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MAINSTORMING 2019

ECONOMY & AGRICULTURE I

Shankar IAS Academy™

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MAINSTORMING 2019

ECONOMICS & AGRICULTURE I (JUNE 2018 TO FEBRUARY 2019)

1. GROWTH AND DEVELOPMENT

1.1 IMF's Projection on India

Why in news?

International Monetary Fund (IMF) has posited India as the world's growth engine for the next 30 years.

What are the findings of IMF?

- IMF has projected a medium-term growth rate of 7.75% on the back of macro-financial and structural policies to help boost inclusive growth.
- The GST and the insolvency code are expected to lift India's productivity.
- This will also lead to an increase in investment activity to 32.2% of GDP in 2018-19, against 30.6% in 2017-18.
- It also projected a 13.2% increase in exports this year and 10.1% the next.

What are the macroeconomic concerns of India?

- The current account deficit (CAD) is estimated at 2.6% this fiscal and 2.2% in the next.
- The rising oil prices and strong demand for imports offset by a slight increase in remittances.
- Whether a rising CAD can create situations of volatility on the external account is a moot point.
- It is not clear on what basis the IMF is banking on an improvement in investment, which has dipped from 34.2% of GDP in 2014-15 to 30.6% now.
- There isn't convincing evidence of any surge in demand in agriculture, industry and services.
- Apart from this an area of acute concern is India's poor socio-economic indicators, affecting both labour productivity and technological up gradation.

What measures needs to be taken?

- IMF suggests that public dis savings should be curtailed to curb the CAD.
- In this situation, the reliance on FDI and portfolio flows cannot be underestimated.
- A projected headline inflation of 5.2% in 2018-19 is way above the Reserve Bank's comfort level, with the IMF hoping for a prudent fiscal policy to keep it in check.
- Reducing trade documentation requirements, lowering tariffs and generally improving governance may avoid choking of growth.
- Despite supply-side reforms, which have pushed India up several notches in the 'ease of doing business index', investment needs a demand stimulus.

1.2 Back Series GDP Data

Why in news?

- The report on back series GDP data by an expert committee set up by National Statistical Commission (NSC) was released recently.
- It has led to debates on the validity of the figures, and the MoSPI has termed the estimates 'unofficial'.

What is the report on?

- Back series calculations are done to link a new series of national accounts with an old series.
- This gives a better comparison of growth over the years.
- The NSC had constituted a Committee on Real Sector Statistics under the Chairmanship of Sudipto Mundle in 2017.

- The objective was improvement and modernisation of the real sector database.
- The committee has worked out a back series for economic growth from 1994-95.

What is the complication?

- The report compared growth rates between old series (2004-05) and new series based on 2011-12 prices.
- E.g. As per the old series (2004-05), the expansion in the GDP at constant prices was 9.57% during 2006-07.
- As per the new series (2011-12), the growth number stands revised at 10.08%.
- The committee has thus adjusted the GDP figures from 2005-06 to 2014-15.
- This was based on the new base period adopted in 2015 (from 2004-05 to 2011-12).
- Notably, the series was for the new form of calculation of gross domestic product (GDP) and gross value added (GVA).
- GVA gives a picture of the state of economic activity from the producers' side or supply side.
- On the other hand, GDP gives the picture from the consumers' side or demand perspective.
- The back series calculation has been complicated because of the change in methodology.
- As, some of the data used under the new methodology is not available for earlier years.
- These recommendations of the NSC Committee will be examined by MoSPI and other experts.
- The appropriate methodology to be adopted for generating the back series estimates will then be decided.
- The data would be released officially later by the MoSPI.

What are the highlights?

- The GDP growth, calculated at market prices, touched double digits twice - in 2007-08 and in 2010-11.
- The overall trend follows a spurt in growth during the boom of the mid-2000s.
- It is followed by a sharp deceleration in 2008-09, the year of the global financial crisis.
- GDP growth at factor cost went down from 9.3% in 2007-08 to 6.7% in the crisis year.
- However, there was a quick recovery, with unprecedented increase in public spending and subsidies in that year.
- The stimulus helped the economy reach boom-level heights in the first years of the second UPA government.
- But a combination of over-extension, high oil prices and administrative paralysis following the anti-corruption movement caused a swift fall.
- The country went down to 5.4% growth in 2012-13 but recovery then began in 2013-14.
- It was benefitted from the current government's cautious approach to macroeconomic stability.
- Also, rapidly improving global growth and a sharp fall in oil prices helped.

What does it imply?

- The broad structural trends in the Indian economy have not been changed by these figures.
- The average growth rate under the current NDA does not reach the levels achieved under either the first or second terms of the UPA.
- The back series reveals again that much of the expansion in the 2000s was driven by government action.
- This is the period when GDP growth is higher than GVA growth.
- (Both measures need not match because of the difference in treatment of net taxes)
- This means that subsidies are increasing more than indirect taxes.
- Worryingly, there was no major upward momentum since the broad recovery that began in 2012-13.
- This is despite the fact that global growth has largely recovered, in the past few quarters in particular.

1.3 Understanding Back Series GDP Data

What is the issue?

- An expert committee set up by National Statistical Commission (NSC) released recently the report on back series GDP data.
- In this context, it is essential to understand certain aspects associated with the report and the calculations.

What was the 2015 shift?

- In 2015, the government moved to a new base year of 2011-12 from the earlier 2004-05 for national income accounting.
- The base year of national accounts had been revised earlier in 2010.
- In the new series, the Central Statistics Office (CSO) did away with Gross Domestic Product (GDP) at factor cost.
- It adopted the international practice of valuing industry-wise estimates as gross value added (GVA) at basic prices.

What was its effect?

- With the new base year, the growth rate of the economy for 2013-14 was estimated at 6.9%.
- But notably, it was 4.7% on the 2004-05 base.
- Similarly, the growth rate for 2012-13 was revised upwards to 5.1% from 4.5%.
- Growth of the manufacturing sector also became higher in the new series.

What was the resultant challenge?

- **MCA-21** - It is an e-governance initiative of the Ministry of Company Affairs (MCA) that was launched in 2006.
- It allows firms to electronically file their financial results and advance filing of corporate accounts to calculate national accounts.
- The CSO, as usual, used the establishment-based datasets.
- These are Index of Industrial Production (IIP) and Annual Survey of Industries (ASI).
- But apart from this, it started to use the enterprise-level corporate database of MCA-21.
- **Data** - With the above change, for years preceding 2011-12, the CSO faced issues for evaluating GDP with the new base year.
- This was due to the lack of availability of the MCA-21 database.
- Hence the back series calculation proved to be a "major statistical challenge".

What does the GDP, GVA difference imply?

- As per the new methodology, CSO calculates GDP by adding product taxes to the GVA at basic prices, and removing subsidies.
- [GDP = GVA at basic prices + Product taxes - subsidies on products]
- GDP, which incorporates indirect tax collections net of subsidies, should normally be higher than GVA.
- But if net indirect tax collections grow slower than subsidies, GVA could be higher than GDP.
- The new series shows that on at least 12 occasions out of 18 until 2011-12, GVA was higher than GDP.
- This is possibly because fertiliser subsidy was scaled up significantly from 2005-06 following poor agricultural growth.

1.4 Understanding 8.2% GDP Growth

Why in news?

The GDP estimates show that the economy grew at the rate of 8.2% in the first quarter of 2018 (April-June).

What is the anomaly in it?

- Despite the impressive growth, a feel-good sentiment has been largely missing.
- There is also confusion on how to interpret the growth while the economy faces various serious issues like
    1. the depreciating rupee,
    2. rising bank bad loans, or NPAs,
    3. a trade deficit that has shot up to a five-year high,
    4. and retail fuel prices that are inching up every day.

What is the reason for the anomaly?

- **Base effect -** A part of the reason for this is the low base, which has produced a statistical effect, making growth appear faster.
- **Sectoral differences -** Some parts of the economy grew faster, while a few others did not.
- Agricultural GDP growth quickened as two successive years of good rains improved farm produce.
- Manufacturing and construction industries, that were dealt a severe shock by demonetisation, recovered.
- Services growth slowed. The sector includes trade, hotels and transport, and the financial, real estate and professional services as well as public administration and defence services.
- Services sector largely represents the economic sentiment of the urban and semi-urban Indians.
- Hence the poor performance of services probably explains the sense of disconnect with the growth estimate being expressed in some quarters.
- **Consumption -** Private consumption expenditure growth has quickened, relative to the preceding quarter, as well as compared to the same quarter last year.

So what drives the current GDP growth?

- The current GDP growth is largely driven by consumption.
- There are further suggestions that a consumption boom is in the making.
- This is possibly driven by the government salary and pension hikes including at the State level.
- Consumer industries are also reporting robust rural sales growth.

What is the need for caution?

- **Unsustainablity** - The high growth in the years preceding the 2008 global financial crisis was driven by savings and investments.
- The global economic downturn disrupted this trend and hence investments slowed down.
- There were expectations that this would revive, but the economy is still not out of the investments slowdown.
- So the GDP growth continues to be powered by consumption, and not investments.
- This is a cause for concern as the consumption-led growth is sustainable only up to a point.
- **Quarterly estimates** - The estimates for the upcoming quarters will not enjoy the benefit of the low-base effect.
- Moreover, the first quarter estimates are early indicators, which may not necessarily be representative of the remaining months.

1.5 Revised estimates of GDP

Why in news?

The Union Ministry of Statistics and Programme Implementation has recently released its revised estimates of national income for 2017-18.

What does the data reveal?

- The CSO in its advance estimate had pegged the GDP growth rate for **2018-19** at 7.2%.

- Growth in real GDP for **2017-18**was revised upwards to 7.2% from the earlier estimate of 6.7%.
- It also revised the actual growth rate in **2016-17** to 8.2% from the 7.1% estimated earlier.
- This relatively slow growth in 2017-18, when compared to 2016-17, is explained as due to a slowdown in manufacturing, communications, agriculture and mining.
- Thus, it appears that growth immediately following the demonetisation exercise of November 2016 was not too badly affected on the one hand.
- On the other hand, it appears there might have been something of a deceleration in 2017-18 following that high growth in 2016-17.
- Also, the gross fixed capital formation (GFCF) as a proportion of gross domestic product went up marginally from 28.2% to 28.6% in the two years under consideration.
- The government says that estimates of GDP have undergone revision on account of the use of the latest data available on agricultural production, industrial production, and government expenditure.
- It is also due to more comprehensive data available from various source agencies like the MCA and the NABARD and State/Union Territory Directorates of Economics and Statistics.

What are the concerns?

- Though GFSF was raised, much of this was driven by government spending, and the proportion of household investment in GFCF fell.
- Thus, it is not clear that private investment recovery had taken hold in 2017-18.
- A major concern was laid upon in the demonetisation year of 2016-17, which shows a strong growth in sectors that were widely agreed to have been badly hit by the exercise.
- For 2016-17, a hike of 1.1% in GDP growth was cited.
- The main factor for this was cited as the increase in private final consumption expenditure, which has also increased 1 percentage point.
- But post-demonetisation, people hold less cash to make purchases and hence it creates questions whether there was actually an increase in household expenditure.
- Also, it was cited that the main driver of the upward revision on the output side in 2016-17 was the construction sector, which has been revised upwards by 4.7%.
- However, Construction is also a sector which has a large informal sector component and all earlier analyses had indicated that demonetisation adversely affected the informal sectors.
- Also, the other two main drivers of the upward revision — the mining and quarrying sector and the public administration sector, have data that is compiled by the government itself.
- So, it was criticised as it should not have undergone such a vast revision.

