** or otherwise withdrawal by cheque, draft, order or otherwise".

In India, the banking system consists of the State Bank of India and 20 public sector commercial banks (14 nationalized in 1969 and 6 in 1980); Regional Rural Banks (established in 1976); private sector banks, co-operative societies and banks that are registered with the RBI and regulated by it.

Importance of banks: Banks play an important role in economic development. They mobilize the savings of the public and make these available for investors, thereby helping the process of capital formation. Banks provide a convenient way of remittance (transfer) of money through the accounts of the customers. Banks offer higher rates of interest on fixed deposits. They give loans to the borrowers at lower rates of interest. They also discount the bills of exchange. They lend money to agriculture, industry and service activities for their development. They issue demand drafts, credit cards, debit cards. The banks also invest the funds on securities of the government.

Reserve Bank of India (RBI) and its functions

The Reserve Bank of India Act, 1934 provides the statutory basis of the functioning of the Bank, which commenced operations on April 1, 1935.
Though originally privately owned, since nationalisation in 1949, the Reserve Bank is fully owned by the Government of India.

The following are the various functions of RBI:

1. Monetary Management/Authority

The most important function of central banks is formulation and execution of monetary policy to *regulate the issue of RBI notes and the keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage.*

2. Regulation and Supervision of the Banking and Non-Banking Financial Institutions

The objective of this function is to protect the interest of depositors through an effective prudential regulatory framework for orderly development and conduct of banking operations and liquidity and solvency of banks and to maintain overall financial stability through various policy measures. RBI derives these powers from the RBI Act 1934 and the Banking Regulation Act 1949. RBI's regulatory and supervisory functions extends not only to the Indian banking system but also to the

Non-Banking Financial Institutions. The following are various functions of RBI regarding commercial banks, cooperative banks, regional rural banks, Financial Institutions, NBFCs, Primary Dealers, CICs etc:

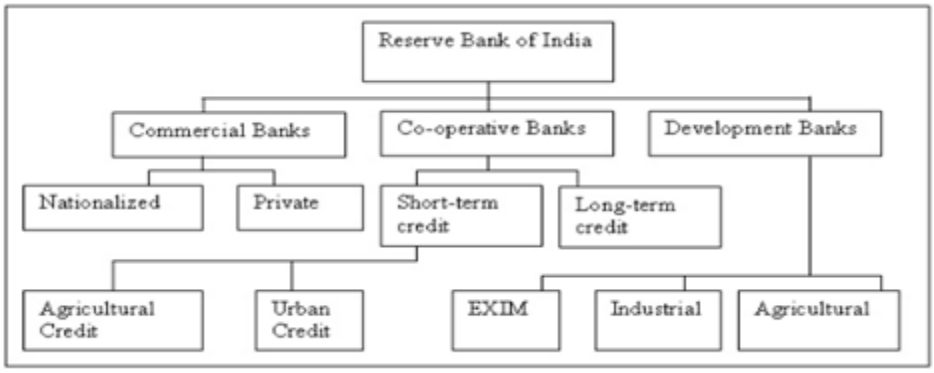
Commercial Banks

- A license is required from RBI to commence banking operations, opening of new bank branches and closing of branches or change in the location of existing branches. RBI regulates merger, amalgamation and winding up of banks. *(For shifting, merger and closure of urban branches, now no approval is required)*

- RBI issues various guidelines for directors of banks and also has powers to appoint additional directors on the board of a banking company. Banks need prior approval of RBI for appointment/termination of Chairman, Directors and CEO. RBI in consultation with Central Govt., can supersede the Board of Directors of Banks. Public Sector Banks (PSBs) are under dual regulation of Central Govt. and RBI. RBI's powers are curtailed regarding PSBs, where RBI cannot remove directors and management, cannot supersede banks board and does not have the power to force a merger or trigger liquidation.

- RBI regulates the banks to maintain certain reserves in the form of CRR and SLR

- The interest rate on most of the categories of deposits and lending have been deregulated and are largely determined by banks but RBI regulates the interest rate on NRI deposits, export credits (loans) and a few other categories.



Cooperative and Regional Rural Banks (RRBs)

- Rural Cooperative banks are regulated by RBI and supervised by NABARD
- RRBs are also regulated by RBI and supervised by NABARD
- Urban Cooperative Banks are under the dual control of respective State governments/ Central government and the RBI. While the non-banking aspects like registration, management, administration and recruitment, amalgamation and liquidation are regulated by the State/ Central Governments, matters related to banking are regulated and supervised by the Reserve Bank under the Banking Regulation Act, 1949

Financial Institutions, NBFCs, Primary Dealers and Credit Information Companies (CIC)

- The four All India Financial Institutions - NABARD, NHB, EXIM Bank and SIDBI are
  under full-fledged regulation and supervision of the RBI. NBFCs, Primary Dealers
  and CICs are also under the regulation and supervision of RBI.

3. Regulation of Foreign Exchange Market, Govt. Securities Market and Money Market

Foreign Exchange Market: For a long time, foreign exchange in India was treated as a controlled commodity because of its limited availability. The early stages of foreign exchange management in the country focused on control of foreign

exchange by regulating the demand due to limited supply of foreign exchange for which the statutory powers was provided by the Foreign Exchange Regulation Act (FERA), 1973. Prompted by the liberalisation measures introduced since 1991 and developments in the external sector such as substantial increase in foreign exchange reserves, growth in foreign trade, liberalisation of Indian investments abroad and participation of foreign institutional investors in Indian stock market, the Foreign Exchange Management Act (FEMA) was enacted in 1999 to replace the FERA 1973 with effect from June 2000. So now, RBI oversees the foreign exchange market in India and supervises and regulates it through the provisions of the FEMA Act 1999.

Government securities market, which trades securities issued by the Central and State Governments are regulated by the RBI for which RBI derives its powers from the RBI Act 1934.

Money Market (explained in financial markets topic), which trades short term and highly liquid debt securities are also regulated by the RBI for which RBI derives its powers from the RBI Act 1934.

4. Management of Foreign Exchange Reserves

The foreign exchange reserves include foreign currency assets (FCA), Special Drawing Rights (SDRs) and gold. The RBI, as the custodian of the country's foreign exchange reserves, is vested with the responsibility of managing their investment. The legal provisions governing management of foreign exchange reserves are laid down in the RBI Act 1934. The RBI Act permits the RBI to invest these reserves in the following types of instruments:

- Deposits with Bank for International Settlement and other central banks
- Deposits with foreign commercial banks
- Debt instruments representing sovereign or sovereign guaranteed liability
- Other instruments as approved by the Central Board of the RBI

5. Banker to Central and State governments

- As a banker to the government, RBI receives and pays money on behalf of the various Government departments. As it has offices in only 27 locations, the RBI appoints other banks to act as its agents for undertaking the banking business on behalf of the governments.
- RBI maintains the account for the central and state government funds like Consolidated Fund, Contingency Fund and Public Account.
- RBI also provides "Ways and Means Advances" - a short term interest bearing advance - to the Central and State Governments, to meet the temporary mismatches in their receipts and payments. Besides it arranges for investments of surplus cash balances of the Governments as a portfolio manager.
- The RBI also acts as advisor to the Government, whenever called upon to do so, on
  monetary and banking related matters.

7. Debt Manager of Central and State governments

The RBI manages the public debt and issues new loans on behalf of the Central and State Governments. The RBI's debt management policy aims at minimising the cost of borrowing, reducing risk, smoothening the maturity structure of debt.

8. Banker to Banks

- RBI enables banks to open their (current) accounts with RBI for maintenance of
- statutory reserve requirements (CRR and SLR)
- RBI acts as a common banker for different banks to enable settlement of interbank
- transfer of funds
- RBI provides short term loans and advances to banks for specific purposes
- RBI acts as lender of last resort

9. Developmental Role

RBI's developmental role includes ensuring credit to productive sectors of the economy, creating institutions to build financial infrastructure and expanding access

to affordable financial services. The following schemes come under the developmental role of RBI:

Priority Sector Lending:

Priority sectors refers to those sectors of the economy which may not get timely and adequate credit in the absence of this special scheme. **Scheduled Commercial banks(for both domestic and foreign banks)** are mandated to give a portion (40%) of their total credit to these sectors. Priority sector guidelines do not lay down any preferential rate of interest for priority sector loans. Typically these are small value loans to those sectors of the society/economy that impact large segments of the population and weaker sections, and to the sectors which are employment intensive such as agriculture and small enterprises. The following have been declared as the priority sectors by RBI:

- Agriculture
- Education
- Housing
- Micro, Small & Medium Enterprises (MSME)
- Export Credit
- Social Infrastructure (Schools, hospitals etc)
- Renewable Energy
- Others (weaker sections like artisans, village cottage industries, SC/ST, Self Help
- Groups etc.)

Kisan Credit Card and **Lead Bank Scheme** are part of development functions of RBI.

2017-KAS

64. Consider the following statements about the Reserve Bank of India :

A. Reserve Bank of India was nationalized on 1st January 1949.

B. Reserve Bank of India is a member bank of the Asian Clearing Union.

Which of the above statements is/are correct ?

Select the code for the correct answer from the options given below :

(1) A only

(2) B only

(3) Both A and B

(4) Neither A nor B

2011-KAS

A target of 32 per cent of bank credit is stipulated for lending to the priority sector by the

(1) public sector banks

(2) private sector banks

(3) foreign banks having offices in India

(4) domestic scheduled commercial banks

(The Asian Clearing Union (ACU) was established with its head-quarters at Tehran, Iran, on December 9, 1974 at the initiative of the United Nations Economic and Social Commission for Asia and Pacific (ESCAP), for promoting regional co-operation. The main objective of the clearing union is to facilitate payments among member countries for eligible transactions on a multilateral basis, thereby economizing on the use of foreign exchange reserves and transfer costs, as well as promoting trade among the participating countries.

Central Banks and the Monetary Authorities of Bangladesh, Bhutan, India, Iran, Maldives, Myanmar, Nepal, Pakistan and Sri Lanka are currently the members of the ACU.

The Asian Monetary Units (AMUs) is the common unit of account of ACU and is denominated as 'ACU Dollar' and 'ACU Euro', which is equivalent in value to one US Dollar and one Euro respectively.)

The Total Priority Sector target of 40 percent for foreign banks with less than 20 branches has to be achieved in a phased manner as under:-

Financial Year	The Total Priority Sector as percentage of ANBC or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher
2015-16	32
2016-17	34
2017-18	36
2018-19	38
2019-20	40

Money Supply

In an economy, money consists of mainly currency notes, coins and deposits of public in banks. In India coins and currency notes are issued by the Reserve Bank of India (RBI), which is the monetary authority (or Central Bank) in India. (*Coins are minted by Government of India*).

The total stock of money in circulation among the **public** at a particular point of time is called money supply. RBI publishes figures for four alternative measures of money supply. They are as follows:

M1 = Currency notes and coins + Net demand deposits held by commercial banks
M2 = M1 + Savings deposits with Post Office savings banks
M3 = M1 + Net time deposits of commercial banks
M4 = M3 + Total deposits with post office savings banks

Net implies that only deposits of the public held by the banks are to be included in money supply. The deposits that one commercial bank holds with other commercial banks are not considered as part of money supply. Money lying with government and RBI is also **not part** of money supply.

M1 is the most liquid and M4 is the least liquid. M1 and M2 are called narrow money and M3 and M4 are called broad money. M3 is the most commonly used measure of money supply and is also called "aggregate monetary resources".

Monetary Policy:

Monetary Policy is the process by which monetary authority (RBI) of a country controls the creation and supply of money in the economy. The monetary policy framework in India, as it is today, has evolved over the years. A new "**Monetary Policy Framework**" Agreement was signed between the Government of India and RBI in Feb 2015. As per the new monetary policy framework agreement, following are the important points:-

- The objective of the monetary policy is to primarily maintain **price stability**, while keeping in mind the objective of growth
- The monetary policy framework is operated by RBI
- The inflation target is 4% with a band of +/- 2%
- The inflation target is decided by the Government of India in consultation with RBI
- The inflation is the "Consumer Price Index (CPI) - Combined" published by CSO
- The RBI shall be seen to have failed to meet the Target if inflation is more than 6% or less than 2% for three consecutive quarters
- In case RBI fails to meet the target, it will have to give a written report to Government of India explaining the reasons of failure, remedial actions to be taken and an estimated time period within which the Target would be achieved.

The Government of India constituted a "Monetary Policy Committee" (MPC) in September 2016 which now determines the Policy (Repo) Rate required to achieve the inflation target.

The MPC has 6 members, three from RBI (including the RBI Governor) and 3 appointed by the Government of India. All the members have one vote and in the event of equality of votes, the Governor gets a second or casting vote. **The decision of the MPC is binding on RBI. MPC has the authority to decide the repo rate only and not CRR or SLR**. Earlier, the RBI Governor individually used to decide the Repo Rate.

The following are the major instruments/tools that RBI uses for conducting its monetary policy:

An important tool by which the RBI also influences money supply is **Open Market Operations**. Open Market Operations refers to buying and selling of bonds issued by the Government in the open market. This purchase and sale is entrusted to the Central bank on behalf of the Government. When RBI buys a Government bond in the open market, it pays for it by giving a cheque. This cheque increases the total amount of reserves in the economy and thus increases the money supply. Selling of a bond by RBI (to private individuals or institutions) leads to reduction in quantity of reserves and hence the money supply.

There are two types of open market operations: outright and repo. Outright open market operations are permanent in nature: when the central bank buys these securities (thus injecting money into the system), it is without any promise to sell them later. Similarly, when the central bank sells these securities (thus withdrawing money from the system), it is without any promise to buy them later. As a result, the injection/absorption of the money is of permanent nature. However, there is another type of operation in which when the central bank buys the security, this agreement of purchase also has specification about date and price of resale of this security. This type of agreement is called a **repurchase agreement or repo**. The interest rate at which the money is lent in this way is called the repo rate. Similarly, instead of outright sale of securities the central bank may sell the securities through an agreement which has a specification about the date and price at which it will be repurchased. This type of agreement is called a reverse repurchase agreement or reverse repo. The rate at which the money is withdrawn in this manner is called the reverse repo rate. The Reserve
Bank of India conducts repo and reverse repo operations at various maturities: overnight, 7-day, 14- day, etc. This type of operations have now become the main tool of monetary policy of the Reserve Bank of India.
Repo Rate is called the "Policy Rate"; and Repo Rate and Reverse Repo Rate comes under "Liquidity Adjustment Facility (LAF)" introduced in June 2010. Only Repo Rate

is announced by the RBI and Reverse Repo Rate, Bank Rate and MSF rate are linked to the Repo Rate in the following way:

- Reverse Repo Rate = Repo Rate - 0.25%
- MSF Rate = Repo Rate + 0.25%
- Bank Rate = MSF Rate

Repo Rate: The (fixed) interest rate at which the Reserve Bank provides overnight liquidity up to a certain limit (0.25% of their NDTL) to banks against the collateral of government and other approved securities.
Bank Rate It is the standard rate at which the Reserve Bank is prepared to buy debt instruments (for example commercial paper). On introduction of LAF, the Reserve Bank has discontinued this operation. As a result, the Bank Rate became dormant as an instrument of monetary management. It is now aligned to MSF rate and used for calculating penalty on default in the cash reserve ratio (CRR) and the statutory liquidity ratio (SLR). For example, the current penal rate on shortfall in reserves is Bank Rate plus 3 percent.

Marginal Standing Facility (MSF) It is also a liquidity adjustment facility introduced in 2011. It is a facility under which scheduled commercial banks can borrow additional amount of overnight money from the Reserve Bank against their excess SLR securities or by dipping into their SLR portfolio up to a limit at a penal rate of interest. This provides a safety valve against unanticipated liquidity shocks to the banking system.

Reverse Repo Rate: The (fixed) interest rate at which the RBI absorbs liquidity, on an overnight basis, from banks against the collateral of eligible government securities.

2017_KAS

59. Consider the following measures :

A. Repo Rate

B. Cash Reserve Ratio (CRR)

C. Reverse Repo Rate

Which of the above given measures is/are used in Liquidity Adjustment Facility (LAF) ?

Select the code for the correct answer from the options given below :

(1) A and B only

(2) B and C only

(3) A and C only

(4) A only

3. Reserve Requirements (Fractional Reserve Banking):

Cash Reserve Ratio (CRR) The amount of cash that the scheduled commercial banks are required to maintain with RBI with respect to their NDTL on a daily basis is called CRR. Scheduled Commercial Banks are required to maintain CRR as per RBI Act 1934.

Statutory Liquidity Ratio (SLR) The amount of reserves that the scheduled commercial banks are required to maintain with themselves on a daily basis in safe and liquid assets such as government securities, gold and cash with respect to their NDTL is called SLR.

Excess CRR balance are also treated as liquid assets for the purpose of SLR. Scheduled Commercial Banks are required to maintain SLR as per the Banking Regulation Act 1949. *The requirement of CRR and SLR is to make public deposits safe and liquid and enable RBI to control the amount of money that banks can create. It ensures that banks have a safe cushion of assets to draw on when account holders want to be paid.*

4. Market Stabilization Scheme (MSS)/ Sterilization:

Many developing countries have reaped handsome rewards from surging capital inflows in recent years. This is widely regarded as a very welcome phenomenon, raising levels of investment and encouraging economic growth. But surging capital inflows can also lead to destabilizing side effects, including a tendency for the local currency to appreciate, undermining the competitiveness of export industries, and potentially giving rise to inflation. Why inflation? When foreign investors bring foreign currency/dollars, ultimately this dollar comes to RBI and new money/currency is given by RBI to the investors which increases money supply (and monetary base) in the economy without a corresponding increase in production: **too much money begins to chase too few goods and services resulting in inflation**.