2. PUBLIC FINANCE

2.1 Assessing the GST Regime

What is the issue?

With one year of GST in place, a retrospective look at its impact, particularly for industry and services sector, becomes essential.

What was the objective?

- 'One nation one tax' was the philosophy and narrative of the government for GST.
- It was also a part of the vision to improve India's ranking in 'ease of doing business'.
- GST thus aims at addressing the country's complex indirect tax framework.

What are the favourable aspects?

- Governments have had an open approach towards GST implementation constraints.

- They have undertaken immediate corrective measure to resolve issues.
- The GST Council has demonstrated a collaborative effort and consensus-based approach.
- The government thus carried out a rate rationalisation exercise.
- This was to reduce rates on about 178 items from 28% to 18%.
- This had a positive effect to an extent, reducing the tax burden.

What are the concerns?

- **Rate changes** - Given the short time-line, it resulted in several challenges for business.
- As, they had to revise their IT systems overnight.
- Revising pricing labels, revising pricing strategy were the other challenges.
- Besides, some had to deposit huge sums of money due to anti-profiteering for failing to execute required changes in time.
- **E-Way Bill** - This was one of the major changes on the supply chain and logistics front.
- This was to ensure common documentation for movement of goods across the country.
- But the e-way bill provisions are not uniform across States.
- This has diluted the very objective of a common e-way bill.
- It has created problems for businesses operating with pan-India presence.
- As, they had to set up State-wise e-way bill systems.
- **Services Sector** -Under the Constitution's framework, State and Centre collaborate for taxing a particular services transaction.
- Logically, there have been implementation challenges in terms of billing for pan-India contracts, and State-wise credit pools.
- Also, the sector is dealing with challenges around intra entity supplies and input service distribution.
- **Compliance** - One aspect that affected all the sectors was filing three parts of the monthly return for regular dealers.
- This had to be done with matching of the invoice-level details of the supplier with that of the recipient of supply.
- Government has abandoned its original plan and instead implemented a simplified return without any matching concept.
- This is, however, only on a temporary basis.

What next?

- Next wave of GST is likely to include products that are currently not in the ambit of GST.
- These may include petroleum products, alcohol and real estate.
- Changes are expected to be made to the GST law in the next Parliament session.
- The GST Council has been working on this draft to address some of the key issues.
- The objective of GST to improve the ease of doing business largely depends on further appropriate streamlining of the regime.

How has it impacted revenues?

- Despite its glitches and snarls, the new tax has taken firm root and is altering the economic landscape positively.
- Over 4.5 million entities have entered the tax net, many of which would have so far been part of the cash-driven, informal economy.
- Thus, GST has significantly expanded the indirect tax net, which might also positively impact the direct tax base.

- Significantly, clear buoyancy in revenue after a wobbly initial trend is already perceptible, and monthly revenue targets are exceeding estimated sums.
- Government was eyeing about Rs. 90,000 crores a month to make up for the revenues earned under the earlier regime (& for compensating some states).
- But interestingly, Finance Ministry has recently expressed confidence that collections would touch as much as Rs. 110,000 crore per month in this year.

2.2 CBDT's Decision on Tax Appeals

Why in news?

CBDT has reportedly announced a new scheme aimed at a speedier disposal of tax appeals.

What is the status of Tax appeals in India?

- Every tax appeal before the CBDT comes to the First Appellate Forum (FAF) before cases move on to the Income Tax Appellate Tribunals, the high courts and finally the Supreme Court of India.
- The number of appeals before the FAF has been rising and now total over 320,000.
- As of March 31, 2018 the amount involved is over 55% of estimated collections for the current financial year.
- By its recent move CBDT aims to reduce litigation and enhance the credibility of tax administration in order to secure a fair system.
- CBDT's move is with regard to dealing with issues causing tax disputes, the latest move incentivises CIT(A)s to actually further enhance assessments.
- It aims to do so by adhering to stiff timelines for disposing of cases and by instilling a sense of accountability in the whole process.

What are the concerns with CBDT's move?

- While all measures of CBDT are commendable, the method chosen by the government to achieve it is likely to be counter-productive.
- As part of the CBDT Action Plan, Commissioners of Income Tax (Appeals), or CIT (A), will be given additional credits of two units per order in case they pass what is called a "quality" order.
- Quality orders essentially include those that strengthen the assessment order of an assessing officer and levy penalties on such orders.
- But CIT(A) levy penalties when, under law, its proceedings are supposed to be independent of the assessment process.
- Incentivising CIT(A) to enhance assessment orders introduces a conflict of interest given that the CIT(A)'s quality order will be judged by his immediate supervisor, i.e. the chief commissioner.
- It also undermines its impartiality as he or she is prejudiced against the concerned taxpayer.
- Given that such credits might well be used in determining career growth, they will lead to decisions that will increase litigation further, instead of its stated objective of reducing it.

2.3 CBDT Time Series Data

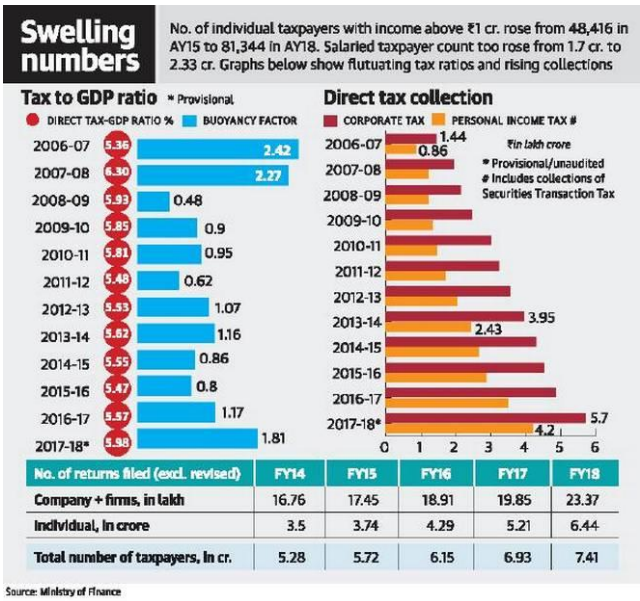
Why in news?

CBDT released the new time series data (same data points recorded at regular intervals) as updated up to FY 2017-18.

What are the highlights?

- **Returns** - The direct tax base has significantly widened in the last few years.
- There is a growth of more than 80% in the number of returns filed in the last four financial years.
- They rose from 3.79 crore in FY 2013-14 to 6.85 crore (these figures include revised returns) in FY 2017-18.

- Further, the number of persons filing income tax returns also increased by about 65% during this period.
- **Income** - The CBDT made public the income-distribution data for assessment year (AY) 2016-17 and AY 2017-18.
- There has been a continuous increase in the amount of income declared.
- This is true with all categories of taxpayers, over the last three assessment years.
- For AY 2014-15, corresponding to FY 2013-14 (base year), the return filers had declared gross total income of Rs. 26.92 lakh crore.
- This has increased by 67% to Rs. 44.88 lakh crore for AY 2017-18.
- This shows a higher level of compliance resulting from various legislative and administrative measures, including the enforcement measures against tax evasion.
- **Taxpayers** - The overall number of taxpayers declaring an income above Rs. 1 crore a year saw a sharp growth of about 60% over the 3 years under consideration.



No. of returns filed (excl. revised)	FY14	FY15	FY16	FY17	FY18
Company + firms, in lakh	16.76	17.45	18.91	19.85	23.37
Individual, in crore	3.5	3.74	4.29	5.21	6.44
Total number of taxpayers, in cr.	5.28	5.72	6.15	6.93	7.41

- This included corporates, firms, and Hindu Undivided Families.
- Likewise, the number of individual taxpayers disclosing income above Rs. 1 crore saw a growth of 68% in this period.
- There is also an improvement in the compliance of salaried taxpayers.
- It rose from 1.70 crore for AY 2014-15 to 2.33 crore for AY 2017-18, an increase of 37%.
- The average income declared by these salaried taxpayers has also gone up by 19%.
- In the same period, there has been a growth of 19% in the number of non-salaried individual taxpayers.
- Also, the average non-salary income declared rose by 27% between AY 2014-15 and AY 2017-18.
- **Tax-GDP ratio** - The direct tax-GDP ratio rose to 5.98% in FY 2017-18, the highest it has been in the last 10 years.

What were the driving factors for widening tax base?

- Some of the reasons for increase in the number of tax returns include -
  1. the effect of demonetisation
  2. the increase in the use of information being collected digitally and being used by the tax department
  3. the movement towards digital assessment and decrease in the number of cases being picked up for scrutiny
  4. the ease of getting refund, majorly by small and medium taxpayers
- **TDS** - The system of tax deduction at source (TDS) is mandated by law on all those who make payments above a specified level in a year.
- It allows the tax department to mobilise income-tax and corporation tax without much hassle or additional cost.
- In 2014-15, the share of TDS in gross direct tax receipts was about 32% and had risen to 36% last year.
- **Advance taxes** - Advance tax is the payment of income tax in advance instead of lump sum payment at year end i.e. 'pay as you earn tax'.
- The combined share of these two instruments (TDS and advance tax) in total direct tax collections is almost 76%.

- Also, the cost of direct tax collections has come down from a high of 0.66% of total revenue garnered in 2016-17 to 0.61% in 2017-18.

What is the concern with direct taxes share?

- The contribution of direct taxes to the total amount of taxes collected rose every year through the first decade of this century.
- It increased from around 36% in 2000-01 to nearly 60% in 2009-10.
- But this was reversed in 2010-11, when the share fell to around 56%.
- Also, thereafter, despite spikes in some years, the broad trend has been that of decline.
- The share of direct taxes has fallen every single year since 2013-14, except this year.
- It is about 52% in 2017-18, but less than the 2009-2010 peak of 60%.
- So most of the rise in the total tax collection in the last few years has come from indirect tax collections.

2.4 Interim Budget 2019

Why in news?

Interim Finance Minister Piyush Goyal presented the Interim Budget on 1st February 2019.

What are the fey announcements?

State of the Economy

- India is the fastest growing major economy in the world.
- India is now the 6th largest economy in the world (11th in 2013-14)
- Inflation - 4.6%
- Fiscal deficit - 3.4% of GDP
- Current Account Deficit (CAD) - 2.5% of GDP
- FDI $239 billion during the last 5 years.
- Tax collections increased from Rs.6.38 Lakh Cr in 2013-14 to almost Rs.12 lakh Cr this year.
- The number of returns filed has also almost doubled showing 80%.
- The State revenues are improving with guaranteed 14% annual revenue increase for the first five years from GST.

Vision for the next Decade

- Becoming a $5 Trillion Economy in the next 5 years
- $10 Trillion Dollar Economy in the next 8 years thereafter
- 10 Dimensions to concentrate are-
  1. Physical as well as social infrastructure for a $10 Trillion Dollar Economy and to provide ease of living
  2. Creating a Digital India reaching every sector of the economy,
  3. Making India pollution free
  4. Expanding rural industrialisation
  5. Clean Rivers, with safe drinking water
  6. Development powered by coastline and ocean waters
  7. Outer skies
  8. Self-sufficiency in food
  9. A healthy India
  10. Minimum Government Maximum Governance nation

Poor and backward classes

Rs.60,000 crores are being allocated for MGNREGA in BE 2019-20.

Farmers

- **Pradhan Mantri KIsan SAmman Nidhi (PM-KISAN*)*** is announced to provide an direct income support at the rate of `6,000 per year' to vulnerable landholding farmer families, having cultivable land upto 2 hectares.

Click here to know more on the scheme

- **Rashtriya Kamdhenu Aayog** will be setup to upscale sustainable genetic up-gradation of cow resources and to enhance production and productivity of cows.
- India is the second largest fish producing nation in the world accounting for 6.3% of global production and an annual growth > 7%.
- **Department of Fisheries** will be created to provide focused attention.
- 2% interest subvention to the farmers pursuing the activities of animal husbandry and fisheries, who avail loan through **Kisan Credit Card**.
- In case of timely repayment of loan, they will also get an additional 3% interest subvention.
- **Natural calamities -** Generally the crop loans are rescheduled for farmers affected by severe natural calamities.
- Now, these farmers affected by natural calamities, where assistance is provided from NDRF, will be provided with 2% interest subvention and prompt repayment incentive of 3% for the entire period of reschedulement of their loans. (at present it is 2% only for the first year)

Labour and Workers Dignity

- 42 crore workers in the unorganised sector
- **Pradhan MantriShram-Yogi Maandhan**to providea monthly pension of Rs.3,000 from the age of 60 years on a contribution of a small affordable amount by the worker during their working age for the unorganised sector workers with monthlyincome upto ` 15,000.
    1. Rs.100/month for a worker joining at the age of 29 years
    2. Rs. 55/month for a worker joining at the age of 18 years
    3. The Government will deposit equal matching share
- A **Committee under NITI Aayog** will be set up to complete the task of identifying De-notified, Nomadic and Semi-Nomadic communities not yet formally classified.
- A **Welfare Development Board** will also set up under the Ministry of Social Justice and Empowerment specifically for the purpose of implementing welfare and development programmes for these communities.

Empowering Youth

- **National Programme on 'Artificial Intelligence'** will be implemented by establishing a National Centre on Artificial Intelligence as a hub along with Centres of Excellence
- A National Artificial Intelligence portal will also be developed.

Empowering MSMEs and Traders

- **Government e-Marketplace (GeM)** is now being extended to all CPSEs.
- Department of Industrial Policy and Promotion, which will now be renamed as the **Department for Promotion of Industries and Internal Trade** as it was recently assigned the subject of "promotion of internal trade including retail trading and welfare of traders, and their employees".

National Security

- Defence Budget will be crossing Rs.3,00,000 crore for the first time in 2019-20.

Infrastructure

- **Vande Bharat Express** will the first indigenously developed and manufactured semi high-speed train that will give the Indian passengers world class experience with speed, service and safety.
- Total Railway Budget is of Rs.1,58,658 crore.
- Specific recommendations of a high level **Inter-Ministerial Committee** to transform the system of bidding for exploration and to change from revenue sharing to exploration programme for Category II and III basins will be implemented.

Digital India

- **Digital Villages initiative** will connect as many as 1 lakh villages with the digital services offered by the Government, within the next 5 years with the assistance of Common Service Centres (CSCs).

Entertainment

- Single window clearance for ease of shooting films will be available to Indian filmmakers. (Earlier it was available only to foreigners).
- Anti-camcording provisions in the Cinematograph Act will be introduced.

Customs and Trading Across Border Reforms

- **Abolition of Customs duties on 36 capital goods** along with introduction of single point of approval are introduced under section 65 of the Customs Act.
- Full digitalization of export/import transactions and leveraging RFID technology to improve export logistics are being introduced.

Tax

- **Rebate -** Individual taxpayers having taxable annual income up to Rs.5 lakhs will get full tax rebate and therefore will not be required to pay any income tax.
- Besides, under section 80C, a deduction of Rs 1,50,000 can be claimed from total income, for investments made in LIC, PPF, Mediclaim, incurred towards tuition fees, etc.
- So effectively persons having gross income up to Rs.6.50 lakhs may not be required to pay any income tax if they make such investments.
- **Deductions -** Additional deductions such as interest on home loan up to Rs.2 lakh, interest on education loans, NPS contributions, medical insurance, medical expenditure on senior citizens etc, are announced.
- **Standard Deduction -** For salaried persons, a Standard Deduction is raised to Rs.50,000 from Rs.40,000 i.e Rs.50,000 can be exempted from Taxatioon.
- **TDS threshold** - TDS threshold on interest earned on bank/post office deposits is being raised from Rs.10,000 to Rs.40,000.
- **Housing & Real Estate –**
  1. Income tax on notional rent on a **second self-occupied house** is also now exempted.
  2. TDS threshold for deduction of tax on rent is to be increased from Rs.1,80,000 to Rs.2,40,000.
  3. **Rollover of capital gains** under section 54 of the Income Tax Act will be increased from investment in one residential house to two residential houses for a tax payer having capital gains up to Rs.2 crore. This benefit can be availed once in a life time.
  4. **Section 80-IBA -** Tax on notional rent, on unsold inventories, has been exempted from one year to two years, from the end of the year in which the project is completed (applicable to project approved till 31st March, 2020).

What are the positives?

- **Small taxpayers -** Various proposals announced in the interim Budget are aimed to ease tax burden on salaried class, small taxpayers as well as passive income earners such as senior citizens.
- In the absence of a social security net or unemployment benefits for unorganised sector workforce, the new pension scheme will be of significant advantage.
- **Tax net** - The limit of Income-tax Rebate has now been increased to Rs 12,500 from Rs 2,500 for taxpayers having income up to Rs. 5 lakh.

- But people will have to file returns to earn a rebate, thus enlarging the tax base.
- **Reduced red tape** - The complicated filing forms, elaborate disclosures, demand notices and scrutiny assessments have been concerns for individual taxpayers.
- The 2019 Budget has now promised to process tax returns within 24 hours with quick refunds and move scrutiny assessments wholly to the electronic mode.
- **Real Estate -** Tax policies of governments in recent years have controlled the Indian investors' obsession for real estate, and have directed them towards financial investments.
- But signalling a change of stance, the 2019 Budget has proposals that would work as significant incentives for home buyers.

What are the criticisms?

- There has been a general perception that this elaborate interim Budget is aimed at seeking votes.
- e.g PM-KISAN will benefit over 120 million farmer families, among which a third of these families live in UP and Bihar. The electoral benefit of such a scheme is very evident.
- Schemes towards benefitting middle class is also seen as identifying and targeting the sections of population that are in distress and unhappy with the Centre.
- No Interim Budget in the past announced a new programme with as huge an annual expenditure outlay as the Rs 75,000 crore, thus breaking precedence of minimum spending during election years.
- While these sops will benefit sections of the population, the question is
- No Interim Budget in the past also announced as big an income-tax concession.
- So it is not right for a government that will be in power for few months to constitute a financial burden for the coming years as well.

2.5 Relaxation in LTCG

Why in news?

A proposal was made in 2019 Budget to relax the condition required for saving on long term capital gains (LTCG) made on the sale of a residential property.

What is the current norm under Sec 54 of IT Act?

- Gain from sale of a residential property (land, house or apartment) within 2 years of its purchase is considered short-term capital gain (STCG).
- After two years, the gain is considered long-term capital gains (LTCG).
- While STCG is taxed at the slab rate, LTCG is taxed at the rate of 20.6% (including cess) with indexation done for property (by applying CII (cost inflation index)).
- So currently, Section 54 of the Income-tax Act, 1961 offers a benefit of rollover of capital gains on sale of property.
- This means that the otherwise taxable proceeds (from sale of property) is allowed to be reinvested (rolled over) within a specified time and with certain preconditions, for exemption from capital gains tax.
- Under this, LTCG arising from the sale of an immovable property is exempt from tax if the profit is reinvested in a single property or other specified instruments, within the stipulated timeline.
- The assessee needs to buy the new property within 1 year before the date of transfer of the property or 2 years after the transfer.
- In case of under-construction properties, the construction needs to be completed within 3 years from the date of transfer.
- However, if the person is unable to stick to these conditions, the amount may be deposited in a public sector bank (or other banks as per the Capital Gains Account Scheme, 1988).
- Also, currently, the above exemption cannot be claimed for properties bought or constructed outside India.

What is the relaxation made now?

- The benefit of rollover of capital gains under section 54 of the IT Act will be now increased from investment in one residential house to two residential houses.
- This will be applicable for a taxpayer having capital gains up to Rs 2 crore.
- Also, this benefit can be availed only once in a life time.
- So if one spreads out the capital gains in 2 different properties, the next time s/he has LTCG from sale of a house, s/he has to restrict only to one property to avail the benefit.

2.6 Easing of Conditions for Angel tax

Why in news?

Following the concerns raised earlier, the Centre has decided to ease the conditions for angel tax/taxing investments in start-ups.

What is angel tax?

- An angel investor is one who provides capital for a business start-up, usually in exchange for convertible debt or ownership equity.
- In simple terms, angel tax is the tax levied on such investments made by external investors in startups or companies.
- At times, capital is raised by unlisted companies via issue of shares where the share price is seen in excess of the 'fair market value' of the shares sold.
- So the entire investment is not taxed but only the amount that is considered above "fair value" valuations of the startup.
- Currently, funds from angels are subjected to over 30% tax if it is more than the fair market value (FMV).
- It was introduced in the 2012 Union Budget to arrest laundering of illegal wealth by means of investments in the shares of unlisted private companies at extraordinary valuations.
- However, under certain conditions, exemption to startups is offered under Section 56 of the Income Tax Act.

What are the concerns with it?

- The share issued to an investor has to be valued to decide whether the price is in excess of fair value.
- The valuation of a startup is usually based on a commercial negotiation between the company and the investor.
- It is based on the company's 'projected earnings' at that point in time.
- However, as startups operate in a highly uncertain environment, many are not always able to perform as per their financial projection.
- Equally, some companies exceed the projection if they are doing well.
- Resultantly, startups are often valued subjectively and it causes differing interpretations of "fair value".
- Startups are thus vulnerable to unduly high taxes because the taxman feels the investment is too high over their valuation.

What are the new proposals?

- The proposals aim to simplify the process of exemptions for Startups under section 56 of the Income Tax act.
- An entity shall be considered a startup up to 10 years from its date of incorporation / registration instead of the existing period of 7 years.
- The turnover for any of the financial years since its incorporation/registration should not have exceeded Rs 100 crore (instead of the existing Rs 25 crore).
- All investments into eligible startups by Non-Residents, Alternate Investment Funds-Category I registered with SEBI shall also be exempt under Section 56 of IT Act.

How will it benefit?

- Stringent rules on angel tax have had an adverse effect on investor confidence in startups.

- So the relaxations will help the start-ups which are in desperate need for capital to fund their growth and other business requirements.
- Further, the new rules are set to be applied retrospectively.
- So many young companies that have received notices from the IT Department in the last few years will be relieved by the change in rules.

What are the continuing concerns?

- Companies wishing to make use of the latest exemption will first have to be registered with the government as start-ups.
- To be classified so, a company should not have invested in any land unrelated to the business, vehicles worth over Rs.10 lakh, or jewellery.
- These requirements (aimed at preventing money-laundering) can lead to considerable bureaucratic delays and rent-seeking.
- Also, the concerns with calculation methodology on evaluating the share prices against the fair market value are not addressed yet.
- Notably, it is impossible to know the market value, let alone the fair market value, of shares that are not openly traded in the marketplace.
- So despite the relaxations, the rules can again cause the old problem of arbitrary tax demands by tax authorities.
- In all, unless the government addresses the arbitrary nature of the angel tax, the damage to investor confidence may remain.