To ease the threat of currency appreciation or inflation, central banks often attempt what is known as the "**sterilization**" of capital flows. In a successful sterilization operation, the domestic component of the monetary base/ money supply is reduced to offset the inflow of capital. Sterilization is the use of **open market operations**, that is, selling Treasury bills and other securities by RBI to reduce the domestic component of the monetary base/ money supply.

Credit Control Measures

These are broadly classified into two types, namely i) quantitative control measures, and ii) qualitative or selective control measures.

A. Quantitative Credit Control Measures

The quantitative credit control measures directly affect the quantity of money available to the business and people. They comprise of the following:

i. Bank Rate Policy: The bank rate is the rate at which the RBI lends funds to banks. This affects the rate at which banks can lend to its borrowers. Higher the bank rate, lower the credit creation and vice-versa. RBI also varies the *Repo Rate* and *reverse Repo Rate* affecting the interest rate on short term borrowings and deposits, respectively, by the commercial banks, thereby affecting their capacity to lend.

ii. Open Market Operations: Open market operations is the buying and selling of government securities by the central bank from and to the banks. The sale of government securities to banks reduces their reserves and vice-versa.

iii. Varying Reserve Requirements (Legal Reserve Ratio): Banks are obliged to maintain reserves with the central bank in two accounts. One is the Cash Reserve Ratio (CRR) and the other is Statutory Liquidity Ratio (SLR). The ratio of their deposits, which the banks are required to keep with RBI, is the CRR. The minimum cash which the banks have to keep with themselves as a ratio of their deposits is the SLR. By varying these CRR and SLR the RBI can vary the lending capacity of banks.

B. Qualitative Credit Control Measures

The qualitative or selective credit control measures affect the usage of credit for different purposes. They affect the quality of usage of credit. Important qualitative instruments of credit control are:

i. Change in lending margins: Collateral security is required for obtaining any loan. The percentage value of the security required to be kept with the bank for getting loan is called as the margin. Margin against a particular security is reduced or increased in order to encourage or to discourage the flow of credit to a particular sector.

ii. Ceiling on credit or credit rationing: The RBI fixes the maximum amount of credit given to a particular use or sector. The rationing of credit is done to prevent excessive expansion of credit.

iii. Moral suasion: Moral suasion is a method of persuading the commercial banks to advance the credit or reduce the credit to certain activities. The RBI does this through periodical letters and circulars to the banks.

iv. Direct Action: Direct control consists of the measures taken by the central bank against commercial banks and financial institutions when all other methods prove ineffective.

Base Rate and MCLR:

Base Rate:

Base Rate was introduced in July 2010 replacing the Benchmark Prime Lending Rate (BPLR) system. Base Rate is the minimum rate below which Scheduled Commercial Banks cannot lend. RBI publishes guidelines for calculation of Base Rate and every bank calculates its own base rate.

Base rate calculation methodology was based on the following four factors:

- **(Average) Cost of deposits/funds** (interest rate that bank offers to its depositors)
- Cost of maintaining CRR and SLR (if the banks are required to keep higher reserves like CRR and SLR, then they will be able to lend less money & will have to charge higher interest rate)
- Operational Costs of Banks
- Return/profit on Net worth (investment)

From 1st April 2016, RBI has introduced a new methodology for calculation of the Base Rates based on marginal cost of funds rather than average cost of funds. This new methodology is called Marginal Cost of Funds based Lending Rate (MCLR) or Base Rate based on marginal cost of funds.

MCLR

MCLR calculation methodology is based on the following four factors:-

- **Marginal cost of deposits/funds**
- Cost of maintaining CRR and SLR
- Operational Costs of Banks
- Tenor Premium (based on the time period for which loan is given)

The basic difference between the previous Base Rate and the new MCLR based rate is the change of calculation of cost of deposits from **average** to **marginal**. The banks shall review and publish their MCLR every month.

Basel Norms:

Basel III: In 2010, Basel III guidelines were released. These guidelines were introduced in response to the financial crisis of 2008. A need was felt to further strengthen the system as banks in the developed economies were under-capitalized, over-leveraged (high debt) and had a greater reliance on short-term funding. Also the quantity and quality of capital under Basel II were deemed insufficient to contain any further risk. Basel III norms aim at making most banking activities such as their trading book activities more capital-intensive. The guidelines aim to promote a more resilient banking system by focusing on four vital banking parameters viz. capital, leverage/debt, funding and liquidity.

The main objectives of Basel III are:

- Improve the banking sector's ability to absorb shocks arising from financial and
- economic stress
- Improve risk management and governance
- Strengthen banks' transparency and disclosure

India has agreed to adopt the Basel III norms by 31st March 2019.

As per the international (Basel III) norms, the minimum capital required is 10.5% which includes 2.5% capital conservation buffer. In India RBI has kept Capital Adequacy Requirement of 11.5% (including 2.5% capital conservation buffer).

Prompt Corrective Action (PCA)

RBI, under its supervisory framework, uses various measures/tools to maintain sound financial health of banks. Under Prompt Correction Action (PCA) framework, RBI has specified certain regulatory trigger points in terms of three parameters, i.e. capital to risk weighted assets ratio (CRAR), net non-performing assets (NPA) and Return on Assets (RoA). Once banks hit certain level of threshold in terms of these three parameters, RBI initiates certain structured and discretionary actions.

For banks under PCA, RBI may put restrictions on branch expansion, distributing dividends, capping compensation and fees of management and directors. In certain cases banks may be stopped from lending and there can be a cap on lending to specific sectors/entities.

Further, RBI may take steps to bring in new management/Board, appoint consultants for business/ organizational structuring, take steps to change ownership and can also take steps to merge the bank

Under PCA framework, RBI's objective is to facilitate the banks to take corrective measures including those prescribed by the Reserve Bank, in a timely manner, in order to restore their financial health. The framework also provides an opportunity to the Reserve Bank to pay focused attention on such banks by engaging with the management more closely in those areas. The PCA framework is, thus, intended to encourage banks to eschew certain riskier activities and focus on conserving capital so that their balance sheets can become stronger. The RBI has clarified that the PCA framework is not intended to constrain normal operations of the banks for the

general public like lending and depositing. The PCA framework is applicable only to commercial banks and not extended to co-operative banks and nonbanking financial companies (NBFCs).

Insolvency and Bankruptcy (IBC) Code 2016

Insolvency is a situation when an individual or company is unable to pay its debt while bankruptcy is a legal procedure for liquidating (winding up) a business (or property owned by
an individual) which cannot fully pay its debts out of its current assets.

Before the IBC code, there were multiple overlapping laws and adjudicating forums in India like Company Law Boards, Debt Recovery Tribunal, SARFAESI Act 2002, Sick Industrial Companies (Special Provisions) Act, 1985 and the winding up provisions of the Companies Act, 1956 etc. dealing with financial failure of companies and individuals leading to significant delays in winding up a company. The legal and institutional framework did not help lenders in effective and timely recovery or restructuring of defaulted assets and caused undue strain on the Indian credit system. Recognizing that reforms in the bankruptcy and insolvency regime were critical for improving the business environment and alleviating distressed credit markets, the Government enacted the Insolvency and Bankruptcy Code in **May 2016**, making it easier to wind up a failing business and recover debts.

The Code makes a significant departure from the existing resolution regime by shifting the responsibility on the creditor to initiate the insolvency resolution process against the corporate debtor. Under the previous legal framework, the primary onus to initiate a resolution process lied with the debtor, and creditor may pursue separate actions for recovery, security enforcement and debt restructuring.

Under the IBC code, a creditor or the corporate debtor may initiate corporate insolvency resolution process in case a default is committed by corporate debtor. An application can be made before the National Company Law Tribunal (NCLT) for initiating the resolution process. The creditor needs to give demand notice of 10 days to corporate debtor before approaching the NCLT. If corporate debtor fails to repay dues to the creditor or fails to show any existing dispute or arbitration, then the creditor can approach NCLT. Upon admission of application by NCLT, Corporate insolvency process shall be completed within 180 days during which time NCLT

hears the proposals for revival and decide on the future course of action. NCLT appoints the Insolvency Professionals (IP) upon confirmation by the Insolvency and Bankruptcy Board (IBB). NCLT causes public announcement to be made of the initiation of corporate insolvency process and calls for submission of claims by any other creditors. After receiving claims pursuant to public announcement, IP constitutes the creditors' committee constituting all creditors (first interim IPs are appointed and when the creditors' committee approves, then the IPs are confirmed as Resolution Professionals). Resolution Professionals shall submit the insolvency resolution plan before the creditors' committee for its approval.

The creditors' committee has to then take decisions regarding insolvency resolution (within 180 days but in complex cases it can be further extended to 90 days) by a 66% majority voting. Once a resolution is passed, the creditors' committee has to decide on the restructuring process that could either be a **revised repayment plan** for the company, or **liquidation of the assets** of the company. The resolution plan will be sent to NCLT for final approval, and implemented once approved. If no decision is made during the resolution process, the debtor's assets will be liquidated to repay the debt.

The objective of the new law is to promote entrepreneurship, availability of credit, and balance the interests of all stakeholders by consolidating and amending the laws relating to reorganization and insolvency resolution of companies and individuals in a time bound manner and for maximization of value of assets. Some business ventures will always fail, but they will be handled rapidly and swiftly. Entrepreneurs and lenders will be able to move on, instead of being bogged down with decisions taken in the past.

Fugitive Economic Offenders Act 2018

The Bill aims to stop economic offenders who leave the country to avoid due legal process. Offences involving amounts of ₹100 crore or more fall under the purview of this law. Economic offences are those that are defined under the Indian Penal Code, the Prevention of Corruption Act, the SEBI Act, the Customs Act, the Companies Act, Limited Liability Partnership Act, and the Insolvency and Bankruptcy Code. The bill will extend not only to loan defaulters and fraudsters, but also to individuals who

violate laws governing taxes, black money, benami properties and financial corruption.

According to the Bill, a 'fugitive economic offender' (FEO) is "any individual against whom a warrant for arrest in relation to a scheduled offence has been issued by any court in India,

who:

- leaves or has left India so as to avoid criminal prosecution; or
- refuses to return to India to face criminal prosecution."

A Director, appointed by the central government, will have to file an application to a Special Court to declare a person as a 'fugitive economic offender'. The Court will issue a notice to the person named a 'fugitive economic offender'. Within six weeks from the date of notice, the person (or through his lawyer) will have to present themselves at "a specified place at a specified time". If the offender fails to do so, then the court can proceed to hear the application in the absence of the defence. Once the court is convinced, it can declare him/her a 'fugitive economic offender' and may order the confiscation of the properties. The Government can confiscate the proceeds of crime in India or abroad, even if it is not owned by the FEO and any other property, including benami property, owned by the FEO. The proceeds from the disposed property will be used to satisfy creditors' claims. Once the property is confiscated, the offender cannot file a civil claim. But, if at any point of time in the course of the proceeding prior to the declaration, however, the alleged FEO returns to India and submits to the appropriate jurisdictional court, proceedings under the proposed Act would cease by law. Those classified as fugitives will also not be able to pursue civil cases in India unless they come back to India and face prosecution. The bill will help the government confiscate properties of fugitives even before FEOs are convicted. Enforcement Directorate will be the apex agency to implement the law.

Letter of Credit, Letter of undertaking, Line of Credit

A letter of credit is a letter from a bank guaranteeing that a buyer's payment to a seller will be received on time and for the correct amount. In the event that the buyer is unable to make payment on the purchase, the bank will be required to cover the full or remaining amount of
the purchase.

A line of credit is a preset amount of money that a bank has agreed to lend you. You can
draw from the line of credit when you need it, up to the maximum amount. You'll pay interest on the amount you borrow.

Letter of Undertaking (LOU), in international banking system, is a provision of bank guarantee, under which a bank allows its customer to raise money from another Indian bank's foreign branch in the form of a short term credit. The LOU serves the purpose of a bank guarantee.

FDI in e-commerce - rules changes

- Any entity having equity participation by e-commerce marketplace entity or its group companies, or having control of its inventory by e-commerce marketplace entity or its group companies, will not be allowed to sell its products on the platform run by such marketplace entity.
- Any vendor who purchases 25% or more of its inventory from an e-commerce group company will be considered to be controlled by that e-commerce group company and thereby barred from selling on its portal. (They will be considered an inventory based model)
- E-commerce marketplace entity will not mandate any seller to sell any product
  exclusively on its platform only
- E-commerce firm will not be allowed to influence the price of a product sold on its portal by giving incentives to particular vendors.

THE BALANCE OF PAYMENTS

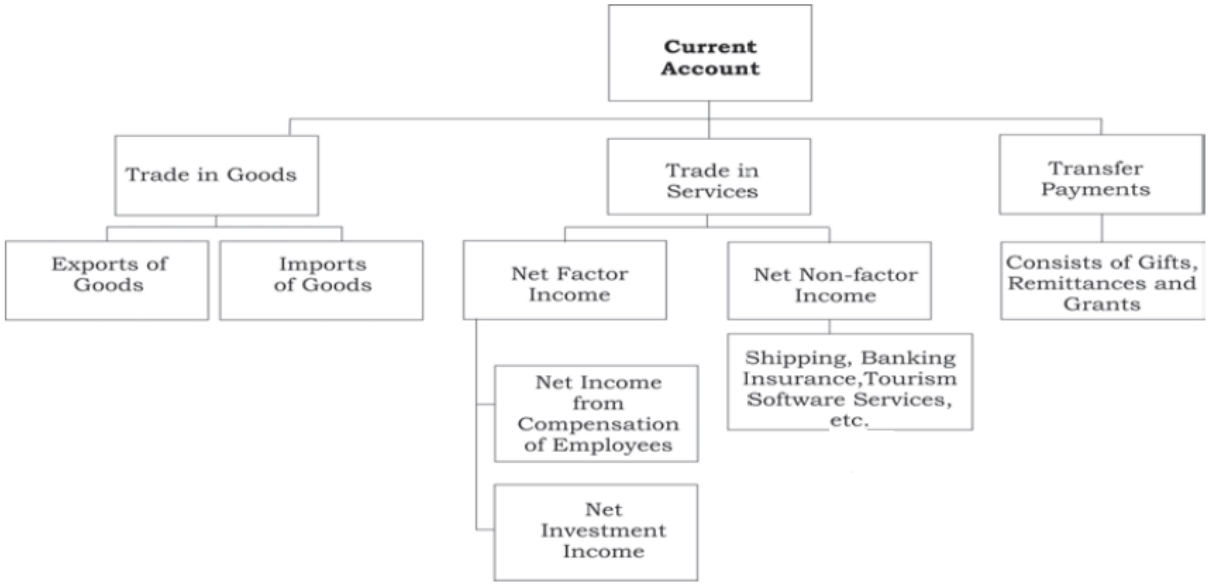
The balance of payments (BoP) record the transactions in goods, services and assets between residents of a country with the rest of the world for a specified time period typically a year. There are two main accounts in the BoP — the current account and the capital account.

Current Account

Current Account is the record of trade in goods and services and transfer payments. Figure given below illustrates the components of Current Account. Trade in goods includes exports and imports of goods. Trade in services includes factor income and non-factor income transactions. Transfer payments are the receipts which the residents of a country get for 'free', without having to provide any goods or services in return. They consist of gifts, remittances and grants. They could be given by the government or by private citizens living abroad.

Buying foreign goods is expenditure from our country and it becomes the income of that foreign country. Hence, the purchase of foreign goods or imports decreases the domestic demand for goods and services in our country. Similarly, selling of foreign goods or exports brings income to our country and adds to the aggregate domestic demand for goods and services in our country.

Components of Current Account



2017-KAS

81. The Current Account on the Balance of Payments in India is functionally classified into which two categories ?

(1) Merchandise and Invisibles

(2) Loans and Amortisation

(3) Foreign Investments and Foreign Currency Deposits

(4) None of the above

2014-KAS

The current account of the balance of payments comprises the

(a) balance of trade only

(b) net investment incomes and net transfers

(c) balance of trade, net investment incomes and net transfers

(d) net transfers and balance of trade

2011-KAS

Current account of India's balance of payments does ***not*** include

(1) Exports and imports

(2) Non-factor services and transfers

(3) Income from factor services

(4) Foreign direct investment

Balance on Current Account

Current Account is in balance when receipts on current account are equal to the payments on the current account. A surplus current account means that the nation is a lender to other countries and a deficit current account means that the nation is a borrower from other countries.

Current Account Surplus	Balanced Current Account	Current Account Surplus
Receipts > Payments	Receipts = Payments	Receipts < Payments

Balance on Current Account has two components:

- Balance of Trade or Trade Balance
- Balance on Invisibles

Balance of Trade (BOT) is the difference between the value of exports and value of imports of goods of a country in a given period of time. Export of goods is entered as a credit item in BOT, whereas import of goods is entered as a debit item in BOT. It is also known as Trade
Balance.

BOT is said to be in balance when exports of goods are equal to the imports of goods. Surplus BOT or Trade surplus will arise if country exports more goods than what it imports. Whereas, Deficit BOT or Trade deficit will arise if a country imports more goods than what it exports.