2.7 RBI's Interim Dividend to the Government

Why in news?

The RBI recently approved an interim dividend (surplus transfer) payout of Rs 28,000 crore to the government.

How does the RBI generate surplus?

- **Income** - A central bank's income comes largely from the returns it earns on its foreign currency assets.
- This could be in the form of bonds and treasury bills of other central banks or top-rated securities, deposits with other central banks.
- Other sources include the -
  - i. interest it earns on its holdings of local rupee-denominated government bonds or securities
  - ii. management commission on handling the borrowings of state governments and the central government
- The RBI buys these financial assets against its -
  - i. fixed liabilities such as currency held by the public
  - ii. deposits issued to commercial banks
- **Expenditure** - A central bank's expenditure is mainly on the printing of currency notes.
- Other components include the expenditures -
  - i. on staff
  - ii. on commissions to banks for undertaking transactions on behalf of the government across the country
  - iii. on commissions to primary dealers, including banks, for underwriting some of the borrowings
- **Surplus** - Generally, the central bank's total expenditure is only about a seventh of its total net interest income.
- This implies that it certainly generates a large surplus out of the excess of income over expenditure.

What is an interim dividend?

- The surplus transfer is generally done in early August, after the completion of the bank's July-June accounting year.
- The RBI had thus already transferred Rs 40,000 crore to the government in August 2018.
- So the current one is an interim transfer, in addition to the usual one.
- With this, the government will get a total of Rs 68,000 crore from the central bank in the current fiscal.

Why is it transferred to the government?

- The central bank transfers its surplus to the government under the provisions of Section 47 of the Reserve Bank of India Act, 1934.
- The Government of India is the sole owner of India's central bank, the RBI.
- So the government can make a legitimate claim to this surplus.
- Also, by virtue of its role as the manager of the country's currency, the RBI generates more surplus than the entire public sector put together.
- So this surplus, in effect, belongs entirely to the country's citizens.
- Given this, the RBI pays the remaining surplus after setting aside what is needed to be retained as equity capital to maintain its creditworthiness.

Is giving extra dividends a problem?

- Much of the surplus that the RBI generates comes from the interest on government assets, or from the capital gains through other market participants.
- When this is paid to the government as dividend, the RBI is actually putting back into the system the money it has made from it.
- Logically, there is no additional money-printing or reserve-creation involved.
- But when the RBI pays an additional dividend to the government, it has to create additional permanent reserves i.e. it has to print money.
- Instead, to compensate for the special dividend, the RBI would have to withdraw an equivalent amount of money from the public.
- The RBI does this by selling government bonds in its portfolio.
- Besides, all central banks worry that large payouts could limit their ability to create buffers to make up for the impact of a crisis.

What does surplus transfer say about government finances?

- This is the second year running that the RBI has paid an interim dividend to the government.
- Last year, the RBI paid out an interim dividend of Rs 10,000 crore.
- Notably, during periods of high growth as seen during the last decade, the government does not make demands on RBI's surplus.
- But the government has asked for an interim surplus for the financial year 2018-19 as well as the amount retained by the RBI from surpluses of the previous two years.
- So surplus transfer from the RBI does indicate that the government finances are under pressure.
- The current transfer is expected to help keep the fiscal deficit at the projected 3.4% of GDP for 2018-19.

How is it elsewhere?

- Almost all central banks, the US Federal Reserve, Bank of England, Reserve Bank of Australia and Germany's Bundesbank are owned by their respective governments.
- They have to transfer their surplus or profits to the Treasury, or the equivalent of India's Finance Ministry.
- The UK has a formal Memorandum of Understanding on the financial relationship between the Treasury and the Bank of England.
- It lays down a clear framework for passing on 100% of net profits to the government.

- The US Fed too, transfers all its net earnings to the Treasury.

3. INFLATION

3.1 Repo Rate Hike

Why in news?

The monetary policy committee (MPC) of the RBI has decided to increase the repo rate by 25 basis points.

What are the driving factors?

- **Inflation** - Fear of rising inflation rates has been a major factor for raising the policy rates.
- According to the RBI, inflation outlook is likely to be shaped by several factors:

1. The foremost is the government's decision to increase the minimum support price (MSP) for kharif crops.

MSP hike may have a direct impact on food inflation and eventually on headline inflation.

2. The gradual impact of HRA (house rent allowance) revision by state governments could push inflation further up.
3. There is a continuing volatility in crude oil prices and is also vulnerable to geopolitical tensions.

The resultant supply disruptions is one of the main risks to the inflation outlook.

4. Rainfall has so far been 6% below the long-period average and deficient over a wider area than last year.

This has resulted in a drop in the total sown area under kharif.

Regional imbalances in rainfall could pose risks to paddy output and eventually reflect in CPI inflation.

5. The recent round of the RBI's survey of households also reported a rising inflationary trend.
6. Moreover, RBI's inflation projection stands at 5% in the first quarter of 2019-20.

It has projected inflation at 4.6% in Q2 and 4.8% in the second half of the financial year 2018-19, with risks evenly balanced.

So the overall inflation trend demands that India opt for a tight policy (higher rates).

Repo Rate

- Repurchase rate or the repo rate is the rate at which the RBI lends money to commercial banks.
- This is availed by the banks in the event of any shortfall of funds.
- Reverse repo is the rate at which the RBI borrows money from commercial banks within the country.
- RBI has now increased the repo rate by 25 basis points to 6.5% in the recent MPC meet.
- The Reverse repo is adjusted to 6.25 per cent.

- **Currency** - The recent global trade war has resulted in competitive currency devaluation.
- In the event of a currency war, the domestic currency has to give way for depreciation pressure of the region.
- But depreciation is likely to contribute to the vulnerability of the economy. Click here to know more
- Thus, avoiding such risks is essential for ensuring macroeconomic stability.
- It is also crucial for maximising the chances of a growth profile of 7 to 7.5% in India.
- A rate hike by the central bank thus attempts to strengthen the currency and avoid getting affected by the currency war.
- **Recovery** - The MPC was for long wary of an interest rate hike due to the impact it could have on growth prospects.
- However, there was an increased output of the eight core industries in the recent period.
- This suggested that the economic recovery was back on track.
- It was thus convincing for MPC to now focus on containing headline inflation.
- Given all these, the rate hike seems to be a right measure at the right time to ensure growth as well as avoid risks.

Why a neutral stance?

- Given the projected inflationary risks, there were widespread demands for higher policy rates.
- But the RBI has maintained fairly a neutral policy stance.
- This means that RBI has made only a marginal increase which is proportionately lesser to the inflation projections.
- One of the reasons is that the risks that are cited as the factors for the rate hike are not well established.
- Primarily, the CPI inflation risks are only a projection, though informed, with a fair bit of uncertainty.
- Hence a neutral stance would help accommodate the upcoming domestic and external uncertainties.
- This could be in relation with the
    i. impact of government's policies
    ii. oil price direction
    iii. trade disputes and impact on global growth
    iv. US rate trajectory
- So according to RBI, a neutral stance would keep the policy options open for any future economic scenario.

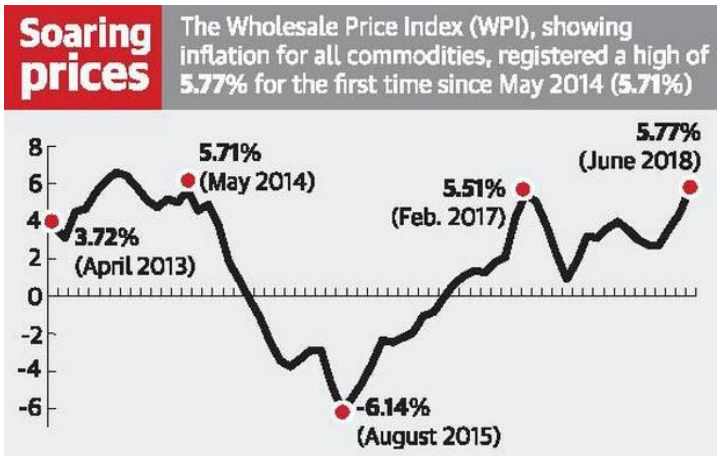
3.2 Four-Year High Wholesale Price Inflation

What is the issue?

- The Wholesale Price Index (WPI) rose 5.77% on a year-on-year basis to a 54-month high in June 2018.
- The inflation scenario demands a closer look at the macro-economic conditions.

What are CPI and WPI?

- Both measure the inflationary trends i.e. movement of price signals within the broader economy.
- WPI tracks year-on-year wholesale inflation at the producer or factory gate level.
- It is a marker for price movements in the purchase of bulk inputs by traders.
- Consumer Price Index (CPI) tracks changes in prices levels at the shop end.
- It is thus reflective of the inflation experienced at the level of consumers.
- The two indices differ in the manner in which weightages are assigned.
- This applies to food, fuel and manufactured items as well as their sub-segments.
- E.g. weightage of food in CPI is far higher (46%) than in WPI (24%).
- Also, WPI does not capture changes in the prices of services but CPI does.
- **What are the driving factors for WPI rise?**
- Rising crude oil prices has persistently driven inflation.
- Inflation in the fuel and power group has risen every month in the recent period.
- Food articles, especially vegetables, have been on a rising trend as well.
- The inflation in politically sensitive duo of potatoes and onions is a notable cause.
- Manufactured products (largest weight in the WPI) are also on an inflationary trend.
- WPI rise is also to be seen from the perspective of an unfavourable base effect.



- It is the effect of the previous year taken as the base for calculation.
- This is because the WPI inflation in June 2017 was just 0.9%.

Is WPI rise a concern?

- **Policy** - In 2014, RBI had adopted CPI as its key measure of inflation from the earlier WPI.
- India thus shifted to CPI as the benchmark for deciding policy rates (e.g. repo rate).
- Accordingly, RBI has a target to keep consumer-level inflation at 4% (+/- 2%).
- Any rise in CPI inflation beyond this comfort zone pressurises RBI to hike interest rates.
- So WPI rise might not appear relevant from a policy perspective.
- **Economy** - However, price changes at the producer level usually get transmitted to the consumers.
- But this could come with a time lag or may not be to the full extent of the impact at the producer level.
- So, the apprehensions with a higher WPI may not be valid at all times.
- Nevertheless, a steady rise in WPI is certainly an indicator of an overall inflationary pressure.
- It reflects the unbalanced conditions within the broader economy.
- **Retail** - There is a concern of a cascading effect of WPI increase on the CPI.
- This remains even after discounting for the base effect.
- Evidently, the retail inflation (CPI) had risen to a 5-month high of 5% in June, 2018.

How does it affect growth?

- Inflation-growth relationship is "significantly negative" if inflation is above a threshold value.
- It is "insignificant or significantly positive" if inflation is below the threshold value.
- Simply, inflation to a certain extent is favourable to the economy, above which it becomes harmful.
- But generally, the threshold values in developing countries are relatively higher.
- In India's case, roughly 4 to 5.5% inflation is said to be the range, above which it retards GDP growth rate.
- But substantial gains can be achieved if inflation is kept below the threshold.
- **How does the future look?**
- Government has recently decided to increase the minimum support price for kharif crops.
- A possible inflationary pressure due to this exists already.
- On the other hand, inflationary trend has reinforced the expectations of a repo rate hike.
- As, rate hike would be a measure of controlling the inflationary trend.
- However, IMF in a recent update has said the Indian economy will grow slower than estimated earlier.
- It has also cut India's growth projection for 2018-19 by 10 basis points to 7.3%.
- The pressure on growth due to the added impacts of inflation and faster interest rate hikes is the reason.
- Thus, balancing between inflation and growth prospects would be a challenging task for the policy makers in the near future.