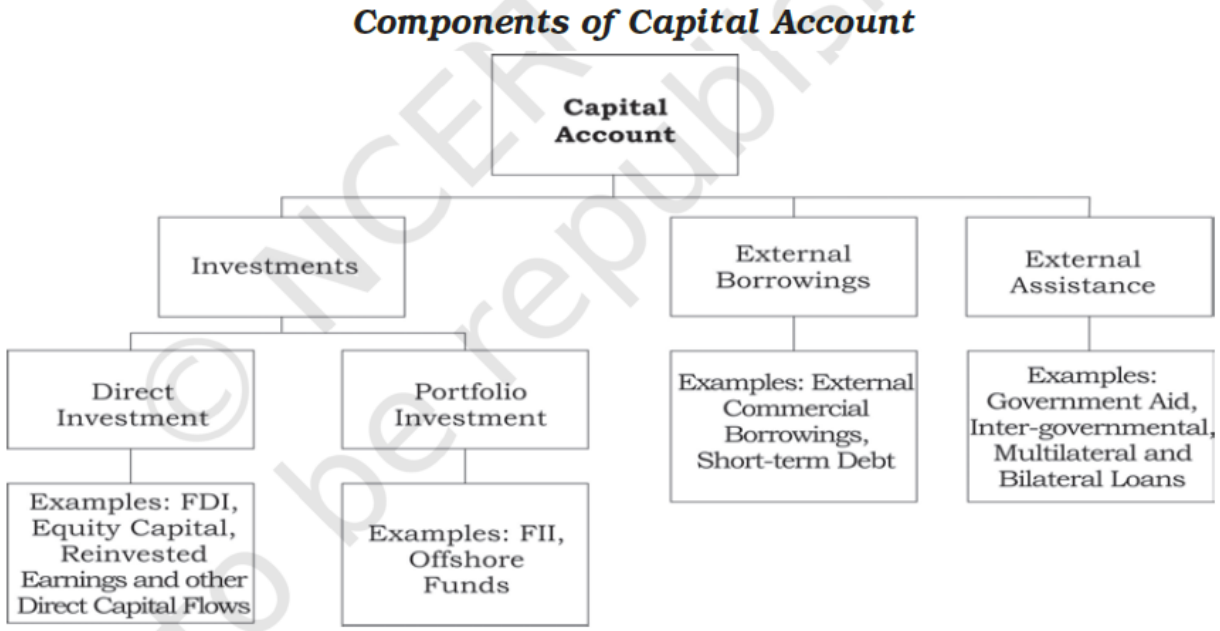
Net Invisibles is the difference between the value of exports and value of imports of invisibles of a country in a given period of time. Invisibles include services, transfers and flows of income that take place between different countries. Services trade includes both factor and non-factor income. Factor income includes net international earnings on factors of production (like labour, land and capital). Non-factor income is net sale of service products like shipping, banking, tourism, software services, etc.

Capital Account

Capital Account records all international transactions of assets. An asset is any one of the forms in which wealth can be held, for example: money, stocks, bonds, Government debt, etc. Purchase of assets is a debit item on the capital account. If an Indian buys a UK Car Company, it enters capital account transactions as a debit item (as foreign exchange is flowing out of India). On the other hand, sale of assets like sale of share of an Indian company to a Chinese customer is a credit item on the capital account. Figure given below classifies the items which are a part of capital account transactions. These items are Foreign Direct Investments (FDIs), Foreign Institutional Investments (FIIs), external borrowings and assistance.

Balance on Capital Account

Capital account is in balance when capital inflows (like receipt of loans from abroad, sale of assets or shares in foreign companies) are equal to capital outflows (like repayment of loans, purchase of assets or shares in foreign countries). Surplus in capital account arises when capital inflows are greater than capital outflows, whereas deficit in capital account arises when capital inflows are lesser than capital outflows.



Balance of Payments Surplus and Deficit

The essence of international payments is that just like an individual who spends more than her income must finance the difference by selling assets or by borrowing, a country that has a deficit in its current account (spending more than it receives from sales to the rest of the world) must finance it by selling assets or by borrowing abroad. Thus, any current account deficit must be financed by a capital account surplus, that is, a net capital inflow.

Current account + Capital account= 0

In this case, in which a country is said to be in balance of payments equilibrium, the current account deficit is financed entirely by international lending without any reserve movements. Alternatively, the country could use its reserves of foreign exchange in order to balance any deficit in its balance of payments. The reserve bank sells foreign exchange when there is a deficit. This is called official reserve sale. The decrease (increase) in official reserves is called the overall balance of payments deficit (surplus). The basic premise is that the monetary authorities are

the ultimate financiers of any deficit in the balance of payments (or the recipients of any surplus).

What constitute Forex reserves?

- ✓ Hard currencies with RBI like US dollars etc
- ✓ Reserve Tranche position with IMF
- ✓ Special drawing rights(SDR)
- ✓ Gold with RBI
- ✓ Surplus on Balance of payments
- ✓ Government securities

THE FOREIGN EXCHANGE MARKET:

The market in which national currencies are traded for one another is known as the foreign exchange market.

Let us assume that a single Indian resident wants to visit London on a vacation (In England it is an import of tourist services). She will have to pay in pounds for her stay there. She will need to know where to obtain the pounds and at what price. Here in comes the role of forex market. The major participants in the foreign exchange market are commercial banks, foreign exchange brokers and other authorised dealers and monetary authorities.

Foreign Exchange Rate:

Foreign Exchange Rate (also called Forex Rate) is the price of one currency in terms of another. It links the currencies of different countries and enables comparison of international costs and prices. For example, if we have to pay Rs 50 for $1 then the exchange rate is Rs 50 per dollar.

Determination of the Exchange Rate

Different countries have different methods of determining their currency's exchange rate. It can be determined through Flexible Exchange Rate, Fixed Exchange Rate or Managed Floating Exchange Rate.

1) Flexible Exchange Rate

This exchange rate is determined by the market forces of demand and supply. *It is also known as Floating Exchange Rate.* Increase in exchange rate implies that the price of foreign currency (dollar) in terms of domestic currency (rupees) has increased. This is called Depreciation of domestic currency (rupees) in terms of foreign currency (dollars).

Similarly, in a flexible exchange rate regime, when the price of domestic currency (rupees) in terms of foreign currency (dollars) increases, it is called Appreciation of the domestic currency (rupees) in terms of foreign currency (dollars). This means that the value of rupees relative to dollar has risen and we need to pay fewer rupees in exchange for one dollar.

2) Fixed Exchange Rates:

In this exchange rate system, the Government fixes the exchange rate at a particular level.

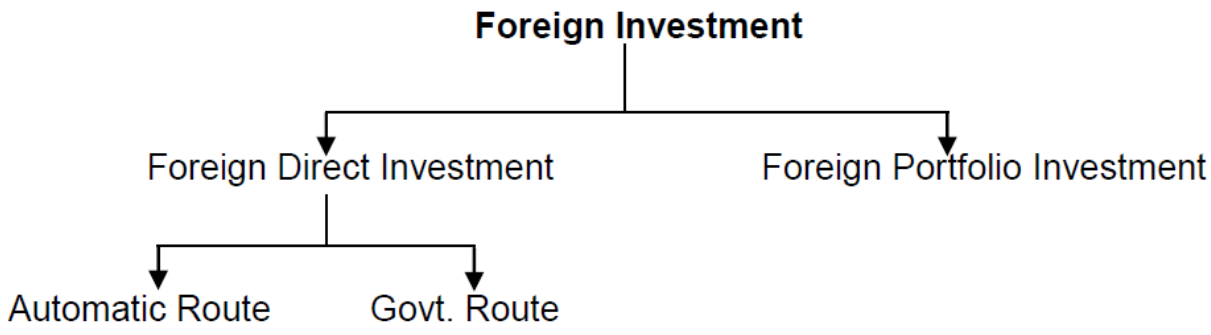
In a fixed exchange rate system, when some government action increases the exchange rate (thereby, making domestic currency cheaper) is called Devaluation.

On the other hand, a Revaluation is said to occur, when the Government decreases the exchange rate (thereby, making domestic currency costlier) in a fixed exchange rate system.

3) ***Managed Floating:***

It is a mixture of a flexible exchange rate system (the float part) and a fixed rate system (the managed part). Under this system, also called dirty floating, central banks intervene to buy and sell foreign currencies in an attempt to moderate exchange rate movements whenever they feel that such actions are appropriate.

Foreign Investment:



- Foreign investment is defined as an investment (either in debt or equity) made by a company or entity based in one country into a company or entity based in another country. Foreign investment is broadly classified into Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI):
- More than 95% of the FDI comes in India through the "Automatic Route" where no government approval is required and are subject to only sectoral laws. Certain sectors that are still under "Government approval route" are scrutinised and cleared by the respective departments and ministries. (Earlier

these used to be approved by Foreign Investment Promotion Board under Department of Economic Affairs).

- In respect of applications in which there is a doubt about the Administrative Ministry/Department concerned, DIPP shall identify the Administrative Ministry/Department where the application will be processed. In respect of proposals where the respective department/ ministry proposes to reject the proposals or in cases where conditions for approval are stipulated in addition to the conditions laid down in the FDI policy or sectoral laws/regulations, concurrence of DIPP shall compulsorily be sought by the said Ministry. The Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce and Industry sets the rules for foreign investment and makes policy pronouncements on FDI through various Press Releases.
- As per the regulations under Foreign Exchange Management Act (FEMA) 1999, an Indian company receiving FDI does not require any prior approval of RBI at any stage. It is only required to report the capital inflow and subsequently the issue of shares to the RBI in prescribed formats under both the routes.
- Foreign Portfolio Investors (FPIs) are institutions incorporated outside India and include mutual fund, insurance company, pension fund, banks, NRIs etc. registered with SEBI. Government has accepted the international practice regarding the definitions of FDI and FPI. Where the investor's stake is 10 percent or less in a company it will be treated as FPI and, where an investor has a stake of more than 10 percent, it will be treated as FDI. A single foreign portfolio investor can invest maximum up to 10 percent in an Indian company and all FPIs on aggregate basis can maximum invest up to 24% or the sectoral cap/ statutory ceiling as applicable for that sector under foreign investment.

Difference between FDI and FII

FDI	FII
It is only in equity/shares	It is in both equity and debt
It happens through primary market	Generally through secondary market but can happen through primary market as well
Generally new shares are issued and the	Generally only the owners change hands

new capital (money) comes to the company through which the company invests in new factory, machines etc.	and new capital does not come to the company
The foreign investor appoints Board of Directors and get involved in the decision making (active management) of the company	Foreign investors generally do not get involved in the management of the company
Foreign investors try to make the company profitable through their decision making and target the profit of the company	Foreign investors target the share price of the company and derive their gain from rise or fall of share prices
Foreign investors try to make the company profitable through their decision making and target the profit of the company	Foreign investors target the share price of the company and derive their gain from rise or fall of share prices
It is sector specific. For example, a steel company in US will invest only in a steel company in India and try to make that company profitable through their management and get a share of the profit	It is in general capital market. For example, a foreign investor is not particular about any company/ sector and is willing to invest in any company which gives a chance of share price appreciation
It is a long term investment as to turn the company profitable, the foreign investor needs to get invested for a long time.	It is generally short term investment
Generally there is a lock in period (one year) and during this period the foreign investor cannot sell his investment and hence it is quite stable	There is no lock in period and the foreign investor can return any time by selling his investment. This makes the currency volatile
It can happen through three routes:	Only buying of share

• Purchase of shares • Forming a Joint Venture company • Establishing a subsidiary	

Inflation:

The rate at which general level of prices of goods and services rises and subsequently purchasing power falls is called inflation.

Depending on the level of severity, it can be classified into three categories.

1. Low Inflation:

Prices that rise slowly and predictably and the rate is in single digit annually. In case of low inflation, people are willing to save money and put in bank deposits. People are willing to sign long term contracts (linked with inflation index) in money terms because they are confident that the relative prices of goods and services they buy and sell will not get too far out of line.

2. Galloping Inflation:

Inflation in double digit or triple digit range of 20, 100 or 200 percent per year is called galloping inflation or very high inflation. It is found in countries suffering from weak governments, war or revolution. In this case people will hoard goods, buy houses and never ever lend money at low nominal interest rates. People are not

willing to deposit money in banks as banks offer less nominal interest rate (deposit rate) as compared to the inflation rate prevailing in the economy.

3. Hyper Inflation:

Prices rise over a million percent per year and relative prices become highly unstable. In early 1920's, Germany could not raise taxes and used monetary printing press to pay the government bills. People used to carry money in bags to purchase goods. In USSR in 1991 when prices were freed from the government controls, prices rose by 4,00,000 percent in next five years.

There are mainly two causes of inflation:

1. Demand Pull Inflation:

Demand-pull inflation occurs when there is an increase in aggregate demand, categorized by the four sectors of the economy: households, private, governments and foreign buyers. When these four sectors concurrently want to purchase more output than the economy can produce, then it leads to increase in prices. This excessive demand, also referred to as "too much money chasing too few goods", usually occurs in an expanding economy. Demand pull inflation may be caused due to over expansion of the money supply, government reducing tax and spending more etc.

2. Cost Push or Supply Shock Inflation:

Cost-push inflation basically means that prices have been "pushed up" by increases in costs of any of the four factors of production (labour, capital, land or entrepreneurship) or there is a supply shortage which allows the producer to raise prices. Inflation occurs because of increase in cost of inputs rather than because of increase in demand. Cost push inflation may be caused due to wage inflation (overall increase in the cost of goods due to rise in wages), monopoly situation, natural disasters, devaluation of exchange rates (leads to inflation in imported products) etc.

Deflation:

A general decline in prices, often caused by a reduction in the supply of money. Deflation can also be caused by a decrease in government, personal or investment spending. The opposite of inflation, deflation is bad because of the following reason: When prices start falling i.e. there is deflation, people become less willing to spend and postpone their purchase decisions. This is because when prices are falling, just sitting on cash becomes an investment with a positive real yield. This decreases the demand in the economy and prices fall further and economy slows down. People are less willing to borrow also even for a productive investment because it has to be repaid in rupees that are worth more than the rupees borrowed. Deflation thus increases unemployment since there is a lower level of demand in the economy, which may also lead to an economic depression.

2017-KAS

. Which one among the following is an appropriate description of deflation ?

(1) It is a sudden fall in the value of a currency against other popular currencies of the world.

(2) It is a persistent recession in the economy for some considerable time period.

(3) It is a persistent fall in the general price level of goods and services.

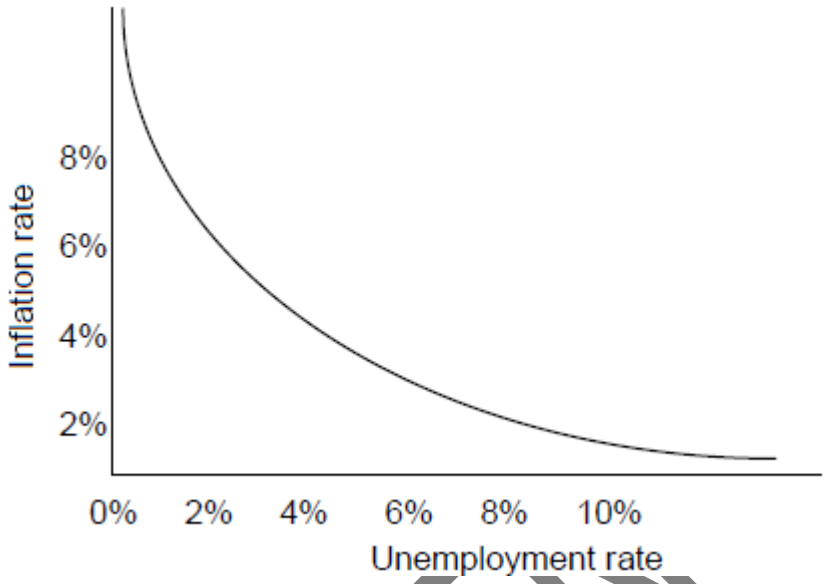
(4) It is fall in the rate of inflation over a period of time.

Disinflation

Disinflation is the slowing down in the rate of price inflation. It means there is inflation in the economy but the inflation percentage is decreasing and is positive.

Phillips Curve

It states that inflation and unemployment have a stable and inverse relationship. According to the Phillips curve, the lower an economy's rate of unemployment, the more rapidly wages paid to labour increase in that economy and hence higher the inflation in the economy. The theory states that with economic growth comes inflation, which in turn should lead to more jobs and less unemployment.



Inflation Indices

An index is a number designed to measure the relative change in the level of an activity/phenomenon from time to time. An index is used to measure the changes in various fields like stock market, wages, prices etc. An inflation index is a tool used to measure the rate of inflation in an economy.

To measure the price rise in the economy, an inflation index is chosen for a particular year as the base year. Generally the index is taken as 100 in the base year. In the next year when the inflation in the economy increases, then this index also moves up proportionately.

Suppose, for example we assume inflation index as 100 in the year 2010 (base year). We need to keep in mind that 100 is just a representation of the price level in the year 2010 and not the average price and we can start this number from 1000 or

100,000 also, it does not matter. If the inflation in the economy increases by 10% in the year 2011 then this index number of 100 is moved up to 110. If the inflation in the economy is 5% in the year 2012 then this index number moves to 115.5 and so on.

An index can be designed to measure the price increase of a particular commodity or average price increase of a basket of commodities. Since the variation in prices of different commodities may be different, we generally take the (weighted) average increase in the prices of a basket of commodities to measure the inflation. In India, we predominantly use two indices to measure the average price increase for a basket of commodities.

Consumer Price Index (CPI):

CPI measures the change in prices paid by the ultimate consumers in the retail market. Since different class of consumers' consumption pattern varies, there can be difference in the price increase in the basket of commodities consumed by poor people and rich people. So, in India we had earlier three CPI indices for different class of consumers and in 2010 we designed 3 new CPI indices:

- **CPI - Industrial Workers (CPI -IW)**: This index measures the change in price of commodity basket consumed by the industrial workers
- **CPI - Agricultural Labourers (CPI -AL)**: This index measures the change in price of commodity basket consumed by the agricultural labourers
- **CPI - Rural Labourers**: This index measures the change in price of commodity basket consumed by the rural labourers.