4. BANKING

4.1 Securing Fugitive Offenders

What is the issue?

- Fugitive Offenders are those who've migrated elsewhere to escape prosecution in a particular jurisdiction.
- India has moved the UK for extradition of Vijay Mallya, and Interpol for a 'Red Corner Notice' (RCN) against Nirav Modi (also in UK soil).

What is the progress in the Nirav Modi case?

- UK authorities have confirmed that Nirav Modi is residing in their soil and India has sought an RCN from Interpol to restrict his movement.
- But RCN alone can't bring him back to India, as that requires India to send an extradition request to UK.
- Extradition would involve a legal process where the accused is provisionally arrested and a case is initiated to validate charges against the accused.
- Contrarily, if UK authorities agree to deport him, then the accused can be secured without a trial and the lengthy extradition process.

What are the rules for provisional arrest and extradition?

- India's treaty partners — which include the UK — have an obligation to consider requests for provisional arrest.
- In the absence of a treaty, India can still make a request, which the other country will decide in accordance with its laws.
- This may be followed by a detailed presentation requesting extradition.
- The concerned law enforcement agency in India prepares the request, which is then forwarded to the concerned authority of the other country.

What offences are covered under extradition treaties?

- Most treaties seem to follow at least five principles:
  - Extradition applies only to offences stipulated as extraditable
  - The offences must be covered under the national laws of both countries
  - The requested country must be satisfied of a prima facie case
  - The person must be tried only for the offence specified in extradition
  - There must be a fair trial.

What is the nature of the India-UK Extradition Treaty?

- It was signed in 1992 and has been in effect since 1993.
- As per Article 2, an extradition offence is one which, under the laws of each state, entails imprisonment for at least one year.
- Presently, 10 cases of Indian fugitives are said to be living in UK and their cases are pending in various stages.
- Significantly, UK authorities have previously rejected Indian extradition requests in as many as 6 cases by citing the lack of a convincing case.
- More strikingly, despite the numerous requests, India has extradited only one person named "Samirbhai Vinubhai Patel" from UK thus far (in 2016).
- From the UK's side, it has been seeking the custody of 17 people through extradition from India – but has successfully extradited only 2 people till now.

With which countries does India share extradition treaties?

- India currently has extradition treaties with 48 countries including - US, UAE, Hong Kong, France, Germany, Netherlands, Spain, Switzerland and UK.

- India has worked extradition arrangements with Croatia, Italy, Sweden, Fiji, Italy, Thailand, Papua New Guinea, Singapore, Sri Lanka, and Tanzania.
- Notably, apart from Samirbhai Vinubhai Patel from the UK, only four fugitives have been extradited to India from various countries since 2014.
- But significantly, during 2002-13, 54 terrorists and other fugitives were extradited to India from multiple countries.

4.2 Inter-Creditor Agreement

Why in news?

- More than a dozen of lenders led by State Bank of India recently signed the inter-creditor agreement (ICA).

What is the agreement on?

- The agreement is part of the proposed Project Sashakt.
- "Sashakt" plan is approved by the government to address the problem of resolving bad loans.
- The objective is to use this ICA for faster facilitation of resolution of stressed assets.
- It is aimed at the resolution of loan accounts with a size of Rs. 50 crore and above that are under the control of a group of lenders.

How did it evolve?

- Over the last few years, stressed assets resolution has been a challenge, despite RBI's consistent direction to banks.
- A panel led by banker Sunil Mehta identified the disagreement among joint lenders as the biggest problem in resolution.
- It recommended the bank-led resolution approach in the form of inter-creditor agreement.
- This is an improvement on the earlier model of solely relying on the joint lenders' forum to arrive at a consensus.

What are the provisions?

- If 66% of the lenders agree to a resolution plan it would be binding on all lenders.
- A 'dissenting creditor' is that which votes against or abstains from voting for the resolution plan approved by the committee.
- A dissenting creditor could sell its loan at a discount of 15% of the liquidation value to other lenders.
- Liquidation value is the amount at which a company could sell its assets and settle liabilities.
- Another option is to sell their loans to any person at a price mutually arrived between dissenting lender and the buyer.
- However, it cannot sell it to an asset reconstruction company.
- The agreement has a standstill clause wherein all lenders are barred from enforcing any legal action against the borrower.
- During standstill period, lenders are also barred from transferring or assigning their loan to any other person except a bank or finance company.

What are the concerns?

- The obligation on the lead lender to come up with a time-bound resolution plan can have unintended consequences.
- Banks may be compelled to engage in a rush sale of stressed assets due to arbitrary deadlines.
- This will work against the interests of lenders looking to get the best price for their stressed assets.
- Besides, the biggest challenge to bad loan resolution is the absence of buyers to purchase stressed assets.
- There is also the unwillingness of banks to sell their loans at a deep discount to their face value.

4.3 Mehta Panel Report on NPAs

Why in news?

The Sunil Mehta Committee submitted a five-point plan on bad loan resolution.

What are the key recommendations?

- The Committee was set up for restructuring stressed assets and creating more value for public sector banks (PSBs).
- It has proposed **Project Sashakt** to recover banks and stressed companies.
- The five-pronged resolution route outlines five features for bank resolution:
  - an SME resolution approach
  - bank-led resolution approach
  - AMC/AIF led resolution approach
  - NCLT/IBC approach
  - asset-trading platform
- This route will be applicable to the following, which have a potential for turnaround -
  - smaller assets with exposure up to ₹ 50 crore
  - mid-size assets between ₹ 50 crore and ₹ 500 crore
  - large assets with exposure of ₹ 500 crore and more
- **Large assets** - For large assets, an independent asset management company (AMC) will be set up.
- The resolution route is also applicable to larger assets already before the National Company Law Tribunal (NCLT).
- It would also cover any other asset whose resolution is still pending.
- The process will cover both performing and non-performing assets.
- **Mid-size assets** - The committee called for a bank-led resolution approach for these.
- The resolution plan has to be approved by lenders holding at least 66% of the debt.
- The independent steering committee appointed by the Indian Banks Association (IBA) has to validate the process within 30 days.
- The resolution for this category would be achieved in 180 days.
- In this category, the key challenge would be to arrive at a consensus.
- This is because the exposure is held by multiple banks/lenders.
- **SMEs** - The committee suggested setting up of a steering committee by banks for SMEs resolution.
- This will formulate and validate the schemes, with a provision for additional funds.
- The resolution should be complete within 90 days.
- It also suggested that the resolution be under a single bank's control.
- The bank will have the liberty to customise the resolution process.
- **AIF** - Alternative investment fund (AIF) would raise funds from institutional investors.
- Banks would be given an option to invest in this fund if they wish.
- AIFs can also bid for assets in National Company Law Tribunal (NCLT).
- The lead bank can discover price discovery through the open auction route.

What is the significance?

- The recommendations offer a transparent market-based solution and are fully compliant with RBI regulations.
- It focusses on asset turnaround to ensure job protection and creation.

- The resolution process would help bring in credible long-term external capital.
- This could limit the burden on the domestic banking sector.
- It could also ensure robust governance and credit architecture and prevent any build-up of NPAs in the future.

What are the concerns?

- **Approach** - Large banks helping smaller lead banks to run the resolution process, if required, sounds an ineffective suggestion.
- The bank-led resolution approach has largely failed in the past.
- Clearly, this is the reason why alternative plans to resolve NPAs quickly are being sought.
- **Consensus** - The lead bank's resolution plan to be approved by 66% of the lenders (by value) merely replaces the earlier JLF.
- The JLF (joint lenders' forum) structure failed miserably as it fell short of building consensus.
- The present committee report has missed to address this real challenge.
- **Small banks** - The structure also fails to serve the interests of smaller banks.
- If restructuring involves additional finance, small banks may be affected.
- As, unlike the larger ones, smaller banks may not prefer giving good money after the bad loans.
- **Reconstruction** - The report points out the lacunae in the existing functioning of asset reconstruction companies (ARCs).
- But it fails to address how such issues will be tackled under the proposed AMC or AIF structure.
- Success of price discovery through open auction under AMC/AIF depends on banks' willingness and capability to take financial risks.
- Clearly, unattractive returns and poor recovery rates have discouraged investors from bringing in capital in the past.
- **Complex** - The objective of early resolution to NPAs may be hampered by complicated work processes.
- E.g. there is lack of clarity on how AIFs will work with a series of AMCs for a quick resolution.
- Also, there are 26 ARCs and a couple of resolution advisory service companies in operation.
- Given this, creation of new platforms like the AMC in AIFs for NPA resolution seems illogical.

4.4 Estimates committee's Report on NPAs

Why in news?

Parliament's Estimates Committee on public sector banks headed by Raghuram Rajan released its report recently on NPA's.

What are the contents of the report?

- It says that gross NPAs of banks rose to Rs 10.3 lakh crore in FY18, or 11.2% of advances.
- **Reasons for rising bad loans -**

1. **Over-optimism** - Banks extrapolate past growth and performance of the companies that made them to **accept higher leverage** in projects.
2. **Slow Growth** - Domestic demand slowdown after GFC crisis (2008) affected strong demand projections.
3. **Government decision-making** - Governance problems as in allocation of coal mines, Project cost overruns etc., made projects unable to service debts.
4. **Loss of Interest** - Banks' **deceptive accounting** by failing to restructure and recognize losses or declare the loan NPA, to make the business look profitable to the shareholders.
5. **Malfeasance** - Lack of an independent analysis in the system which multiplies the possibilities for undue influence.

6. **Fraud** – Increase in the number of of fraud cases in PSBs.

- **RBI's rationale to introduce schemes**
  1. The **Debts Recovery Tribunals** (DRTs) were set up to help banks recover their dues speedily without being subject to the procedures of civil courts.
  2. The **SARFAESI Act** was setup to enable banks a to enforce their security interest and recover dues even without approaching the DRTs.
  3. Yet the recovery was only 13% of the amount at stake and only 25% of these cases were disposed off during a year.
  4. So **CRILC** was created, that includes all loans over Rs. 5 crores, to identify early warning signs of distress in a borrower such as habitual late payments.
  5. **Joint Lenders' forum** was created to decide on an approach for resolution, while giving the opportunity to exit for unconvinced borrowers.
  6. 5/25 scheme was created to establish reliability on projects that have long dated future cash flows.
  7. Strategic Debt Restructuring (SDR) scheme to enable banks to displace weak promoters by converting debt to equity.
  8. All these tools effectively created a resolution system that replicated an **out-of-court bankruptcy**.
- **Importance of recognising NPAs**
  1. To restructure or write down loans, the bank has to recognize it has a problem i.e classify the asset as a Non Performing Asset (NPA).
  2. Only then the bank balance sheet will represent a true and fair picture of the bank's health, as a bank balance sheet is meant to.
- **RBI's role in creation of NPAs**
  1. Bankers, promoters, and circumstances create the bad loan problem.
  2. The RBI is just a referee, not a player in the process of commercial lending.
- **Reason to initiate the Asset Quality Review**
  1. Banks were simply not recognizing bad loans, neither were they following uniform procedures.
  2. Hence, Asset quality review was done to ensure every bank followed the same norms on every stressed loan and to look for signs of ever-greening.
- **Reason for NPAs even after AQR**
  1. Risk-averse bankers
  2. Lethargy of promoters before Bankruptcy Code was enacted, hoping to regain control though a proxy bidder, at a much lower price.
  3. The government's delay on project revival etc
- **Recommendations to RBI**
  1. RBI should probably have raised more flags about the quality of lending in the early days of banking exuberance.
  2. It should have initiated the new tools earlier, and pushed for a more rapid enactment of the Bankruptcy Code.
  3. RBI could have also been more decisive in enforcing penalties on non-compliant banks.

4.5 Bank of Baroda, Dena Bank & Vijaya Bank Consolidation

Why in news?

The government recently proposed the amalgamation of state-owned Bank of Baroda (BoB), Dena Bank and Vijaya Bank.

How did it take shape?

- **Committee** - A committee headed by former RBI Governor M Narasimham was appointed in 1991.
- It made the first call for pruning the number of government-owned banks which was over two dozen.
- It recommended having three or four large banks including State Bank of India that could be positioned as global banks.
- **Capital infusion** - In 2016, the government decided to pursue consolidation after first pumping in more capital and to put back on track many banks weighed down by a huge pile of bad loans.
- To facilitate this, the government last year put in place an Alternative Mechanism on bank mergers.
- By this, an inter-ministerial panel was to be set up to supervise merger proposals and approve them.
- The first such proposal is the recent Bank of Baroda (BoB), Dena Bank and Vijaya Bank consolidation.

What is the rationale?

- It has been recognised for long that having several banks that are majority-owned by the government was not a sensible strategy as they do the same business, and compete for the same set of customers.
- It also meant a lower return on the capital employed by the government.
- There are other factors as well to be taken into account, including -
    i. changing face of banking marked by technological changes
    ii. challenges to raising capital that the owner (the government) has to provide periodically
    iii. the need for consolidation in the sector
    iv. putting an end to fragmentation
- The government is also emboldened by the experience of the merger of five susbidiaries of the State Bank of India last year.

What are the possible benefits?

- The amalgamation will create India's third-largest bank.
- It would take form as a business of Rs 14.82 lakh crore and over 9,600 branches across the country.
- There could be synergy in operational efficiency with a large pool of staff in a merged entity.
- It could help boost business, expand reach and offer more services or products.
- On a standalone basis, Vijaya Bank had strength in the South.
- On the other hand, Bank of Baroda and Dena Bank had a stronger base in Western India.
- This would mean wider access for both the proposed new entity and its customers.
- Besides, the move will lead to a lower NPA (non-performing assets) ratio for the new bank.
- The NPA ratios are now 11.04% for Dena Bank, 5.4% for Bank of Baroda and 4.1% for Vijaya Bank.
- This could, in turn, mean lower capital requirements from the government.
- The new bank, with its higher capital base (12.25%) can have better ability to lend more.

What are the concerns?

- **Implication** - After the merger announcement, shares of Bank of Baroda and Vijaya Bank fell significantly.
- On the other hand, Dena Bank gained sharply.
- Notably, Dena Bank is the bank in the worst financial situation among the three entities.
- It is currently under the Reserve Bank of India's *prompt corrective action* framework.
- Unlike the other two banks, its shareholders are set to gain from being part of a new bank with greater financial strength.
- But the weaker banks would make an unhealthy impact on the operations of the stronger one.

- Clearly, forced mergers such as the current one make little business sense for the stronger banks.
- **Bad loans** - The merger is part of the government's efforts to consolidate the banking industry to overcome the bad loan crisis.
- Asking healthy banks to take over weak banks appears to be the strategy to handle the bad loans crisis.
- But they are less likely to solve the bad loan crisis that has gripped the banking system as a whole.
- **Shareholders** - A dominant shareholder in the form of the government is dictating critical moves.
- This impacts the minority shareholders as they are left with no say in the matter.
- A merger as significant as this one should have been first discussed and approved in the board rooms of the banks concerned.

What could be a cautious move?

- Ideally, mergers ought to be between strong banks.
- It is important to ensure that such mergers do not end up creating an entity that is weaker than the original pre-merger strong bank.
- Certainly, mergers are just one way of managing the problem and therefore cannot be discounted totally.
- However, the trick lies in ensuring that the merger fallout is managed prudently.
- Identifying synergies and exploiting scale efficiencies will be crucial here.

4.6 RBI Surplus Transfer to Government

Why in news?

- RBI has transferred a surplus of Rs 50,000 crore to the central government in FY18.
- It has also made a provision of Rs 14,190 crore and transferred it to contingency fund (CF).

What are the transfers for?

- Contingency Fund is the fund that the central bank has built over the years.
- This is to meet unexpected exigencies and risks
    - from sharp fluctuation in the value of securities held by it
    - from monetary or exchange rate policies of central banks
    - from other systemic risks
- Besides, RBI transfers the surplus generated from its functions to the government at the end of each financial year.
- This is after accounting for any funds transferred to the contingency reserve or the asset development fund.
- It follows July-June financial year.

What is the recent trend?

- Transfer of surplus to the government has risen by around 63% during the financial year ended June, 2018.
- RBI had transferred a surplus of around Rs 30,600 crore to the government in financial year 2016-17.
- During 2017-18, RBI's balance sheet increased by 9.49% or Rs 3.13 trillion.
- The increase on the asset side was mainly due to rise in foreign investments, and loans and advances.
- On the liability side, the increase was due to increase in notes issued and other liabilities and provisions.
- Domestic assets, foreign currency assets and gold recorded marginal increase from the previous year.

Why is the CF contribution laudable?

- RBI had been transferring a chunk of its surplus to the contingency fund up to 2012-13.
- However, these transfers temporarily ceased thereafter.

- The transfers resumed from 2016-17 and this prudential policy continues in 2017-18.
- The RBI faces pressure to transfer funds to the Centre, to help bridge the fiscal deficit.
- Despite this, RBI has continued to transfer a portion to the Contingency Fund.
- This year's contribution is also slightly higher than the CF transfers of last year.

What are the challenges?

- There are heightened worries of turbulence in global financial markets due to the ongoing trade war.
- There is also an explosive political situation in the US.
- There is also the threat of value erosion to currencies of emerging economies.
- Given these, the value of the RBI's foreign currency assets is at a greater risk.

4.7 India Post Payments Bank

Why in news?

India Post Payments Bank (IPPB) was recently launched by the Prime Minister.

What is IPPB?

- India Post Payments Bank (IPPB) is a financial service provider that will operate under the country's postal department.
- The government-owned payments bank will be able to accept deposits of up to Rs. 1 lakh from customers.
- But they do not have the rights to use these funds to advance risky loans at higher interest rates.

What are the features?

- **Accounts** - India Post Payments Bank (IPPB) offers three types of savings accounts—regular, digital and basic.
- A digital savings account can be opened through the IPPB mobile app.
- However, it is valid only till 12 months.
- Within this, it has to be converted into a regular savings account by providing biometric data to the postman.
- A regular and basic account can be opened either through the post office or the postman.
- **Balances** - All three accounts are zero-balance accounts, with no minimum balance rules.
- However, RBI has directed all payments bank account holders to hold not more than Rs 1 lakh in any account at a given point of time.
- So the moment an IPPB account crosses Rs 1 lakh limit, the transaction will be rejected automatically.
- To handle this, IPPB suggests linking a post office savings account with the IPPB account.
- So, any balance in excess of Rs 1 lakh will be transferred to the post office account.
- **Interest rate** - All IPPB accounts attract an interest rate of 4% per annum.
- Calculated on the daily closing balance, the interest rate is paid quarterly.
- **Deposit & withdrawal** - In regular and digital savings accounts, one can withdraw or deposit any number of times.
- In case of a basic savings account, there is a restriction of 4 cash withdrawals monthly.
- For cash deposits and withdrawals, one can approach the nearest post office where the IPPB service is available.
- IPPB accounts do not come with an ATM card and so one cannot withdraw cash from ATMs.
- **Doorstep banking** - Consumers can also call the postman or Grameen Dak Sevaks (GDS) home and make transactions.
- This is done using the QR card that is received with the IPPB account.

- Doorstep banking from IPPB comes at a cost of Rs 25 for cash transactions and Rs 15 for digital transactions.

What is the significance of IPPB?

- The primary rationale is to help in the goal of achieving financial inclusion.
- India's age-old postal department has a wide network of branches across India.
- All the 1,55,000 post offices in the country are expected to be linked to the IPPB system soon.
- IPPB can thus offer savings, remittance, and payments services to the rural and unorganised sectors.
- IPPB's digital services are expected to make financial services more accessible even from remote locations.
- There is also a hope that the payments bank idea will help reinvigorate the postal system.

4.8 Section 7 of the RBI Act

Why in news?

The Central government has reportedly initiated steps towards invoking its powers under Section 7 of the RBI Act of 1934.

What does the section contain?

- It is a provision under which the government can give directions to the RBI to take certain actions in the public interest.
- This provision has been built into the law governing not just the RBI but also regulatory bodies in other sectors.
- Section 7 has two parts - consultation and then issuing a direction to the RBI for taking some action in public interest.
- Under it, the Central Government may from time to time give such directions to the Bank as it may consider necessary in the public interest.
- This has to be done only after consultation with the Governor of RBI.
- Subject to any such directions, the general superintendence and direction of the affairs and business of the Bank shall be entrusted to a Central Board of Directors.
- The Central Board of Directors in turn will exercise all powers and do all acts and things which may be exercised or done by the Bank.
- The Central Board of Directors comprises a Governor and [not more than four] Deputy Governors to be appointed by the Centre, four Directors to be nominated by the Centre and one government official nominated by the Centre.
- Giving control of the RBI to its Board of Directors effectively gives control to the Central Government.
- Until now, however, the government has never exercised its powers under Section 7 of the RBI Act.

What has led to this scenario?

- The central government issued three letters to the central bank in the last one month for consultation under Section 7 of the RBI Act.
- The First letter pertained to exemption for power companies from new stressed asset norms.
- The second one was related to dilute capital threshold norms of the prompt corrective action framework.
- The third one was pertaining to more capital to the government from the reserves of the central bank.
- However, RBI has refused to provide any leeway to stressed borrowers or give in to the demand of higher dividend by the government.
- RBI on its part said that it has responded to all the communications that were sent by the government and has decided to maintain its stance.
- This made the government to invoke its powers and initiate consultations under Section 7.

4.9 Significance of Prompt Corrective Action

Why in news?

In India there is a public debate regarding relaxation of the Prompt Corrective Action (PCA) norms imposed on 11 public sector banks (PSBs).

What is PCA?

- The PCA is triggered when banks breach certain regulatory requirements like minimum capital, return on asset and quantum of non-performing assets.
- To ensure that banks don't go bust, RBI has put in place some trigger points to assess, monitor, control and take corrective actions on banks which are weak and troubled.
- The process or mechanism under which such actions are taken is known as Prompt Corrective Action, or PCA.

What is the PCA plan of USA?

- The PCA framework is employed internationally by regulators as a form of structured early-intervention and resolution mechanism, designed to help banks regain health by preserving capital.
- The 1980s and early 1990s were a period of great stress and turmoil for banks and financial in situations all over the globe.
- In USA, more than 1,600 commercial and savings banks in sued by the Federal Deposit Insurance Corporation (FDIC) were either closed or given financial assistance during this period.
- The cumulative losses incurred by the failed institutions exceeded US $100 billion.
- These events led to the search for appropriate supervisory strategies to avoid bank failures as they can have a destabilizing effect on the economy.