These indices are published monthly by Labour Bureau under Ministry of Labour and Employment for all India as well as States and Union Territories.

Since the above three indices covered only a segment of the population, and not the overall nation, we designed three more indices of CPI

- **CPI - Rural**: This index measures the change in price of commodity basket consumed by rural population
- **CPI - Urban**: This index measures the change in price of commodity basket consumed by urban population
- **CPI - Combined**: It is computed by combining CPI Rural and CPI Urban Index

The base year for the above three indices is 2011-12 and are published monthly by Central Statistical Office (CSO) for all India as well as States and Union Territories.

Wholesale Price Index (WPI):

WPI measures the change in prices in the wholesale market, where goods are traded in bulk. The base year for WPI is 2011-12 and is published monthly by Office of Economic Advisor, Department for promotion of Industries and Internal Trade (DPIIT).

The following are some basic differences in CPI, WPI and GDP deflator:

- In wholesale market services are not traded, so WPI does not include the inflation in services, while CPI and GDP deflator capture inflation in services also.
- The goods purchased by consumers in the retail market do not represent all the goods produced in the country (capital goods are purchased by the companies), so CPI does not include such capital goods but GDP deflator takes into account all such goods and services produced in the country.
- CPI and WPI include prices of goods produced domestically and imported both but GDP deflator does not include prices of imported goods.

2011-KAS

Food inflation in Wholesale Price Index (WPI) is measured in India by

(1) Food Index consisting of primary food articles

(2) WPI of manufactured food products

(3) WPI of primary good articles

(4) Food Index consisting of primary food articles and manufactured food products

International Organizations:

Bretton Woods

- Bretton Woods is a place in New Hampshire State of USA, just like BASEL is a city in Switzerland
- In 1944, President Roosevelt hosted a conference here, to rebuild the world economy, after Second World War.
- Delegates of 44 allied nations came to participate (India was represented by Sir D. Deshmukh, the first Indian Governor of RBI)
- Officially known as United Nations Monetary and Financial Conference, commonly known as Bretton Woods because of the place where it was held.

This conference resulted into creation of four important organizations viz.

- IMF (International monetary fund)
- World Bank
- GATT (General Agreement on Trade and Tarrif) – later becomes WTO in 1995
- Fixed Exchange Rate system (Discarded in 1970s)

International Monetary Fund

- HQ – Washington
- Official language – Chinese, English, French, Russian, Spanish, Arabic
- Formally created in 1945 by 29 member countries
- Stated goal was to assist in the reconstruction of world's international payment system post World War II
- Countries contribute funds to a pool through a quota system from which countries with payment imbalances temporarily can borrow money and other resources.

Organization's objectives as stated in the Articles of Agreement

- To promote international economic co-operation,
- To promote international trade,

- To promote employment and exchange-rate stability,
- Make financial resources available to member countries to meet balance of payments needs

Upon initial IMF formation, its two primary functions were:

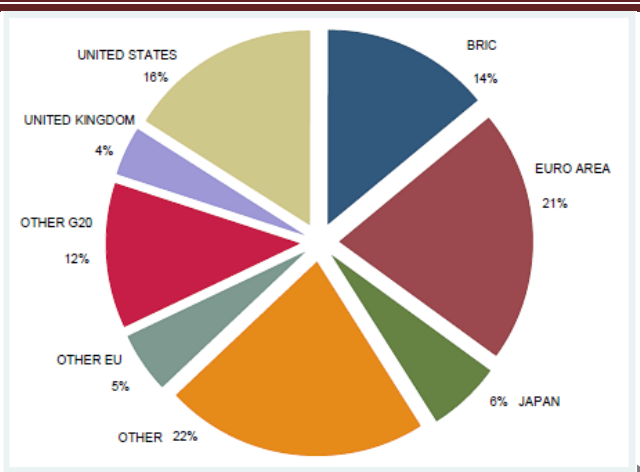
- to oversee the fixed exchange rate arrangements between countries
- to provide short-term capital to aid balance of payments

IMF's role was fundamentally altered after the floating exchange rates post 1971

- Shifted to examining the economic policies of countries
- Researched what types of government policy would ensure economic recovery
- Its function became of surveillance of the overall macroeconomic performance of its member countries
- Now manages economic policy instead of just exchange rates + Promotes international trade
- Publishes surveys on world economy → World Economic Outlook

IMF Quota & Voting Rights

- Quotas was assigned to member countries reflecting their relative economic power & credit deposit to IMF
- Subscription was to be paid 25% in gold or currency convertible into gold (effectively the dollar, which was the only currency then, still directly gold convertible for central banks) and 75% in the member's own currency
- Members were provided voting rights in proportion to their quota, hence member countries with higher quota have a higher say at IMF



Special Drawing Rights

- Special drawing rights (SDRs) are supplementary foreign exchange reserve assets defined and maintained by the International Monetary Fund (IMF)
- SDR is not a currency, instead represents a claim to currency held by IMF member countries for which they may be exchanged.
- The value of an SDR is defined by a weighted currency basket of four major currencies: the US dollar, the euro, the British pound, the Chinese Yuan and the Japanese yen
- Central bank of member countries held SDR with IMF which can be used by them to access funds from IMF in case of financial crises in their domestic market

Reverse Tansche

- A certain proportion of a member country's quota is specified as its reserve tranche.
- The member country can access its reserve tranche funds at its discretion, and is not under an immediate obligation to repay those funds to the IMF.
- Member nation reserve tranches are typically 25% of the member's quota.

World Bank (WB)

- HQ – Washington
- Set up in 1944 with a charter to drive post-World War II reconstruction
- Officially known as IBRD (International bank for reconstruction and Development)
- Provide long term soft loans to rebuild the third world (Soft loans → interest rate is very low)
- The official goal or mission of the World Bank is reduction of poverty
- **Aim** – Promotion of foreign investment and international trade + Facilitation of capital investment

World Bank Consists of Two Institutions viz.

- The International Bank for Reconstruction and Development (IBRD)
- The International Development Association (IDA)

These 5 institutions are as follows –

- International Bank for Reconstruction and Development (IBRD)- Commonly known as the world bank. It is the single largest provider of development loans
- International Development Association (IDA) – assists the poorest countries
- International Finance Corporation (IFC) – supports private enterprise in developing countries.
- Multilateral Investment Guarantee Agency (MIGA) – offers investors insurance against non-commercial risk and help developing country governments attract foreign investment (non commercial risks such as political instability, govt deciding to nationalise a private business etc.)
- International Centre for the Settlement of Investment Disputes (ICSID) – encourages the flow of foreign investment to developing countries through arbitration and conciliation facilities

Except for ICSID, India is member of other four groups. it is so because India does not like external interference such as arbitration in our decision making process, hence not the member of ICSID.

India is one of the founder members of IBRD, IDA and IFC

Key Function Areas (Same as MDG)

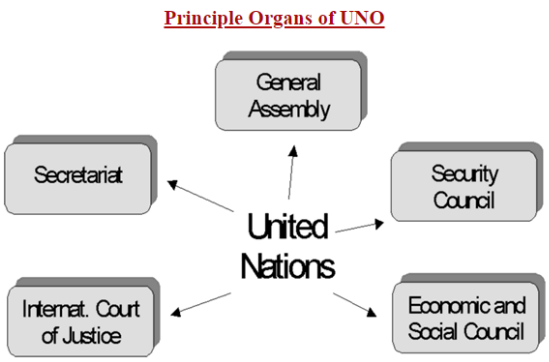
- Universal Primary Education
- Gender Equality
- Reduce Child Mortality
- Improve Maternal Health
- Poverty and Hunger
- Combat HIV/AIDS, Malaria, and Other Diseases
- Ensure Environmental Sustainability
- Develop a Global Partnership for Development

United Nations Organization (UNO)

- An intergovernmental organization established on 24 October 1945 to promote international co-operation.
- As a replacement for the ineffective League of Nations, the organization was created following the Second World War to prevent another such conflict.
- At its founding, the UN had 51 member states committed to maintain international peace and security, developing friendly relations among nations and promoting social progress, better living standards and human rights; now there are 193.
- The Norwegian Foreign Minister, Trygve Lie, was elected as the first UN Secretary-General.
- Headquart- New York
- Official Languages-Arabic, English, French, Chinese, Spanish, Russian
- Members-- 193 (Latest Member South Sudan)
- Secretary General---Ban Ki Moon

The UNO has 4 main purposes

- To keep peace throughout the world;
- To develop friendly relations among nations;
- To help nations work together to improve the lives of poor people, to conquer hunger, disease and illiteracy, and to encourage respect for each other's rights and freedoms;
- To be a center for harmonizing the actions of nations to achieve these goals.



Principle Organs of United Nations Organization(UNO)

General Assembly (New York)

- Composed of all United Nations member states, the assembly meets in regular yearly sessions, but emergency sessions can also be called
- Led by a president, elected from among the member states on a rotating regional basis, & 21 vice-presidents

Major work area of General Assembly consists of:

- Election of members to other UN organs
- Admission, suspension, and expulsion of member states
- Budgetary matters by majority of votes i.e. 2/3rd of the members present & voting

- Make recommendations on any matters within the scope of the UN, except matters of peace and security that are under consideration by the Security Council
- Elects the non-permanent members of the UNSC; all members of ECOSOC; the UN Secretary General (following proposal by the UNSC); and the fifteen judges of the International Court of Justice (ICJ)

Security Council (Policemen of the world) (New York)

- Charged with maintaining peace and security among countries
- While other organs of the UN can only make "recommendations" to member states, the Security Council has the power to make binding decisions on member states
- 5 permanent members (Veto power) + 10 Non-permanent for 2 years

- The five permanent members hold veto power over UN resolutions, allowing a permanent member to block adoption of a resolution, though not debate
- The ten temporary seats are held for two-year terms, with member states voted in by the General Assembly on a regional basis
- The presidency of the Security Council rotates alphabetically each month.

2017-KAS

62. Consider the following regarding the United Nations Security Council (UNSC) :

A. UNSC consists of 15 members.

B. Five permanent members are USA, UK, Japan, Russia and China.

C. Ten non-permanent members are elected on a regional basis to serve for five-year terms.

Which of the above statements is/are correct ?

Select the code for the correct answer from the options given below :

(1) A only

(2) B and C only

(3) A and C only

(4) A, B and C

Secretariat (New York)

- Headed by Secretary-General who acts as the de factospokesperson and leader of the UN
- Secretary-General is appointed by General Assembly, after being recommended by the Security Council
- Carries out tasks as directed by the Security Council, the General Assembly, the Economic and Social Council, and other UN bodies.

International Court of Justice (The Hague, Netherland)

- Composed of 15 judges who serve 9-year terms; appointed by the General Assembly;
- Every sitting judge must be from a different nation
- Hear cases related to war crimes, illegal state interference, ethnic cleansing, and other issues
- ICJ's primary purpose is to adjudicate disputes among states

Economic and Social Council (New York)

- Assists the General Assembly in promoting international economic and social co-operation and development
- Has 54 members, which are elected by the General Assembly for a three-year term
- The president is elected for a one-year term and chosen amongst the small or middle powers represented on ECOSOC

World Trade Organization (WTO)

- Officially commenced on 1 January 1995 under the Marrakesh Agreement, replacing the General Agreement on Tariffs and Trade (GATT), which commenced in 1948
- An organization that intends to supervise and liberalize international trade
- HQ – Geneva, Switzerland

- Official language – English, French, Spanish

Evolution of WTO

- 1944: Bretton Woods conference wanted to make ITO (International Trade Org.) but USA did not ratify. Thus, GATT was born as a stopgap arrangement

- 1947 GATT (General Agreement on Trade & Tariffs) established aimed to reduce barriers to international trade

- 1986: Uruguay Round of Talks Service & Intellectual Property rights related topics included in the debate, 1993, everyone agreed on it

- 1994: Marrakesh treaty under Uruguay round of talks at Morocco

- All nations signed an agreement & WTO was established on Jan 1, 1995
- India → Founding member of WTO

2014-KAS

When did India become member of WTO ?

(a) 1993

(b) 1995

(c) 1994

(d) 1992

WTO Structure

1. Ministerial Conference

- Supreme Decision Making body
- 160 members, Latest member → Yemen (Capital: Sanaa)
- Meets once every two years,
- Deliberates on trade agreements
- Appoints Director General

2. General Council

- Day to day Decision Making body
- Meets regularly at Geneva.
- Implements decision of ministerial conferences
- Has Representative from each member state.
- Has two bodies, with separate chairmen--Dispute settlement body, Trade policy review body

3. Director General

- Appointed by ministerial conference
- Has four years term.
- Heads Secretariat at Geneva

Tariff Barriers → When Govt. puts heavy import duty / custom duty on Foreign Products which protects domestic players from competition from foreign players

Non Tariff barriers → When Domestic players are given subsidies / preference over the foreign players by Govt. for Ex.

- When Govt. is buying some Phones/ Xerox Machines, in the tender it'll mention that only Domestic companies are allowed.
- Making polices in a way that it's hard for foreign player to start factory / introduce his product in India

Key Functions of WTO

- Reduce above stated barriers to international trade – both tariff barriers and non-tariff barriers & Get the members enter into multilateral trade agreements.
- Provide forum for negotiation & dispute settlement for members, if agreements are violated.
- Ensure the developing countries benefit from world trade, especially the least Developed countries
- Cooperate with UN, World and IMF for a global economic policy that improves livelihood, protects environment and promotes sustainable Development.

PRINCIPLES OF WTO

These principles are the foundation of the multilateral trading system.

1.MOST-FAVOURED-NATION (MFN)

Under the WTO agreements, countries cannot normally discriminate between their trading partners. Grant someone a special favour (such as a lower customs duty rate for one of their products) and you have to do the same for all other WTO members. This principle is known as most-favoured nation treatment.

Some exceptions are allowed. Free trade agreements and on national security clause one may not give this status. In general, MFN means that every time a country lowers a trade barrier or opens up a market, it has to do so for the same goods or services from all its trading partners — whether rich or poor, weak or strong.

2.NATIONAL TREATMENT

Imported and locally-produced goods should be treated equally — at least after the foreign goods have entered the market. National treatment only applies once a product, service or item of intellectual property has entered the market. Therefore, charging customs duty on an import is not a violation of national treatment even if locally-produced products are not charged an equivalent tax.

3.FREER TRADE

Lowering trade barriers is one of the most obvious means of encouraging trade.

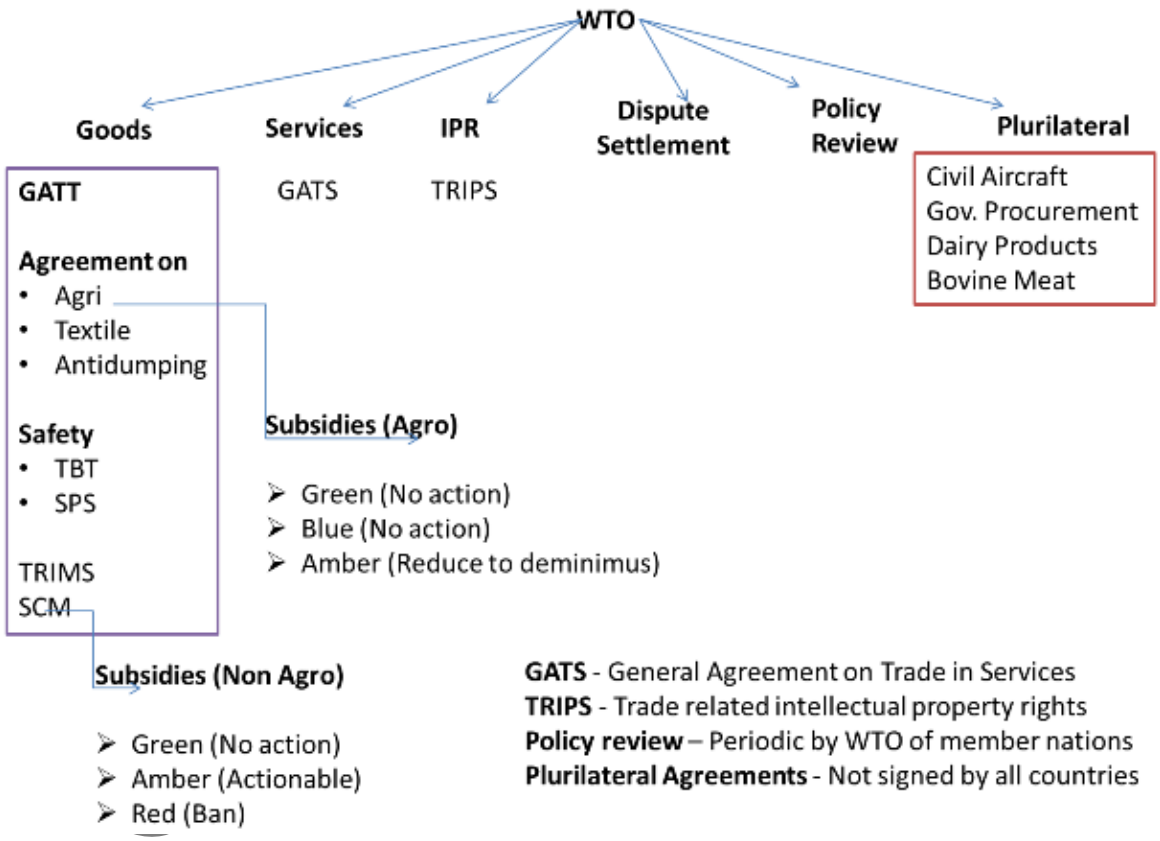
4.PREDICTABILITY

Sometimes, promising not to raise a trade barrier can be as important as lowering one, because the promise gives businesses a clearer view of their future opportunities. With stability and predictability, investment is encouraged, jobs are created and consumers can fully enjoy the benefits of competition — choice and

lower prices. The multilateral trading system is an attempt by governments to make the business environment stable and predictable.