How RBI's PCA differs from USA?

- In the US, the PCA framework is based more on constrained discretion rules that are applied contextually.
- The PCA framework in India is more rule-based and hence more stringent.
- Regulators can be expected to employ their discretion advantageously when there is an opportunity for "learning by doing".
- Perhaps the US PCA framework encompasses more learning by doing and hence is less stringent.
- As far as provisioning is concerned, Indian banks are subjected to gradual age-wise provision for substandard assets starting from 15% in the first year to 100% in the fourth year, irrespective of whether collateral is available or not.
- In the US, provisioning norms are purely discretion-based and are provided for by banks as per estimated credit losses associated with the loan portfolio.
- In case of a commercial loan, the fair value of the collateral is taken into consideration to account for provisioning, if any.
- For a mortgage loan, only on 270 days delinquent, all mortgages are placed on non-accrual status only if the realizable value of the collateral is inadequate in servicing the loan value. In fact, if a mortgage loan is fully insured, it is not even placed on non-accrual status even after 90 days.
- While the FDIC triggers the PCA, based on bank capital threshold and leverage, the RBI's PCA thresholds also include asset quality and profitability.

What is the significance of RBI's PCA?

- RBI has set trigger points on the basis of CRAR (a metric to measure balance sheet strength), NPA and ROA.
- Based on each trigger point, the banks have to follow a mandatory action plan.
- Apart from this, the RBI has discretionary action plans too, the rationale for classifying the rule-based action points into "mandatory" and "discretionary" is that some of the actions are essential to restore the financial health of banks while other actions will be taken at the discretion of RBI depending upon the profile of each bank.
- Banks are not allowed to re new or access costly deposits or take steps to increase their fee-based income.

- Banks will also have to launch a special drive to reduce the stock of NPAs and contain generation of fresh NPAs.
- They will also not be allowed to enter into new lines of business, RBI will also impose restrictions on the bank on borrowings from interbank market.

4.10 Removal of Banks from PCA framework

Why in news?

The Reserve Bank of India (RBI) recently removed three state-owned banks from the prompt corrective action (PCA) framework.

What is Prompt Corrective Action?

- Under the PCA norms, the performance of banks was determined on the basis of three criteria — capital, asset quality and profitability.
- It is a quick corrective measure taken in case a bank is found to be having low Capital Adequacy Ratio (CAR) or high NPAs.
- The capital adequacy ratio (CAR) is a measurement of a bank's available capital expressed as a percentage of a bank's risk-weighted credit exposures.
- RBI initiates PCA when CAR goes below 9% or NPA rises above 10%.
- When RBI initiates PCA against a bank, it puts restrictions on fresh loans and dividend distribution.
- The actions could include stricter norms for lending, branch expansion, management change and asset reduction depending on the financial health of the bank.
- The RBI tightened the PCA norms when bad loans situation in the country got worse, with many PSU banks showing high NPA ratio.
- The RBI had put 11 PSBs under PCA with different degree of restrictions.
- Rating agencies like Fitch have hailed the RBI's decision to put stricter norms, saying that it would address the problems of struggling banks.
- However, the government was of the opinion that the RBI should relax the PCA norms to enable more sanction of credit by PSU Banks.

What are the underlying reasons?

- The three banks which are removed from the PCA framework are Bank of India, Bank of Maharashtra and Oriental Bank of Commerce.
- The three banks were among 11 public sector lenders that were brought under the PCA framework by the apex bank.
- Subsequently, the government infused capital in PSU banks and some of the lenders reported better numbers for the third quarter ended December 31, 2018.
- Thus, there was an expectation that at least two banks will come out of the PCA framework.
- For instance, at least two banks — Bank of India and Bank of Maharashtra — had non-performing assets as a percentage of total assets that were lower than the threshold of 6% set by the RBI.
- Bank of India had a net NPA of 5.87%, while Bank of Maharashtra's NPA was 5.91%.
- In case of Oriental Bank of Commerce, the net NPA is 7.15% in the third quarter.
- The government had since infused sufficient capital and the bank had brought down the net NPA to less than 6%.
- Thus, the RBI decided to remove these banks, along with Oriental Bank of Commerce, after a review of the performance of these three banks.

- These banks have met the regulatory norms including Capital Conservation Buffer (CCB) norms.
- It pointed out that these lenders were not in breach of the PCA parameters on the basis of their results in the third quarter, except Return on Assets (RoA).
- According to rules, bank having negative RoA for at least two consecutive years will come under the PCA framework.
- However, the RBI said the lenders with weak ROA have given it in writing that they would comply with the norms of minimum regulatory capital, net NPA and leverage ratio on an ongoing basis.
- Further, they have told the RBI that they are making various structural and systemic improvements.
- Also, the government has also said the capital requirements of these banks will be duly factored in while making bank-wise capital allocations during the current financial year.
- Taking all the above into consideration, these banks are taken out of the PCA framework subject to certain conditions and continuous monitoring.

4.11 RBI's Stance on Bank Capital Norms

What is the issue?

Reserve Bank of India (RBI) has opposed government calls to relax the rules for risk weights and capital requirement for Indian banks.

What is RBI's rationale?

- At present, the capital adequacy norms for Indian banks are higher than those recommended under Basel.
- Government now calls for aligning the capital adequacy norms of Indian banks with those of Basel III to allow Indian banks to lend more.
- But RBI says that applying Basel-specified risk weights would understate the "true riskiness" of loans on the books of these banks.
- Relaxing the current risk-adjusted capital norms (Basel-III-plus norms) could hit the economy at a time when defaults are high and provisions low.
- Indian banking system has a high proportion of nonperforming assets (NPAs) that are not provided for in relation to capital levels.
- Introducing regulatory relaxations before bringing in structural reforms and with inadequate understanding of defaults could be detrimental to economy's interests.
- So the case for a recalibration of risk-weights or minimum capital requirements would need to be carefully assessed.

What are RBI's proposals?

- **Capital norms** - RBI proposes to take a fresh look and intends to issue revised prudential regulations, including guidelines on -
    i. exposure and investment norms
    ii. risk management framework
    iii. select elements of Basel III capital framework
- **Board** - RBI called for legislative changes to do away with the need to nominate the central bank's officials as nominee directors on the boards of public sector banks.
- Former RBI governor Urjit Patel had suggested withdrawal of these nominee directors from the boards to avoid any conflict of interest.
- **PCA** - RBI also upheld the prompt corrective action (PCA) framework for weak banks, another point of contention with the government.
- RBI said that weak banks under the PCA framework have shown improvement in deposits.
- They have also shown lower growth in gross NPAs, relative to non-PCA public sector banks.
- **Besides**, the RBI is also looking at reviewing the guidelines for compensation for private sector banks.

- This follows a demand by banks for an objective assessment of remunerations for whole-time directors.

4.12 Financial Stability Report - RBI

Why in news?

Reserve Bank of India has recently released the financial stability report.

What are the highlights?

- **NPA** - RBI report warns that the gross non-performing assets (GNPAs) could rise.
- The *GNPAs* of scheduled commercial banks could rise from 11.6% in March 2018 to 12.2% in March 2019.
- This would be the highest level of bad debt in almost two decades.
- It is more worrying for GNPAs of banks under *prompt corrective action framework*.
- It is expected to rise to 22.3% in March 2019, from 21% in March 2018.
- **Capital** - GNPAs will increase the size of provisioning for losses and affect banks' capital position.
- The capital to risk-weighted assets ratio of the banking system as a whole is expected to drop.
- It could come down from 13.5% in March 2018 to 12.8% in March 2019.
- **Bank frauds** - RBI notes that more than 85% of frauds could be linked to PSBs.
- But, their share of overall credit is only about 65%.
- The PSBs are far more prone to fraud than the private banks.
- This is significant in light of the recent Punjab National Bank scam.
- It is possibly due to the corporate governance issues in public sector banks.
- This also largely contributed to the weak lending practices, the core of the NPA crisis.

What are the concerns?

- **Banks** - NPA crisis has affected the banking system and impeded credit growth in the economy.
- It was expected to be reaching to the lowest levels.
- But RBI report comes as a caution to the health of the banks and the economy.
- **Economy** - Economy has registered a healthy growth rate of 7.7% in the recent quarter.
- The deteriorating health of banks is in contrast to the recovering economy.
- **External risks** - The RBI, however, has warned about the rising external risks.
- It poses a significant threat to the economy and to the banks.
- Credit has already started to flow out of emerging markets such as India.
- This is due to the
  i. tightening of monetary policy by the US Federal Reserve
  ii. increased borrowing by the U.S. government
- **Prices** - The increase in commodity prices is another risk on the horizon.
- This could pose a significant threat to the rupee and the fiscal and current account deficits.
- All these factors could well combine to increase the risk of an economic slowdown.
- It could, in turn, exert pressure on the entire banking system.

4.13 Fugitive Economic Offenders Bill

Why in news?

Lok Sabha has approved Fugitive Economic Offenders Bill.

What is Fugitive Economic Offenders bill about?

- The Bill defines the fugitive economic offender "as an individual who has committed a scheduled offence or offences involving an amount of ₹ 100 crore or more and has absconded from India or refused to come back to India to avoid facing criminal prosecution in India."
- There is a provision in the Bill that economic offenders who flee from the country will be brought back, prosecuted and their properties will be confiscated.
- The law will apply to all those who have been declared fugitives in big economic crimes by Indian courts.

What is the plan on fugitive economic offenders?

- Union government has already promulgated an ordinance on fugitive economic offenders.
- The recent bill once approved by both the houses and assented by the President, will become an Act and replace the Ordinance promulgated.
- All actions taken under the Ordinance will have the same legal validity once the law is enacted.
- Empowered by the Ordinance, the Enforcement Directorate has already moved a special court for action against most wanted economic offenders.
- Fugitive Economic Offenders Law will be applicable to "any individual who is, or becomes, a fugitive economic offender on or after the date of coming into force of this Act.
- It means the Bill will not be effective from a retrospective date, however this does not provide any relief for offenders who have already been declared fugitive by Indian courts.
- **What is the significance of the bill?**
- It seeks to quickly recover the losses to the exchequer or public sector banks in cases of frauds.
- Among other things, the Bill makes a provision for a Special Court under the Prevention of Money Laundering Act, 2002 to declare a person a Fugitive Economic Offender.
- Fugitive Economic Offenders Bill gave power to agencies to seize properties that are not only in the name of the offender, but 'benami' assets.

4.14 Withdrawal of FRDI Bill

Why in news?

- Union government has decided to withdraw the Financial Resolution and Deposit Insurance (FRDI) Bill.

What is FRDI Bill?

- It aims to limit the fallout of the failure of institutions like banks, insurance companies, non-banking financial companies, pension funds and stock exchanges.
- The FRDI Bill is aimed at insuring the money of a bank's depositors in the case of an eventuality where the bank would have to be liquidated.
- Bail-in clause of the bill gives banks the authority to issue securities in lieu of the money deposited.
- According to this insurance option covers only Rs.1,00,000 of the principal, the remainder of the sum deposited with a bank will be converted to tradable financial assets which can be redeemed.

What are the reasons behind the withdrawal of the bill?