5.PROMOTING FAIR COMPETITION

The WTO is sometimes described as a "free trade" institution, but that is not entirely accurate. The system does allow tariffs and, in limited circumstances, other forms of protection. More accurately, it is a system of rules dedicated to open, fair and undistorted competition.



WTO Agreements

Goods	▪ General Agreement on Tariffs and Trade (GATT)
	▪ Agreements on
	  ▪ Agriculture
	  ▪ Textile
	  ▪ Antidumping
	▪ Safety / Quality check
	  ▪ Sanitary and phytosanitary agreement (SPS)
	  ▪ Technical barriers to trade (TBT)
	  ▪ Trade related investment measures (TRIMS)
	  ▪ Subsidies and countervailing measures (SCM)

Services	▪ General Agreement on Trade in Services (GATS) ▪ To ensure that services' import/export enjoys the same principles of free and fair trade, just like the trade in goods

Agreement on Agriculture, WTO wants to

- Reduce import duty
- Reduce export subsidies
- Reduce Amber box subsides (Domestic subsidies)

Subsidies:

Green Box

- Agriculture R &D, Training programmes, Flood / Drought relief to farmers etc.
- Subsidies that don't disrupt trade balance or cause minimum damage to trade balance
- WTO Limit : there is no limit on this subsidies given by the govt.

Blue Box

- Amber type Subsidies that aim to limit production
- Subsidies that don't increase with production
- For example subsidies linked with acreage or number of animals
- such subsidies are not there in India
- WTO Limit : there is no limit on this subsidies given by the govt.

Amber Box

- Subsidies that disturb trade balance like subsidies on fertilizers, seeds, power and irrigation.
- By this, country's product becomes cheaper than others in the international market
- WTO Limit –subsidies provided by the govt. should be less than De Minimus

Amber Box: De Minimus limits

- The minimal amounts of Amber box subsides permitted by WTO, even though they distort trade
- Calculated on the agriculture production of the given member state in 1986-88
- Limits – Developed (5%), Developing (10%), Least Developed (Exempted)

Important WTO Ministerial Conferences

Ministerial conferences take place every two years. the given below are some important conferences.

Singapore Conference:

Ever since the inception of WTO, the developed countries have been pressurizing for expansion of negotiating agenda. This was clear at the first ever Ministerial Conference held in Singapore in 1996 itself where these countries demanded that the negotiating mandate of WTO be broadened. Hence, there was the birth of four issues which came to be known as Singapore Issues :

- Investment
- Competition Policy
- Government Procurement and
- Trade Facilitation

These Singapore Issues emerged as an apple of discord between the developed and developing countries first at the Doha meeting in 2001 and then at Cancun meeting in 2003.

DOHA round

• Last round of GATT these issues were left –

- Agreement on agriculture
- Non agricultural market access
- General agreement on trade & services

• WTO was established but issues were not resolved and hence they were officially brought in DOHA round.

2014-KAS

Which round of multilateral trade negotiations included services and agriculture for the first time ?

(a) Doha round

(b) Uruguay round

(c) Bali round

(d) Seattle round

Major Issues in Doha Round

- **Agriculture:** More market access, eliminating export subsidies, reducing distorting domestic support, sorting out a range of developing country issues, and dealing with non-trade concerns such as food security and rural development.
- **Non-agricultural market access (NAMA):** reducing or eliminating tariff as well as non-tariff barriers in particular on products of export interest to developing countries.
- **Services**: to improve market access and to strengthen the rules.
- **TRIPs and Public Health**: Any member of the WTO has a right to knock off patents on pharmaceutical products on the grounds of emergency, public health by using compulsory licensing provision.
- **E-commerc**e: Countries won t impose custom duties or taxes on internet products or services.
- **Special and Differential Treatment to help developing countries**: That includes longer time periods for the purpose of implementing agreements. It

requires that all WTO countries safeguard the trade interests of developing countries. It also endeavours to provide financial support to developing countries to build infrastructure needed to handle disputes and implement technical standards.

- **Rule**s: These cover anti-dumping, subsidies and countervailing measures, fisheries subsidies etc.
- **Trade Facilitation**: It is meant to ease customs procedures and to facilitate the movement, release and clearance of goods. Further, it is supposed to cut down bureaucratic hassles and corruption in customs procedures, make trade cheaper and also accelerate it.
- **Environment**: Here, it has two dimensions. Firstly, it refers to freer trade in environmental goods/products like wind turbines, carbon capture and storage technologies, solar panels etc. Secondly, there is the aspect of environmental agreements. It refers to more coherence between trade and environmental rules.

Cancun Ministerial Conference 2003

The debate at Cancun was focussed on two issues: liberalisation of agriculture, and developing new multilateral disciplines on the Singapore issues. A clear divide between the developing and the developed world surfaced at the meeting with the former rooting for a cut in agricultural subsidies by the developed countries and more market access for their farm products, and the latter rooting for a deal on Singapore issues. Both the groups stuck to their points resulting in an impasse. At Cancun developing countries not only held together, but also became more professional in their approach to negotiations.

Further, the July Package (2004) steered by the Five Interested Parties namely India, Brazil, Australia , the EU and the USA led to dropping of three core Singapore issues and launching of negotiations on the fourth remaining Singapore issue, namely, Trade Facilitation.

Hong Kong Ministerial Conference 2005

From the point of view of the developing countries, nothing of consequence was achieved at the Hong Kong Ministerial Conference. India had a very high stake in services particularly in Mode 1 (cross border supply of services) and Mode 4 (movement of natural persons). However, it failed to gain anything on these issues primarily because of the reluctance of the developed countries to make legally binding commitments in them.

Post-Hong Kong Ministerial Important Developments

The important decision taken in Bali Ministerial 2013 was the peace clause enabling developing countries to have increased public stock-holding of foodgrains. Further, it also enabled a long overdue agreement on trade facilitation .

At the **Nairobi Ministerial** 2015, the developed countries came up with new issues.

The 11th WTO Ministerial Conference (MC11) was held from 10 to 13 December 2017 in Buenos Aires, Argentina.

TRIPS LAWS

- Patents
- Copyrights
- Trademarks
- Trade secrets
- Geographical indicators

Patent

- Right provided to inventor of technology
- Rights for 20 yrs
- for inventions which are Novel , non obvious and commercial utility
- Evergreening not allowed – done to maximise profits and to have

monopoly

Copyrights

• Over written and published material e.g. books , materials etc.
• For lifetime
• After death of the holder it may stay with successor for 60 yrs

Trademark
• Logo or symbol which becomes the identity of a company
• Renewed after 10 yrs

Trade secrets
• Usually companies use some secrets-a secret device or technique used by a company in manufacturing its products.
they will have right to protect them

Geographical indicators

• Certain products are of distinct quality because of their georgraphical origin, like Darjelling Tea, Channapatna toys etc.
• On such products no patent can be given
• GI tag is given to such products

New Development Bank (BRICS Bank)

- Agreed in 5th BRICS summit held in Durban, South Africa in 2013
- 6th BRICS summit held in Fortaleza, Brazil, 2014, signed the document for $100 billion BRICS Development Bank and a reserve currency pool worth over another $100 billion
- Headquartered at Shanghai with African Regional Centre at Johannesburg

- 1st President – India, Chairman of the Board of directors – Brazil, Chairman of Board of governors – Russians

Terms & Objectives

- Primary focus of lending will be infrastructure projectswith authorized lending of up to $34 billion annually
- Will have starting capital of $50 billion, with capital increased to $100 billion over time
- Brazil, Russia, India, China & South Africa will initially contribute $10 billion each to bring the total to $50 billion
- No member can increase its share of capital without other 4 members agreeing – a primary requirement of India
- The bank will allow new members to join but the BRICS capital share cannot fall below 55%
- Official Languages – Chinese, English, Russian, Portuguese, 22 official languages of India

Initial authorized capital	100 billion
Initial subscribed capital	50 billion (each member gave 10 billion)
Contingency reserve arrangement (CRA)	Total → 100 billion ▪ China → 41 Billion ▪ Brazil, India, Russia → 18 Billion Eacl ▪ S Africa → 5 billion
Official language	▪ Chinese ▪ English ▪ Portuguese ▪ Russian ▪ 22 Official Languages of India

Contingent Reserve Arrangement (CRA)

- Provision of support through liquidity & precautionary instruments in response to potential short-term balance of payments pressures

- To provide protection against global liquidity pressures including currency issues where members' national currencies are being adversely affected by global financial pressures.
- Total $100 Billion – China will contribute $41 billion, Brazil, Russia and India would give $18 billion each, and South Africa would contribute $5 billion

IMF, World Bank & BRICS

Data	IMF	World Bank	BRICS Bank
By which summit?	Bretton Woods, USA		6th BRICS summit at Fortaleza, Brazil
Year	1944		2014, July. Although ops may by 2016.
HQ	Washington		Shanghai, China.
members	188	188 (IBRD); 172 (IDA)	only five
voting power	Different voting powers based on Quota system.	Differs according to shareholding	All five members have equal voting power.
components	–	IBRD, IDA, IFC, ICSID & MIGA	–
Purpose	▪ Loans to solve Balance of Payment (BoP) crisis. ▪ Technical assistance in policy making ▪ Surveillance over International economy	▪ Poverty reduction to 3% by 2030. ▪ Soft loans for development projects. ▪ Promoting foreign investment and international trade.	▪ Loans for infrastructure and sustainable development projects ▪ Helping country in balance of payment (BoP) crisis

Why BRICS Bank Born?

- BRICS – Collectively 1/5thof World GDP and 2/5th of world population
- No reforms in IMF or Word Bank → Highly dominated by USA & G7
- To defend BRICS economy from volatility in dollar exchange rate
- In the long run, it'll make Chinese Yuan as an alternative to US Dollar, for global financial system

2014-KAS

During which of the following summit BRICS Development Bank was launched ?

(a) Russia

(b) South Africa

(c) China

(d) Brazil

2011-KAS

BRIC countries refer to

(1) Bangladesh, Russia, Ireland and Congo

(2) Belgium, Romania, Iran and Canada

(3) Brazil, Russia, Italy and China

(4) Brazil, Russia, India and China

Economic Planning in India

Economic Planning

Economic planning is a process in which a central authority of a country defines a set of goals to be achieved within a specified period, sets out a plan to achieve those goals, keeping in view the country's resources. Planning commission defines economic planning as, 'Economic planning means utilisation of country's resources in different development activities in accordance with national priorities'. Now, let us understand what a 'plan' is?

• A plan spells out how the resources of nation should be efficiendy utilised.

• It should have some general goals which are achieved through specific objectives within a specified period of time.

To formulate plans, Planning Commission was set up in 1950 under the chairmanship of Jawaharlal Nehru, the first Prime Minister of independent India. Its aim was to promote rapid rise in standard of living of the people, increase production and offer employment opportunities in India. To facilitate economic planning Five Year Plans were forniulated. The first Five Year Plan was introduced in April 1951.

All the Five Year Plans are formulated keeping the below objectives in mind

1. Growth

It refers to increase in the country's capacity to produce the output of goods and services within the country. It implies either a larger stock of productive capital or a large size of supporting services like transport and banking.

Increase is GDP is a good indicator of economic growth. Gross Domestic Product (GDP) is the market value of all final goods and services produced in the different sectors of an economy, viz the primary sector, the secondary sector and the tertiary sector during an year within the domestic territory of a country.

2. Modernization

Adoption of new technology is called modernization. It is done with an aim to increase the production of goods and services. For example, a farmer can increase the output on the farm by using new seed varieties instead of using old ones. Modernisation refers to not only change in production methods, but also change in the social outlook of a society by granting equal status to women and making use of their talent in the productive process.

3. Self-Reliance

A nation can promote economic growth and modernization by using its own resources or by using resources imported from other nations. The first seven Five Year Plans gave importance to self-reliance by avoiding imports. This policy was considered a necessity in order to reduce our dependence on foreign countries especially for food.

4. Equity It refers to reduction in disparity of income or wealth, by uplifting weaker sections of the society. It also refers to distribution of economic power equally or in such way that every Indian should be able to meet his or her basic needs such as food, a decent house, education, healthcare, etc.

Timeline of planning in India

1934	Visvesvaraya plan in this book "The planned economy of India". He was an Engineer, Ex-Diwan of Mysore and Bharat Ratna recipient.
1938	Nehru's Congress plan. But not implemented due to WW2.
1944	Bombay plan by noted industrialists such as JRD Tata, GD Birla, Kasturbhai Lalbhai et al.
1944	Sriman Narayan Agrawal's Gandhian plan.
1945	MN Roy's "people's plan" – with socialist leanings.
1950	Jayprakash Narayan's Sarvodaya Plan based on Vinoba Bhave's philosophy
1950,March 15	Cabinet resolution to form Planning commission.
1952,Aug.	National Development council (NDC) made by Cabinet resolution.
2015, Jan	Government notified the formation of Niti Aayog- **National Institution for Transforming India.**

Plan	Objective/Features	Assessment
First Five year Plan (1951-56)	Rehabilitation of refugees, rapid agricultural development to achieve food self-sufficiency in the shortest possible time and control of inflation.	Targets and objectives more or less achieved. With active role of state in all economic sectors.Five Indian Institutes of Technology (IITs) were started as major technical institutions.
Second Five year Plan (1956-61)	Nehru-Mahalanobis model was adopted. 'Rapid industrialisation with particular emphasis on the development of basic and heavy industries' Industrial Policy of 1956 accepted the establishment of a socialistic pattern of	Could not be implemented fully due to shortage of foreign exchange. Targets had to be pruned. Yet, Hydroelectric power projects and five steel mills at Bhilai, Durgapur, and Rourkela were established.

	society as the goal of economic policy.	
Third Five year Plan (1961-66)	'establishment of a self-reliant and self-generating economy'	Failure. Wars and droughts. Yet, Panchayat elections were started.• State electricity boards and state secondary education boards were formed.
Annual Plan (1966-69)	crisis in agriculture and serious food shortage required attention	A new agricultural strategy was implemented. It involved distribution of high-yielding varieties of seeds, extensive use of fertilizers, exploitation of irrigation potential and soil conservation measures.
Fourth Five year Plan (1969-74)	'growth with stability' and progressive achievement of self reliance' GaribiHatao Target: 5.5% growth	Was ambitious. Achieved growth of 3.5 percent but was marred by Inflation. The Indira Gandhi government nationalized 14 major Indian banks and the Green Revolution in India advanced agriculture.
Fifth Five year Plan (1974-79)	'removal of poverty and attainment of self-reliance'	High inflation. Was terminated by the Janta govt. Yet, the Indian national highway system was introduced for the first time.
Sixth Five year Plan(1980-85)	'direct attack on the	Most targets achieved.

	problem of poverty by creating conditions of an expanding economy'	Growth: 5.5 pc. Family planning was also expanded in order to prevent overpopulation.
Seventh Five year Plan (1985-1990)	Emphasis on policies and programmes that would accelerate the growth in food grains production, increase employment opportunities and raise productivity	With growth rate of 6 pc, this plan was proved successful in spite of severe drought conditions for first three years consecutively. This plan introduced programs like Jawahar Rozgar Yojana.
Annual Plans (1989-91)	No plan due to political uncertainities	It was the beginning of privatization and liberalization in India.
Eighth Five year Plan (1992-97)	Rapid economic growth, high growth of agriculture and allied sector, and manufacturing sector, growth in exports and imports, improvement in trade and current account deficit. to undertake an annual average growth of 5.6%	Partly success. An average annual growth rate of 6.78% against the target 5.6% was achieved.
Ninth Five year Plan (1997-2002)	Quality of life, generation of productive employment, regional balance and self-reliance. Growth with social justice and equality. growth target	It achieved a GDP growth rate of 5.4%, lower than target. Yet, industrial growth was 4.5% which was higher than targeted 3%. The service industry had a growth rate of 7.8%.

	6.5%	An average annual growth rate of 6.7% was reached.
Tenth Five year Plan (2002 – 2007)	To achieve 8% GDP growth rate, Reduction of poverty by 5 points and increase the literacy rate in the country.	It was successful in reducing poverty ratio by 5%, increasing forest cover to 25%, increasing literacy rates to 75 % and the economic growth of the country over 8%.
Eleventh Five year Plan(2007 – 2012)	Rapid and inclusive growth. Empowerment through education and skill development. Reduction of gender inequality. Environmental sustainability. To increase the growth rate in agriculture, industry and services to 4%, 10% and 9% resp. Provide clean drinking water for all by 2009.	India has recorded an average annual economic growth rate of 8%, farm sector grew at an average rate of 3.7% as against 4% targeted. Industry grew with annual average growth of 7.2% against 10% targeted.
Twelfth Five year Plan(2012-2017)	"**Faster, sustainable and more inclusive growth**". proposes a growth target of 8 percent. Raising agriculture output to 4 per cent. Manufacturing sector growth to 10 % Target of adding over	

	88,000 MW of power generation capacity.	

55. The increase in the volume of imports during the Third Five Year Plan, that is from 1961-1962 to 1965-1966 was due to

1. Rapid industrialization necessitated larger imports of machinery, equipment industrial raw materials, etc.
2. The defence needs increased following aggression by China and Pakistan.
3. Extensive crop failure in 1965-66 necessitated the import of a large quantity of food grains.
4. Imports are anti-inflationary because they reduce the scarcity of consumer goods.

Select the correct answer using the codes given below :

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

2014-KAS

Poverty

A condition in which section of society is unable to fulfill its basic necessities of life.
It is of two types- (a) Absolute Poverty (b) Relative Poverty

(a) Absolute Poverty

In this, we calculate an aggregate value (a figure expressing per capita consumer expenditure) of the minimum quantity of commodities which are necessities of life.
Poverty line represents ***the estimated minimum level of income needed to secure the basic necessities of life.*** Alternatively, it indicates the capacity to incur the minimum expenditure to meet the subsistence or basic necessities of a human being, to keep him/her in good health and decency.

The population whose level of income (or expenditure) is below this aggregate value is Below Poverty Line (BPL)In this measure of poverty, we expressed the number of poor as a proportion of the total population. This measure also is known as the headcount ratio.
For example: 13 Percent of People are BPL.

Why we prefer consumption expenditure method instead of income-In per capita income we cannot separate dependent people (children, senior citizen etc.) who are consuming but not earning. So, for correct data calculation, we prefer consumption expenditure method instead of income.

(b) Relative Poverty

In this type of poverty, a person may be above Below Poverty Line but happens to be poor in comparison with the other person whose income is above his income/consumption.
In this type of poverty calculation, income/consumption distribution of the population in different percentile groups is estimated and compares them.

It provides inequality present among the total population. is one of the measures of inequality.

For example: Quintile Income Ratio= Average income of richest 20 Percent/ Average income of poorest 20 person

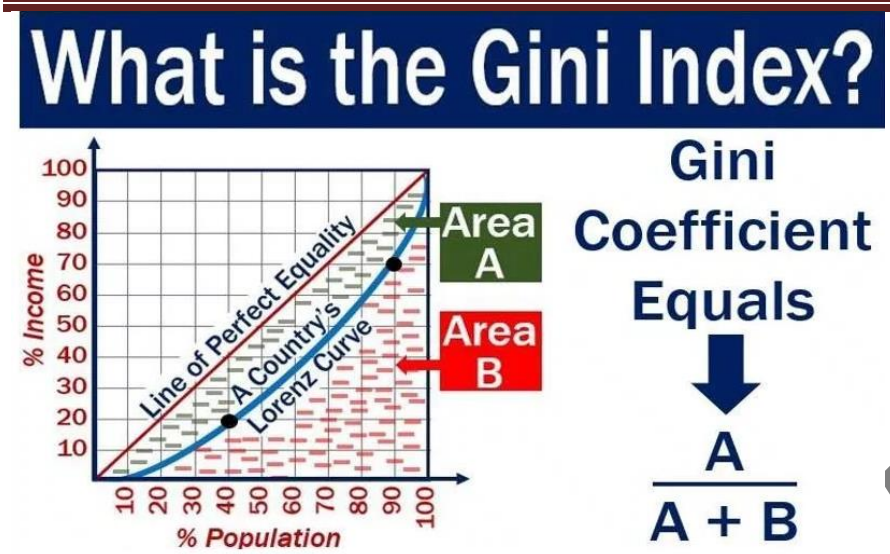
The Poverty Gap Index is the mean distance below the poverty line as a proportion of the poverty line where the mean is taken over the whole population, counting the non-poor as having zero poverty gap.

What is the Gini Index

It is often used as a gauge of economic inequality, measuring income distribution or, less commonly, wealth distribution among a population. The coefficient ranges from 0 (or 0%) to 1 (or 100%), with 0 representing perfect equality and 1 representing perfect inequality. Values over 1 are theoretically possible due to negative income or wealth.

Graphical Representation of the Gini Index

The Gini index is often represented graphically through the Lorenz curve, which shows income (or wealth) distribution by plotting the population percentile by income on the horizontal axis and cumulative income on the vertical axis. The Gini coefficient is equal to the area below the line of perfect equality (0.5 by definition) minus the area below the Lorenz curve, divided by the area below the line of perfect equality. In other words, it is double the area between the Lorenz curve and the line of perfect equality.



Which one of the following statement is correct ?

The 'Sen Measure' of poverty is said to measure the distribution of welfare rather than merely the distribution of wealth in a society because

(a) It identifies poverty in terms of minimum level of living. **2014-KAS**

(b) It measures the energy requirements of a household.

(c) It prescribes a Universal Standard of well being.

(d) It seeks to measure the income shortfall of each person below the poverty.

Poverty estimation in India British India

Earliest estimation of poverty was done by Dadabhai Naoroji in his book-"Poverty and Un-British rule" in India published in 1901.

In 1936, the National Planning committee gave an idea about poverty in undivided India. But data provided by them was not considered as poverty data in the country.

Poverty estimation in Independent India

(A) Dr. V.M. Dandekar and Nilantha Rath (1968-69)

Fixed desired minimum nutrition = 2250 calories/day

In Rural, money required to purchase this amount of nutrition- 170 Rs. / year

In Urban, money required to purchase this amount of nutrition- 271 Rs. / year

Using this reference, they found that 40 Percent of rural resident and 50 Percent of urban residents were below the below poverty line in 1960-61.

(B) Planning commission expert group

Poverty line concept was first introduced by planning commission working group of the planning commission in 1962.

(i) Alagh Committee

- Chairman- Y K Alagh
- Till 1979 poverty estimation was done by on the basis of lack of income, but in 1979 Y K Alagh Committee adopted a new approach based on household per capita consumption expenditure basis. This committee defines the first poverty line in India Daily consumption fixed by the committee
- in Rural= 2400calories/day Daily consumption fixed by the committee
- in Urban= 2100 calories/day
- In rural India value of consumption was put high because of physical labour they undergo.

(ii) Lakdawala Committee

- Formed in 1989.
- Chairman- D.T. Lakdawala
- Submitted report in 1993.
- Daily consumption fixed by the committee in Rural= 2400 calories/day
- Daily consumption fixed by the committee in Urban= 2100 calories/day
- The committee used CPI-IL and CPI-AL for estimation of Poverty
- CPI-IL (Consumer Price Index for Industrial Labourers)
- CPI-AL (Consumer Price Index for Agriculture Labourers)
- Total people were under BPL in 1993-94 = 36 percent

- Total people were under BPL in 2004-05 = 27.5 percent

(ii) **Tendulkar Committee**

- Formed in 2005.
- Chairman- Suresh D. Tendulkar
- Submitted its report in 2009.
- Changed calorie based estimation to nutrition, health and other expenditure based
- Introduce a new term Poverty Line Basket (PLB) which is the basket of all goods selected to determine poverty.
- Consumption quantity fixed the same for both rural and urban people but price differs-Daily per capita expenditure for Rural- Rs. 27
- Daily per capita expenditure for Urban- Rs. 33
- Results-Overall poverty- 37.2 Percent (in the year 2004-05)
- Rural- 41.8 Percent (in the year 2004-05)
- Urban- 25.7 Percent (in the year 2004-05)

(iii) Rangarajan Committee

- Formed in June 2012.
- Chairman- Rangarajan
- Submitted its report in June 2014.
- Again, adopted the calorie-based approach which was used in past.
- Daily per capita expenditure for Rural- Rs. 33
- Daily per capita expenditure for Urban- Rs. 47
- Results-Overall poverty- 29.5 Percent(in the year 2011-12)
- Rural- 30.9 Percent (in the year 2011-12)
- Urban- 26.4 Percent (in the year 2011-12)

(C) Reserve Bank of India Report 2012

- state having least poverty-Goa (5.09 Percent)
- Union territory having least poverty- Andaman and Nicobar(1 Percent)
- State having highest poverty- Chhattisgarh(39.93 Percent)

- Union territory having highest poverty-Dadra and Nagar Haveli (39.31 Percent)

(D) World Bank Report

Poverty line Whose income is less than 1.90 $ per day

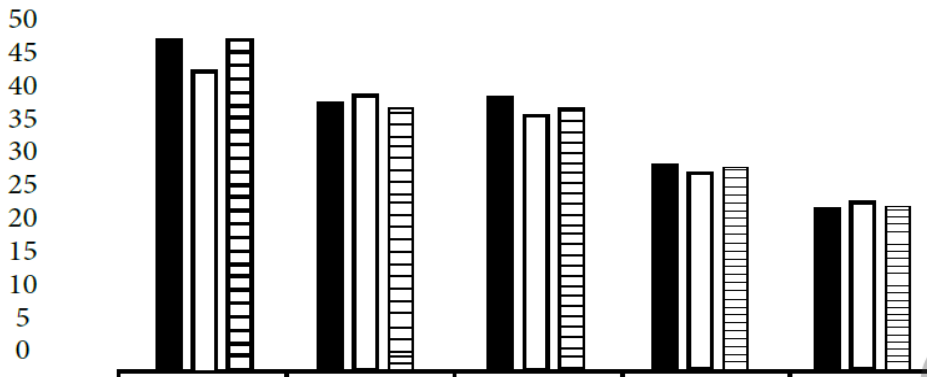
According to the 2015 world bank report- In 2011 India had 12.4 % people below the poverty

(E) Asian Development Bank Report

According to the 2015 Asian development Report , Poverty in India= 21.9 Percent (for 2014)

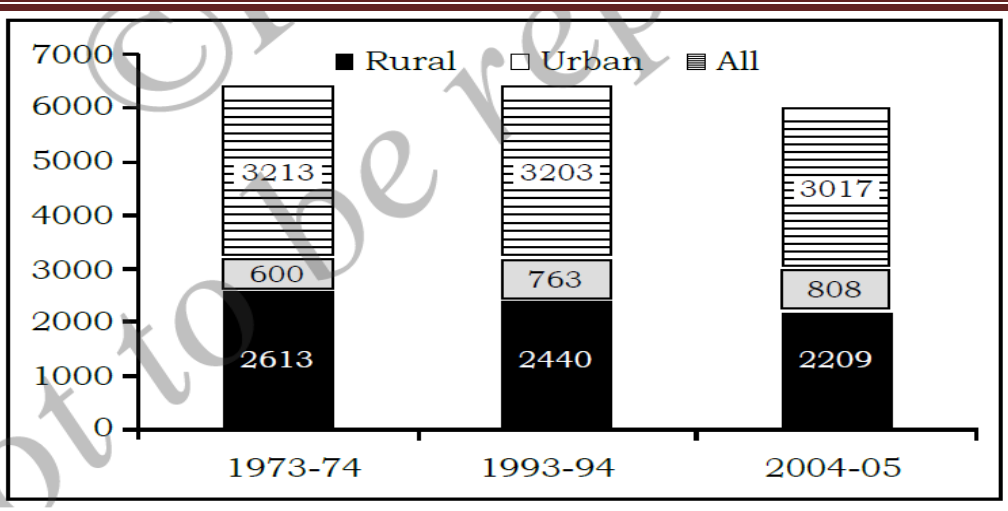
Extent of Poverty in India

Using the definition of poverty line as given by Committees and the data on consumer expenditure generated by the National Sample Survey Organization (NSSO), the number and percentage of people below poverty line have been estimated. Below given figure shows the trends in percentage of people below poverty line.



	1983	1987-88	1993-94	2004-06	2009-10
■ Rural	46-6	38-7	37-0	28-2	20-02
□ Urban	42-5	39-4	33-1	26-1	20.7
Total	46-7	38.9	36.0	27.7	20.3

Trends in Percentage People Below Poverty Line



Estimated number of poor in India (in lakhs)

Causes of Poverty in India

Poverty in India is due to interaction of many factors – historical, economic, social and political. However, the major economic factors that have contributed to the current poverty are :

1. Rapid increase in population: Rapid increase in the population is the major cause as any amount of development is going to be insufficient for providing the basic necessities to people.

2. Low level and growth of national income: Due to the general underdevelopment on the one hand and the rapid rise in population on the other, the percapita income has remained at lower level. This has created a vicious circle of poverty of low income, low savings, low investment, lower productivity and lower income growth. This has kept the people in poverty.

3. Rise in price level: Continuously rising prices have reduced the people's purchasing power, especially of those whose income is lower.

4. Unemployment: Inability of the development process to gainfully absorb the working population is another reason of poverty.

5. Capital deficiency: The low income and lower savings yielded less money for investment for growth of the country. Hence, there has been low and slow capital formation, resulting in low productivity and income earning capacity.

Hunger and Food security

The main features of poverty are hunger and penury. Poor families do not get food easily or adequately. They do not have the means to buy food. Thus, they face food insecurity. India as a whole faces serious hunger problem. In order to measure the

extent of hunger, the International Food Policy Research Institute (IFPRI) calculates the country wise hunger index and publishes in its annual publication 'Global Hunger Index (GHI)'.

Calculation of Global Hunger Index: It is calculated by combining the values of:

Undernourishment : *the proportion of undernourished people as a percentage of the population;*

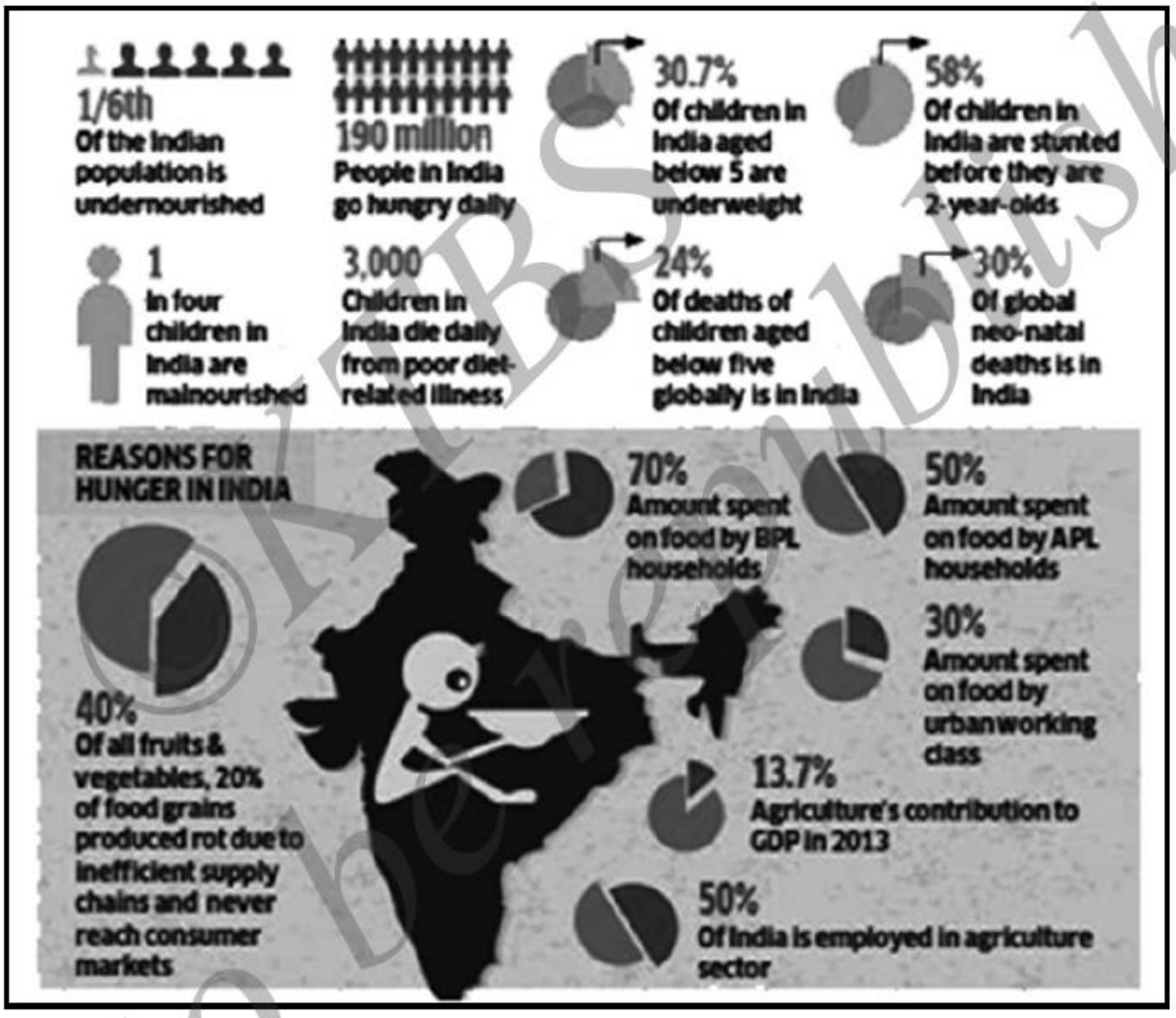
Child wasting : *the proportion of children under the age of five who suffer from low weight for their height;*

Child stunting : *the proportion of children under the age of five who suffer from low height for their age; and*

Child mortality : *the mortality rate of children under the age of five.*

As per the 2015 GHI, one out of every seven people in the world goes to bed without food every day. India's hunger index score is 29 and is put in 'serious' category and ranks 50th among the calculated list of 128 countries.
As per the 2018 GHI report- India has been ranked at the 103rd position among 119 countries.

According to recent National Family Health Survey, around 79% children and 58% pregnant women suffer from anemia in India. One in every two children and one woman among three women are under-weight. 42% of the world's under-weight children are in India. Anemia and under-weight are the results of hunger.



We have almost achieved self-sufficiency in production of food grains. We are the largest producers of milk in the world. Production of fruits and vegetables has also increased significantly. Therefore, it is paradoxical that still many people suffer from hunger and malnutrition in India. Lack of purchasing power among the poor, and the shortcomings in the distribution of food grains are the reasons for this paradox.

Food Security

Every person should be assured of minimum amount of food at an affordable price and it should be supplied nearer to where he stays. This
ensures food security. Providing food security is an affirmative step to improve the quality of life of people. What is food security?

Food Security : Food Security refers to the system which ensures the provision of food at all times to everyone in the country. Food security mean includes :

• providing sufficient food to all people in the country-availability of food

• increasing the purchasing power of the poor-affordability of food

• removing other hindrances for the poor while accessing and absorbing food-accessibility of food

The food security system consists of two aspects:

1. Buffer stock
2. Public Distribution System

Buffer stock: The government purchases the food grains from the farmers at minimum support prices. Food Corporation of India (FCI) was established in 1965 to purchase food grains and construct godowns for scientifically storing them. These stored grains are distributed among the people for consumption. This act of purchasing food grains and making them available for public distribution is called buffer stock operations. Buffer stock operation helps in overcoming the shortage of food.

Public Distribution System (PDS): The food grains procured by the FCI are distributed to the poor people at lesser than market prices through the fair price shops. This is called as the public distribution system. Food grains, sugar, kerosene, cooking oil and other essential items are distributed through these fair price shops. The government has taken steps to open fair price shops in all villages, towns and cities. There are around 5 lakh fair price depots in India today, and around 16 crore families are benefitting from them.

In order to purchase food grains through the fair price shops a household is provided with a ration card. Different types of cards are issued depending upon the economic status. These cards entitle specific quantities of various items to the people. The poor families are provided BPL (Below poverty line) ration cards which entitles them to a higher quantity of grains at very low price or sometimes at free of cost. Antyodaya Anna Yojana scheme is being implemented under which very poor families are distributed food grains at very low prices. Other households too receive a fixed amount of food grains every month. very poor families are distributed food

grains at very low prices. Other households too receive a fixed amount of food grains every month.

Apart from PDS, the government has implemented the Integrated Child Development Services (ICDS) for providing supplementary nutrition to children and pregnant women. Malnourished children and women are given higher quantity under the scheme. The Midday Meal Scheme has been introduced in all schools to provide at least one full meal to school children.

Anna Bhagya

Annabhagya, launched in 2013, is the most ambitious programme of the Government of Karnataka which aims at achieving a hunger-free state. Under the scheme, the government is providing food grains per person free of cost, which includes rice and wheat/ ragi/ jowar. Palm oil, iodised salt and sugar are also provided at highly subsidized price to BPL ration cards. Through this it is hoped to eliminate malnutrition.

Food security Act-2013

- Coverage and entitlement under Targeted Public Distribution System (TPDS) :Upto 75% of the rural population and 50% of the urban population will be covered under TPDS, with uniform entitlement of 5 kg per person per month. However, since Antyodaya Anna Yojana (AAY) households constitute poorest of the poor, and are presently entitled to 35 kg per household per month, entitlement of existing AAY households will be protected at 35 kg per household per month.
- Subsidised prices under TPDS and their revision :Foodgrains under TPDS will be made available at subsidised prices of Rs. 3/2/1 per kg for rice, wheat and coarse grains for a period of three years from the date of commencement of the Act.
- Nutritional Support to women and children :Pregnant women and lactating mothers and children in the age group of 6 months to 14 years will be entitled to meals as per prescribed nutritional norms under Integrated Child Development Services (ICDS) and Mid-Day Meal (MDM) schemes. Higher nutritional norms have been prescribed for malnourished children upto 6 years of age.

- Maternity Benefit :Pregnant women and lactating mothers will also be entitled to receive maternity benefit of not less than Rs. 6,000.
- Women Empowerment :Eldest woman of the household of age 18 years or above to be the head of the household for the purpose of issuing of ration cards.
- Grievance Redressal Mechanism :Grievance redressal mechanism at the District and State levels. States will have the flexibility to use the existing machinery or set up separate mechanism.

Poverty Alleviation Programmes

The government has taken many measures to reduce poverty through varied means. These measures aimed at creation of jobs to poor people, increase their purchasing power, and thus alleviate poverty. These measures can be classified into four groups. They are:

1. Economic development measures: Economic development and poverty are closely related. The extent of poverty declines with a country's economic development. The government has attempted to achieve economic development through five-year plans. The plans have aimed at overall higher growth rate in incomes and equal distribution of that income among all people.

2. Implementation of poverty eradication programmes: From 1960 onwards, the government has been implementing many programmes for providing mployment to people in the rural and urban areas. These programmes can be classified into two groups. They are:

a. Self-employment programmes: Many schemes to promote self-employment among the poor and unemployed people have been taken up by providing loans at low rates of interest and subsidies. Some significant schemes are:

- The 'Integrated Rural Development Programme' (IRDP) implemented in 1980.

- The 'Swarnajayanti Grama Swarozgar Yojana' (SGSY) implemented in 1999.
- The 'Swarnajayanti Shahari Rozgar Yojana (SSRY) implemented in 1997.
- The National Rural Livelihoods Mission (NRLM) also called as Deen Dayal Antyodaya Yojana implemented since 2011.

b. Wage Employment Programmes: Several wage employment programmes have been implemented since 1970 to provide jobs on a daily wage basis to poor, unskilled and asset less people. They are being given jobs in works related to creation of community assets like tanks and bunds, roads, schools, hospitals and others.

In 2006, 'Mahatma Gandhi National Rural Employment Guarantee Scheme' was launched. This has been the most ambitious daily wage program ever launched as it confers the 'right to work' to the needy and poor people. The scheme aims at providing wage employment for a minimum of 100 days in a year to at least one adult member of poor households. The statutory minimum wages are paid through bank or post office accounts and equal wages are paid to male and female workers. Desirous persons have to first register with the Gram Panchayat and obtain a 'job card'. If the registered job-aspirants are not given jobs within 15 days of demand for work, they are given the daily unemployment allowance at rates fixed by the government. This scheme has helped in improving employment and incomes of the poor people in many parts of the country.

3. Provision of minimum basic amenities: Many measures are taken to provide the minimum basic requirements of the rural poor like food, shelter, education, drinking water, hygiene, etc., and improve the quality of their lives. The 'Minimum Needs Programme (MNP)' was launched in 1974- 75. Food grains are being distributed to poor people through the fair price shops. Health insurance is being provided to poor people under 'Yashaswini'

scheme. Houses are constructed for the poor under 'Indira Awas Yojana' and 'Valmiki-Ambedkar Awas Yojana'; pure drinking water is provided to all households; toilets are constructed under 'Nirmal Gram' programme. In 2000, 'Pradhan Mantri Gramodaya Yojana' (PMGY) was implemented under which, the rural poor are provided primary education, primary health care, shelter, drinking water, rural lighting and other services.

4. Social Security Measures: The protection that the government provides to the helpless, the aged and the handicapped among the very poor people is called social security. Deserted old people get old age allowance every month under 'Sandhya Suraksha Yojana'. Handicapped people and helpless people incapable of doing any work get disability pension every month. Poor widows get widow pension every month.

2014-KAS

Consider the following rural development programmes :

1. Food for Work Programme
2. Community Development Programme
3. TRYSEM
4. IRDP

The correct chronological sequence of the launching of these programmes by the Government is

(a) 1, 2, 3, 4
(b) 2, 1, 4, 3
(c) 1, 2, 4, 3
(d) 2, 1, 3, 4

Unemployment in India:

An unemployed person is one who is willing to work at the prevailing wage rate but is unable to find work.

Unemployment is a phenomenon that occurs when a person who is capable of working and is actively searching for the work is unable to find work.

People who are either unfit for work due to physical reason or do not want to work are excluded from the category of unemployed.

The most frequent measure of unemployment is unemployment rate. The unemployment rate is defined as a number of unemployed people divided by the number of people in the labour force.

Labour Force: Persons who are either working (or employed) or seeking or available for work (or unemployed) during the reference period together constitute the labour force.

Measure of Unemployment in India

Usual Status Approach	Weekly Status Approach	Daily Status Approach
Usual Status approach records only those persons as unemployed who had no gainful work for a major time during **the 365 days preceding** the date of survey and are seeking or are available for work. The status of activity on which a person has spent the relatively long time of the preceding 365 days prior to the date of survey is considered to be the **usual principal activity status** of the person.	The weekly status approach records only those persons as unemployed who had no gainful work for a major time during **the seven days preceding** the date of survey.	In the Daily status approach, current activity status of the person with regard to whether employed or unemployed or outside labour force is recorded for each day in the reference week. The measure adopts half day as a unit of measurement for estimating employment or unemployment.

Types of Unemployment

Frictional Unemployment

- ✓ The minimum amount of unemployment that prevails in an economy due to workers quitting their previous jobs and are searching for the new jobs is called Frictional Unemployment.

- ✓ The major reasons for frictional unemployment are lack of information about the availability of jobs and lack of mobility on the part of workers (it means workers are not willing to travel to a distant place or a new state for employment).
- ✓ Frictionally unemployed person remains unemployed for a very short period of time.
- ✓ This type of unemployment is of voluntary nature.

Cyclical Unemployment:

Cyclical unemployment is due to deficiency or fall in effective demand from consumers which lead to fall in production and low demand for labour.

- ✓ Cyclical unemployment is a type of unemployment which is related to the cyclical trends of booms and recessions called as the business cycle.
- ✓ If an economy is doing good, cyclical unemployment will be at its lowest and will be the highest if the economy faces recession.
- ✓ The major reason for this type of unemployment is lack of demand in the economy and slowdown of economic activity.
- ✓ When the demand for goods and services is low, then the firms stop the production due to rise in the unsold stock. As a result of stopping production, the firms lay off workers and unemployment rises.
- ✓ This type of unemployment is for a long period of time and worker remains unemployed during the entire phase of slow down or recession.

Disguised Unemployment

- Disguised unemployment is a situation especially prevalent in poor and developing countries.

- Disguised unemployment is when too many people are employed than what is required to produce efficiently. This kind of employment is not at all productive.
- It is not productive in a sense that production does not suffer even if some of the employed people are withdrawn.
- The key point to remember is that the marginal productivity of labourers under disguised unemployment is zero. The labourers are employed physically, but not economically.
- Marginal productivity of labour is zero or very less.

Under Employment.

Underemployment is the most dangerous kind of unemployment in an economy. Underemployment is a situation under which People with a higher level of skills are employed in less productive jobs. It simply means that the Labour force of the economy is not fully utilized as per their skills and experience.

Example: an individual with an engineering or management degree working as a clerk or accountant in a firm or a social science graduate working as a pizza delivery boy.

Structural Unemployment	Seasonal Unemployment
Structural unemployment refers to a situation which arises due to change in the structure of the economy. Example: An economy transforms itself from a Labour intensive economy to a Capital intensive economy. Structural unemployment usually occurs due to the mismatch of skills. Example, due to advance technological progress, the production of cars is done through robotic machines rather than traditional Machines. As a result, those workers who do know how to operate the new and advanced machines will be removed. The unemployment happened because the current workers do not have the required skills as wanted by their employers.	Seasonal unemployment occurs during certain seasons of the year. In some industries and occupations like agriculture, holiday resorts etc., production activities take place only in some seasons. Therefore, they offer employment for only a certain period of time in a year. People engaged in such type of activities may remain unemployed during the off-season.
Technological Advancement, Robotics, Artificial Intelligence, Mechanisation and Automation are the main causes of Structural unemployment.	Seasonal unemployment mainly occurs in Agricultural sector, Tourism sector and in factories producing seasonal goods.

Causes of Unemployment in India

The major causes of unemployment in India are:

1. Jobless Growth: In the recent days, the growth of Indian economy has been described as jobless. Since 1990's, Indian economic growth is mainly based on manufacturing and service sector. The use of modern technology resulted in low level of employment creation. The low level of growth in primary sector curtailed the job opportunities at rural level. Thus it resulted in a jobless growth.

2. Increase in labour force: Population growth has been adding more labour force to the market. In rural areas, whereas on account of growing labour force unemployment has increased mainly in disguised form, in urban areas it is open and visible.

3. Inappropriate technology: In India, the technology being used in agriculture and industries has become increasingly capital intensive leading to less labour absorption.

4. Dependence on agriculture: Agriculture being a seasonal activity, a large proportion of workers engaged in farming are compelled to remain idle for three to four months in a year.

5. Decline of small scale and cottage industries : The decline of small scale industries which have the capacity to generate significant amount of jobs is another cause of unemployment.

6. Low mobility of labour: Labour mobility is very low in India. Because of their family loyalty, people generally avoid migrating to far-off places for work. Factors like diversity of language, religion and customs also contribute to low mobility. Lower mobility causes greater unemployment.

Employment Generation Programmes in India

Each five year plan implemented had aimed at reducing unemployment. The central and state governments have implemented varied employment generation programmes. They aim at enabling people to generate self employment by starting their own enterprises and also to create wage employment, especially for the unskilled workers.

The following are some of the important employment programmes adopted in India.

Rural Areas

1977 : Food For Work Programme

1979 : Training Rural Youth for Self Employment (Trysem)

1980 : Integrated Rural Development Programme (IRDP)

1980 : National Rural Employment Programme (NREP)

1983 : Rural landless Employment Guarantee Programme (RLEGP)

1989 : Jawahar Rozgar Yojana (JRY)

1993 : Employment Assurance Scheme (EAS)

1999 : Swarna Jayanti Gram Swarojgar Yojana

2004 : National Food for Work programme

2006 : National Rural Employment Guarantee Scheme (NREGS)

Urban Areas

1989 : Nehru Rozgar Yojana (NRY)

1990 : Scheme of Urban wage Employment (SUWE)

1993 : Prime Minister Rozgar Yojana (PMRY)

1997 : Swarna Jayanti Shahari Rojgar Yojana (SJSRY)

Therefore, depending on the need and context, the governments have devised schemes to increase employment opportunities to the people in both urban and rural areas.

Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA)

The MGNREGA, also known as Mahatma Gandhi National Rural Employment Guarantee Scheme (MNREGS), was enacted on August 25, 2005. Implemented with effect from 2-2-2006, it provides a legal guarantee for one hundred days of employment in every financial year

to adult members of any rural household willing to do public work related unskilled manual work at the statutory minimum wage. If the government fails to do so, then

the person is given unemployment allowance. NREGA covers the entire country with the exception of districts that have a hundred percent urban population.

According to a report of the National Council of Applied Economic Research (NCAER), the MGNREGS is the world's largest anti-poverty programme, and has been successful in reducing poverty and empowering women. Outlining the positive impact of MGNREGA, the report said that for the first time women are being paid at par with men, and that women outnumber men in the job scheme. As many of the women got work for the first time, their household income levels also went up. The MGNREGA has also boosted access to a bank account by women as the wages are transferred electronically to the beneficiary's account. However, like its predecessor employment schemes, MGNREGA is also not poorly implemented and monitored. Further, its implementation is not so encouraging in the backward states. Thus, the programme has not achieved expected results.

AGRICULTURAL SECTOR

Before 1947

India's economy under the British colonial rule remained fundamentally agrarian — about 85 per cent of the country's population lived mostly in villages and derived livelihood directly or indirectly from agriculture. However, despite being the occupation of such a large population, the agricultural sector continued to experience stagnation and, not infrequently, unusual deterioration. Agricultural productivity became low though, in absolute terms, the sector experienced some growth due to the expansion of the aggregate area under cultivation. This stagnation in the agricultural sector was caused mainly because of the various systems of land settlement that were introduced by the colonial government. Particularly, under the *zamindari* system which was implemented in the then Bengal Presidency comprising

parts of India's present-day eastern states, the profit accruing out of the agriculture sector went to the *zamindars* instead of the cultivators. However, a considerable number of *zamindars,* and not just the colonial government, did nothing to improve the condition of agriculture. The main

interest of the *zamindars* was only to collect rent regardless of the economic condition of the cultivators; this caused immense misery and social tension among the latter. To a very great extent, the terms of the revenue settlement were also responsible for the *zamindars* adopting such an attitude; dates for

depositing specified sums of revenue were fixed, failing which the *zamindars* were to lose their rights. Besides this, low levels of technology, lack of irrigation facilities and negligible use of fertilisers, all added up to aggravate the plight of the farmers and contributed to the dismal level of agricultural productivity. There was, of course, some evidence of a relatively higher yield of cash crops in certain areas of the country due to commercialisation of agricultue. But this could hardly help farmers in improving their economic condition as, instead of producing food crops, now they were producing cash crops which were to be ultimately used by British industries back home. Despite some progress made in irrigation, India's agriculture was starved of investment in terracing, flood-control, drainage and desalinisation of soil. While a small section of farmers changed their cropping pattern from food crops to commercial crops, a large section of tenants, small farmers and sharecroppers neither had resources and technology nor had incentive to invest in agriculure.

1947-1990

Land Reforms: At the time of independence, the land tenure system was characterised by intermediaries (variously called *zamindars, jagirdars* etc.) who merely collected rent from the actual tillers of the soil without contributing towards improvements on the farm. The low productivity of the agricultural sector forced India to import food from the United States of America (U.S.A.). Equity in agriculture called for land reforms which primarily refer to change in the ownership of

landholdings. Just a year after independence, steps were taken to abolish intermediaries and to make the tillers the owners of land. The idea behind this move was that ownership of land would give incentives to the tillers to invest in making improvements provided sufficient capital was made available to them. Land ceiling was another policy to promote equity in the agricultural sector. This means fixing the maximum size of land which could be owned by an individual. The purpose of land ceiling was to reduce the concentration of land ownership in a few hands. The abolition of intermediaries meant that some 200 lakh tenants came into direct contact with the government — they were thus freed from being exploited by the *zamindars*. The ownership conferred on tenants gave them the incentive to increase output and this contributed to growth in agriculture. However, the goal of equity was not fully served by abolition of intermediaries. In some areas the former *zamindars* continued to own large areas of land by making use of some loopholes in the legislation; there were cases where tenants were evicted and the landowners claimed to be selfcultivators (the actual tillers), claiming ownership of the land; and even when the tillers got ownership of land, the poorest of the agricultural labourers (such as sharecroppers and landless labourers) did not benefit from land reforms.
The land ceiling legislation also faced hurdles. The big landlords challenged the legislation in the courts, delaying its implementation. They used this delay to register their lands in the name of close relatives, thereby escaping from the legislation. The legislation also had a lot of loopholes which were exploited by the big landholders to retain their land. Land reforms were successful in Kerala and West Bengal because these states had governments committed to the policy of land to the tiller. Unfortunately other states did not have the same level of commitment and vast inequality in landholding continues to this day.

The Green Revolution: At independence, about 75 per cent of the country's population was dependent on agriculture. Productivity in the agricultural sector was very low because of the use of old technology and the absence of required infrastructure for the vast majority of farmers. India's agriculture vitally depends on the monsoon and if the monsoon fell short the farmers were in trouble unless they had access to irrigation facilities which very few had. The stagnation in agriculture during the colonial rule was permanently broken by the green revolution. This refers

to the large increase in production of food grains resulting from the use of high yielding variety (HYV) seeds especially for wheat and rice. The use of these seeds required the use of fertiliser and pesticide in the correct quantities as well as regular supply of water; the application of these inputs in correct proportions is vital. The farmers who could benefit from HYV seeds required reliable irrigation facilities as well as the financial resources to purchase
fertiliser and pesticide. As a result, in the first phase of the green revolution (approximately mid 1960s upto mid 1970s), the use of HYV seeds was restricted to the more affluent states such as Punjab, Andhra Pradesh and Tamil Nadu. Further, the use of HYV seeds primarily benefited the wheat growing regions only. In the second phase of the green revolution (mid-1970s to mid-1980s), the HYV technology spread to a larger number of states and benefited more variety of crops. The spread of green revolution technology enabled India to achieve self-sufficiency in food grains; we no longer had to be at the mercy of America, or any other nation, for meeting our nation's food requirements.

Growth in agricultural output is important but it is not enough. If a large proportion of this increase is consumed by the farmers themselves instead of being sold in the market, the higher output will not make much of a difference to the economy as a whole. If, on the other hand, a substantial amount of agricultural produce is sold in the market by the farmers, the higher output can make a difference to the economy. The portion of agricultural produce which is sold in the market by the farmers is called marketed surplus. A good proportion of the rice and wheat produced during the green revolution period (available as marketed surplus) was sold by the farmers in the market. As a result, the price of food grains declined relative to other items of consumption. The low income groups, who spend a large percentage of their income on food, benefited from this decline in relative prices. The green revolution enabled the government to procure sufficient amount of food grains to build a stock which could be used in times of food shortage.

While the nation had immensely benefited from the green revolution, the technology involved was not free from risks. One such risk was the possibility that it would increase the disparities between small and big farmers—since only the big farmers could afford the required inputs, thereby reaping most of the benefits of the green revolution. Moreover, the HYV crops were also more prone to attack by pests and

the small farmers who adopted this technology could lose everything in a pest attack. Fortunately, these fears did not come true because of the steps taken by the government. The government provided loans at a low interest rate to small farmers and subsidised fertilisers so that small farmers could also have access to the needed inputs. Since the small farmers could obtain the required inputs, the output on small farms equalled the output on large farms in the course of time. As a result, the green revolution benefited the small as well as rich farmers. The risk of the small farmers being ruined when pests attack their crops was considerably reduced by the services rendered by research institutes established by the government. You should note that the green revolution would have favoured the rich farmers only if the state did not play an extensive role in ensuring that the small farmer also gains from the new technology.

post 1991

Reforms in Agriculture: Reforms have not been able to benefit agriculture, where the growth rate has been decelerating. Public investment in agriculture sector especially in infrastructure, which includes irrigation, power, roads, market linkages and research and extension (which played a crucial role in the Green Revolution), has fallen in the reform period. Further, the removal of fertilizer subsidy has led to increase in the cost of production, which has severely affected the small and marginal farmers. This sector has been experiencing a number of policy changes such as reduction in import duties on agricultural products, removal of minimum support price and lifting of quantitative restrictions on agricultural products; these have adversely affected Indian farmers as they now have to face increased international competition. Moreover, because of export oriented policy strategies in agriculture, there has been a shift from production for the domestic market towards production for the export market focusing on cash crops in lieu of production of food grains. This puts pressure on prices of food grains.

INDUSTRIAL SECTOR

Before independence:

As in the case of agriculture, so also in manufacturing, India could not develop a sound industrial base under the colonial rule. Even as the country's world famous handicraft industries declined, no corresponding modern industrial base was allowed to come up to take pride of place so long enjoyed by the former. The primary motive of the colonial government behind this policy of systematically reindustrializing India was two-fold. The intention was, first, to reduce India to the status of a mere exporter of important raw materials for the upcoming modern industries in Britain and, second, to turn India into a sprawling market for the finished products of those industries so that their continued expansion could be ensured to the maximum advantage of their home country — Britain. In the unfolding economic scenario, the decline of the indigenous handicraft industries created not only massive unemployment in India but also a new demand in the Indian consumer market, which was now deprived of the supply of locally made goods. This demand was profitably met by the increasing imports of cheap manufactured goods from Britain.

During the second half of the nineteenth century, modern industry began to take root in India but its progress remained very slow. Initially, this development was confined to the setting up of cotton and jute textile mills. The cotton textile mills, mainly dominated by Indians, were located in the western parts of the country, namely, Maharashtra and Gujarat, while the jute mills dominated by the foreigners were mainly concentrated in Bengal. Subsequently, the iron and steel industries began coming up in the beginning of the twentieth century. The Tata Iron and Steel Company (TISCO) was incorporated in 1907. A few other industries in the fields of sugar, cement, paper etc. came up after the Second World War. However, there was hardly any capital goods industry to help promote further industrialisation in India. Capital goods industry means industries which can produce machine tools which are, in turn, used for producing articles for current consumption. The establishment of a few manufacturing units here and there was no substitute to the near wholesale displacement of the country's traditional handicraft industries. Furthermore, the growth rate of the new industrial sector and its contribution to the Gross Domestic Product (GDP) remained very small. Another significant drawback of the new industrial sector was the very limited area of operation of the public

sector. This sector remained confine only to the railways, power generation, communications, ports and some other departmental undertakings.

1947-1990

Industrial Policy Resolution 1956 (IPR 1956):

In accordance with the goal of the state controlling the commanding heights of the economy, the Industrial Policy Resolution of 1956 was adopted. This resolution formed the basis of the Second Five Year Plan, the plan which tried to build the basis for a socialist pattern of society.

This resolution classified industries into three categories:

- ✓ The first category comprised industries which would be exclusively owned by the state
- ✓ the second category consisted of industries in which the private sector could supplement the efforts of the state sector, with the state taking the sole responsibility for starting new units;
- ✓ the third category consisted of the remaining industries which were to be in the private sector.

Although there was a category of industries left to the private sector, the sector was kept under state control through a system of licenses. No new industry was allowed unless a license was obtained from the government. This policy was used for promoting industry in backward regions; it was easier to obtain a license if the industrial unit was established in an economically backward area. In addition, such units were given certain concessions such as tax benefits and electricity at a lower tariff. The purpose of this policy was to promote regional equality. Even an existing industry had to obtain a license for expanding output or for diversifying production (producing a new variety of goods). This was meant to ensure that the quantity of goods produced was not more than what the economy required. License to expand production was given only if the
government was convinced that the economy required a larger quantity of goods.

Small-Scale Industry: In 1955, the Village and Small-Scale Industries Committee, also called the Karve Committee, noted the possibility of using small-scale

industries for promoting rural development. A 'small-scale industry' is defined with reference to the maximum investment allowed on the assets of a unit.

This limit has changed over a period of time. In 1950 a small-scale industrial unit was one which invested a maximum of rupees five lakh; at present the maximum investment allowed is rupees one crore. It is believed that small-scale industries are more 'labour intensive' i.e., they use more labour than the large-scale industries and, therefore, generate more employment. But these industries cannot compete with the big industrial firms; it is obvious that development of small-scale industry requires them to be shielded from the large firms. For this purpose, the production of a number of products was reserved for the small-scale industry; the criterion of reservation being the ability of these units to manufacture the goods. They were also given concessions such as lower excise duty and bank loans at lower interest rates.

Economic Crisis of 1991 and Indian Economy Reforms

Crisis in India is figured out because of the inefficient management of Indian Economy in 1980s. The revenues generated by the government were not adequate to meet the growing expenses. So, the government resorted to borrowing to pay for its debts and was caught is a debt-trap.

Causes of Economic Crisis

Different causes of economic crisis are given as under

(i) The continued spending on development programmes of the government did not generate additional revenue.

(ii) The government was not able to generate sufficient funds from internal sources such as taxation.

(iii) Expenditure on areas like social sector and defence do not provide immediate returns, so there was a need to utilise the rest of its revenue in a highly effective manner, which the government failed to do.

(iv) The income from public sector undertakings was also not very high to meet the growing expenditures.

(v) Foreign exchange borrowed from other countries and international financial institutions was spent on meeting consumption needs and to make repayments on other loans.

(vi) No effort was made to reduce such increased spending and sufficient attention was not given to boost exports to pay for die growing needs. Due to above stated reasons, in the late 1980s, government expenditure began to exceed its revenue by such large margins that meeting the expenditure through borrowings became unsustainable.

Need for Economic Reforms

The economic policy followed by the government upto 1990 failed in many aspects and landed the country in an unprecedented economic crisis. The situation was so alarming that India's reserves of foreign exchange were barely enough to pay for two weeks of imports. New loans were not available and NRIs were withdrawing large amounts. There was an erosion of confidence of international investors in the Indian economy.

The following points highlight the need for economic reforms in the country

(i) Increasing fiscal deficit

(ii) Adverse Balance of Payments

(iii) Gulf crisis

(iv) Rise in prices

(v) Poor performance of Public Sector Units (PSUs).

(vi) High rate of deficit financing.

(vii) Collapse of soviet bloc.

Emergence of New Economic Policy (NEP)

Finally, India approached International Bank for Reconstitution and Development, popularly known as World Bank and International Monetary Fund (IMF) and received $ 7 million as loan to manage the crisis. International agencies expected India to liberalise and open up economy by removhfg restrictions on private sector and remove trade restrictions between India and other countries. India agreed to conditions of World Bank and IMF and had announced New Economic Polity (NEP) which consist of wide range of economic reforms.

The measures adopted in the New Economic Policy can be broadly classified into two groups i.e.,

(i) Stablisation Measures They are short-term measures which were intended to correct some weakness that have developed in the Balance of Payments and to bring Inflation under control.

(ii) Structural Reforms They are longterm measures, aimed at improving the efficiency of the economy and increasing its international competiveness by removing the rigidities in various segments of the Indian economy. The various structural reforms are categorised as

- Liberalisation
- Privatisation
- Globalisation

Balance of Payment It is a system of recording country's economic transactions with the rest of the world over a period of one year. Inflation It is a situation in which general price level of goods and services increases in an economy over a period of time.

Economic Reforms Under Liberalisation:

Industrial Sector Reforms

The following steps were taken to deregulate the industrial sector

(i) Abolition of Industrial Licensing Government abolished the licensing requirement of all industries, except for the five industries, which are

- Liquor
- Cigarettes
- Defence equipment
- Industrial explosives
- Dangerous chemicals, chugs and pharmaceuticals.

(ii) Contraction of Public Sector The number of industries reserved for the public sector was reduced from 17 to 8. At present, only three industries are reserved for public sector. They are

- Railways

• Atomic energy
• Defence(Recently, private players are allowed in this sector also.)

(iii) De-reservation of Production Areas

The production areas which were earlier reserved for SSI were de-reserved.

(iv) Expansion of Production Capacity The producer's were allowed to expand their production capacity according to market demand. The need for licensing was abolished.

(v) Freedom to Import Capital Goods The business and production units were given freedom to import capital goods to upgrade their technology.

Other reforms under Liberalization:

Financial Sector Reforms Financial sector includes financial institutions such as commercial banks, investment banks, stock exchange operations and foreign exchange market.

The following reforms were initiated in this sector

(i) Reducing Various Ratio Statutory Liquidity Ratio (SLR) was lowered from 38.5% to 25%.

Cash Reserve Ratio (CRR) was lowered from 15% to 4.1%.

(ii) Competition from New Private Sector Banks The banking sector was opened for the private sector. This led to an increase in competition and expansion of services for consumers.

(iii) Change in the Role of RBI RBI's role underwent a change from a 'regulator' to a 'facilitator'.

(iv) De-regulation of Interest Rates Except for savings accounts, banks were able to decide their own interest rates

Tax Reforms/Fiscal Reforms

Tax reforms are concerned with the reforms in government's taxation and public expenditure policies which are collectively known as its fiscal policy. Moderate and Simplified Tax Structure Prior to 1991, the tax rates in the country were quite high, which led to tax evasion. The fiscal reforms simplified the tax

structure and lowered the rates of taxation. This reduced tax-evasion and increased government's revenues.

Foreign Exchange Reforms/External Sector Reforms

External sector reforms include reforms relating to foreign exchange and foreign trade. The following reforms were initiated in this sector

(i) Devaluation of Rupee Devaluation implies a fall in the value of rupee against some foreign currency. In 1991, the rupee was devalued to increase our country's exports and to discourage imports.

(ii) Other Measures

• Import quotas were abolished.

• Policy of import licensing was almost scrapped.

• Import duty was reduced.

• Export duty was completely withdrawn.

Economic Growth During Reforms Growth of an economy is measured by the Gross Domestic Product (GDP). The growth of GDP increased from 5.6% during 1980-91 to 8.2% during 2007-2012.

Main highlights of economic growth during reforms are given below

(i) During the reform period, the growth of agriculture has declined. While the industrial sector reported fluctuation, the growth of service sector has gone up. This indicates that the growth is mainly driven by the growth in the service sector.

(ii) The opening up of the economy has led to rapid increase in foreign direct investment and foreign exchange reserves. The foreign investment, which includes Foreign

– Direct Investment (FDI) and Foreign Institutional Investment(FII), has increased from about US $ 100 million in 1990-91 to US $ 400 billion in 2010-11.

(iii) There has been an increase in the foreign exchange Reserves from about US $ 6 billion in 1990-91 to US $ 300 billion in 2011-12. In 2011, India is the seventh largest foreign exchange reserve holder in the world.

Failures of Economic Reforms I- Neglect of Agriculture

There has been deterioration in agricultural growth rate. This deterioration is the root cause of the problem of rural distress that reached crisis in some parts of the country. Economic reforms have not been able to benefit the agricultural sector because

(i) Public investment in agriculture sector especially in infrastructure which includes irrigation, power, roads, market linkages and research and extension has been reduced in the reform period.

(ii) The removal of fertiliser subsidy has led to increase in the cost of production which has severely affected the small and marginal formers.

(iii) Various policy changes like reduction in import duties on agricultural products, removal of minimum support price and lifting of quantitative restrictions have increased the threat of* international competition to the Indian formers.

(iv) Export-oriented policy strategies in agriculture has been a shift from production for the domestic market towards production for the export market focusing on cash crops in lieu of production of food grains.

II- Uneven Growth in Industrial Sector

Industrial sector registered uneven growth during this period. This is because of decreasing demand of industrial products due to various reasons

(i) Cheaper imports have decreased the demand for domestic industrial goods.

(ii) Globalisation created conditions for the free movement of goods and services from foreign countries that adversely affected the local industries and employment opportunities in developing countries.

(iii) There was inadequate investment in infrastructural facilities such as power supply. (iv) A developing country like India still does not have the access to

developed countries markets because of high non-tariff barriers.

55. The increase in the volume of imports during the Third Five Year Plan, that is from 1961-1962 to 1965-1966 was due to

1. Rapid industrialization necessitated larger imports of machinery, equipment industrial raw materials, etc.
2. The defence needs increased following aggression by China and Pakistan.
3. Extensive crop failure in 1965-66 necessitated the import of a large quantity of food grains.
4. Imports are anti-inflationary because they reduce the scarcity of consumer goods.

Select the correct answer using the codes given below :

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

2014-KAS

59. The sub-division and fragmentation of land holdings in India are becoming more & more serious for reason/s

1. The pressure of population on land.
2. The laws of inheritance and succession.
3. The breakup of the joint-family system.
4. The growing indebtedness of small & marginal farmers.

2014-KAS

Select the correct answer using the codes given below :

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

2011-KAS

Since 2000 – 01, India's export of services has been largely contributed by

(1) Business services
(2) Financial services
(3) Software services
(4) Communication services

62. The requirement of Industrial Licensing (Industrial Policy of 1991) has been abolished for all but 5 product categories, these are

(a) Alcohol, Cigarettes, hazardous chemicals, industrial explosives, electronic aerospace and defence equipments of all types and agricultural products.

(b) Alcohol, Cigarettes, hazardous chemicals, industrial explosives and electronic aerospace and defence equipments of all types.

2014-KAS

(c) Alcohol, Cigarettes, hazardous chemicals, industrial explosives and defence equipments.

(d) Cigarettes, hazardous chemicals, industrial explosives, electronic aerospace and defence equipments.