- **Objections -** The Union cabinet decision follows strong objections from several quarters about quite a few provisions of the Bill.
- Unions of workers in nationalised banks and in state-run insurance companies were particularly vociferous in their objections.
- **Poor drafting -** The bail-in provision was poorly drafted, with insufficient transparency in the text.
- There was also ambiguity about the scope of deposit insurance, Given that, this provision served as a poison pill for the Bill as a whole.

- **Concerns about the "Bail-in" provision -** "Bail -in" of the FRDI Bill had simply become too strong and, in the absence of any coherent defence from the Bill's backers in the government.
- It had also become too dangerous for confidence in the banking system overall.
- In particular, there were concerns that the bail-in provision would lead to depositors losing their money.
- **What is the way forward?**
- The government has not abandoned the notion of insolvency legislation for the financial sector altogether.
- It will be important for work to start instantly on drafting a new Bill that serves the purposes that the FRDI Bill was supposed to.
- Hopefully, the new Bill will have clearer provisions for depositor protection.

4.15 SC's Stay on RBI's Circular

Why in news?

The Supreme Court has ordered a stay on the implementation of RBI's February 12 circular dealing with insolvency proceedings.

What is the case on?

- The RBI's circular is part of a revised RBI framework for resolution of stressed assets in the economy.
- It mandates insolvency proceedings under the new Insolvency and Bankruptcy Code (IBC) for a debt servicing default beyond 180 days.
- It also asks banks to recognise loans as non-performing even if repayment was delayed by just one day.
- Power firms have argued that the provision was unfair.
- It's because their debt repayment capacity was directly linked to revenue from power distribution companies.
- It is also depended on the availability of coal, a natural resource closely regulated by the State.
- The Allahabad High Court thus earlier refused to grant relief to troubled power companies facing action from the RBI.
- But the SC has now ordered that insolvency proceedings should not commence against the defaulting power companies.

What is the SC's rationale?

- The current insolvency resolution process has its own flaws, despite the benefits.
- Lenders could realistically expect to recover less than a tenth of their dues if stressed assets are to be liquidated.
- It's because the IBC overemphasises on speedy resolution than the recovery of maximum value from stressed assets.
- Power companies thus argue that their assets could yield better returns if resolved completely outside the IBC's purview.
- With SC's order, the distressed power companies and many other firms in shipping, sugar and textile sectors would be relieved.
- The decision is also helpful for the banks as they would have time for the recognition of bad loan losses.

What are the concerns?

- **Intervention** - The troubles of power companies can be traced to structural issues such as the -
    - absence of meaningful price reforms
    - unreliable fuel supply
    - unsustainable finances of public sector power distribution companies
- So banks are unlikely to make much money out of the stressed assets until these structural problems are addressed.

- Certainly, policymakers, and not courts, would have to take charge and resolve these issues.
- So the Court's decision to intervene will do very little good in the long run to either stressed power companies or their lenders.
- **IBC** - The decision will transfer all pleas seeking exception from RBI's circular to the court itself.
- This has come as the biggest challenge against the Insolvency and Bankruptcy Code (IBC) yet.
- Postponement of next hearing and the resultant delay undermines the new bankruptcy regime's feature of resolution within a strict time frame.
- It is thus likely to cause significant uncertainty in the resolution of stressed assets.
- It would also undermine investor confidence in the bankruptcy process.

4.16 Independent Payments Regulatory Board

Why in news?

The RBI has opposed the government's proposal to set up a separate and independent regulator for the payments industry in the country.

What was the proposal?

- An inter-ministerial committee was earlier set up by the Department of Economic Affairs.
- It was tasked to finalise amendments to the Payment & Settlement Systems (PSS) Act, 2007.
- **Recommendations** - The committee proposed the establishment of an Independent Payments Regulatory Board (PRB).
- The aim is to foster competition and consumer protection, systemic stability and resilience in the payments sector.
- It also recommended having a government-appointed chairperson for the PRB.
- It held that the Securities Appellate Tribunal (SAT) should look at dispute cases related to the payments.
- Besides, the *Payment Council of India* (PCI) also maintained that the payments sector has undergone a sea change in the last 7-8 years.
- So, there are various types of risks involved, and a risk-based regulation is the need of the hour.

Payments Council of India

- The Payments Council of India was formed under the aegis of IAMAI (Internet and Mobile Association of India) in the year 2013.
- It was set up to cater to the needs of the digital payment industry, address and help resolve various industry level issues and barriers.
- It works to promote payments industry growth and to support the national goal of 'Cash to Less Cash Society' and 'Growth of Financial Inclusion'.

What is RBI's rationale?

- In a dissent note, the RBI has rejected the above recommendations.
- It has argued that payment systems are a sub-set of currency, which is regulated by the RBI.
- There is an overarching impact of monetary policy on payment and settlement systems and vice-versa.
- This adds validity to the idea that regulation of payment systems remain with the monetary authority i.e. the RBI.
- Also, the activities of payments banks come well within the purview of the traditional banking system.
- So there is no case of having a separate regulator for payment systems outside the RBI.
- Regulation of the banking systems and payment system by the same regulator provides synergy.
- Nevertheless, RBI is open to changes and is not totally against a new PSS Bill, if required.
- However, the changes should not result in the existing foundations being shaken.
- They should not result in potential creation of disturbances in an otherwise well-functioning and internationally-acclaimed structure.

- RBI also held it would prefer the Payments Regulatory Board to function under the purview of the RBI Governor.
- It, however, may comprise three members nominated by the government and the RBI respectively.
- It should come with a casting vote for the governor to ensure smooth operations of the board.
- The recommendation on Securities Appellate Tribunal was also rejected by the RBI.
- The exchanges and securities markets are not under the purview of the Payment Systems Bill.
- So there is no rationality in bringing SAT for resolving payment system-related cases.

Why is RBI's decision a welcome one?

- There is definite overlapping of the current regulatory powers of the RBI and the proposed regulations for the payments industry.
- A unified regulator can thus help lower the regulatory compliance costs and enable the seamless implementation of rules.
- Further, there is a risk that a brand new regulator may be unable to match the expertise of the RBI in carrying out regulatory duties.
- This is especially given the fact of rapidly growing payments industry which can ill-afford regulatory errors at this point.
- Moreover, the decision comes as an expression of RBI's firm stance against any dilution of its current powers over the financial sector.

5. MONEY MARKET

5.1 P-Notes and Money Laundering

Why in news?

The special investigation team (SIT) on black money has asked the SEBI to furnish details of all those investing through participatory notes (P-Notes).

What are P-Notes?

- P-Notes or Participatory Notes are Overseas Derivative Instruments that have Indian stocks as their underlying assets.
- These instruments are issued by foreign portfolio investors (FPIs) registered with SEBI.
- It allows foreign investors to buy stocks listed on Indian exchanges without being registered with SEBI.
- It gained popularity as foreign institutional investors (FIIs) started betting on stocks through this route.
- This is to avoid the formalities of registering, and to remain anonymous.

What is the concern?

- P-Notes are an internationally accepted route to invest money and there are many genuine players.
- But, the government and the regulator are concerned about round-tripping of money.
- As, there are some who are adopting P-Notes route for illicit money transactions.
- There is a concern that it is being used in money laundering.
- Wealthy Indians, like companies promoters, are using it to bring back unaccounted funds and to manipulate their stock prices.
- The primary reason for the concern with P-Notes is because of the anonymous nature.

Derivatives

- Derivative is a contract between two or more parties and its value is determined by the underlying asset.
- The most common underlying assets include stocks, bonds, commodities, currencies, interest rates and market indexes.

- These investors could be beyond the reach of Indian regulators.

What are SEBI's moves?

- SEBI has recently put in place restrictions on foreign portfolio investors from issuing participatory notes.
- So, P-Notes can be issued only for the purpose of hedging (safeguarding) with respect to the equity shares held.
- SEBI said that existing positions on unhedged P-Note derivatives have to be liquidated by the end of December 2020.
- Earlier to this, SEBI tightened P-Note norms by deciding to levy a fee of USD 1,000 on each instrument.
- It had increased the know-your-customer (KYC) requirement.
- It also issued curbs on transferability, and prescribed more stringent reporting for P-Notes issuers and holders.
- SEBI also barred their issuance for speculative purposes from checking any misuse for channelizing black money.
- It also decided to relax the entry norms for foreign portfolio investors (FPIs) willing to invest directly in Indian markets rather than through P-Notes.
- It also mandated issuers to follow Indian anti-money laundering laws instead of norms prevalent in the jurisdiction of the end beneficial owner.

What is the significance of SIT's directive?

- The tightening of P-Note norms was triggered by the concerns raised by SIT in 2015.
- This was especially over the investment coming from Cayman Islands, the top destination for P-Note investors investing in the Indian securities market.
- Panama Papers leak also compounded the black money concerns.
- The present directive is the first time the government-constituted SIT has sought such massive amount of data.
- It includes the list of beneficial owners and transfer trials of investors taking the P-Note route.
- The SIT wants to ensure that the regulatory changes made by SEBI are sufficient to curb the misuse of such instruments.

5.2 TK Viswanathan Committee

What is the issue?

- The SEBI-appointed TK Viswanathan committee on fair market conduct recently released its report.
- Granting more powers to Securities and Exchange Board of India (SEBI) has given way to many concerns.

What was the committee on?

- The regulation of securities markets has evolved, since the setting up of the SEBI.
- However it is still a work in progress as mischievous practices continue to exist.
- The committee was aimed at addressing the illegal practices and ensuring fair conduct among investors.

What are the key recommendations?

- **Malpractices** - The committee said Benami trading should also be deemed fraudulent if it leads to manipulation.
- Also, SEBI may consider any trading by players beyond their known 'financial resources' as fraud.
- The committee has suggested changes to existing regulations to better prosecute malpractices as these.
- It said the scope of regulations on fraud should not just cover intermediaries.
- It should also cover employees and agents of these intermediaries who often escape after indulging in fraudulent activity.

- It is also suggested that SEBI be given the power to grant immunity to whistle-blowers who help uncover illegal activities.
- **Insider trading** - It is a practice wherein investment decisions are made by having access to otherwise non public information.
- Among a number of recommendations on insider trading, is the creation of two separate codes of conduct.
- One would set minimum standards on dealing with insider information by listed companies.
- The other would set standards for market intermediaries and others who are handling price-sensitive information.
- **Information** - Companies should maintain details of
  i. immediate relatives of designated persons who might deal with sensitive information
  ii. people with whom the designated person might share a material financial relationship or who share the same address for a year
- Such information may be maintained by the company in a searchable electronic format.
- It may also be shared with the SEBI when sought on a case-to-case basis.
- **Calls** - Currently, SEBI has the power to only ask for call records including numbers and durations.
- The committee has recommended direct power for SEBI to tap telephones and other electronic communication devices.
- This is to check insider trading and other frauds.
- However, proper checks and balances over this power are to be ensured by necessary amendment in the relevant laws.
- **Front entities** - Front entities are that which lent their names or trading accounts to others.
- The committee has recommended the inclusion of a new sub-section within the SEBI Act, 1992 in this regard.
- This would specifically prohibit devices, schemes or artifices employed for manipulating the books of accounts or financial statements of a listed company.

What are the benefits?

- A strong regulator serves as a good deterrent to fraudulent practices in the market.
- Greater executive powers can help the regulator take swifter action against offenders.
- They do not, instead, have to rely on government bodies such as the Ministry of Corporate Affairs.
- This could also free SEBI from various manifestations of political influence.
- As SEBI can better understand the complex nuances that financial market fraud entails, it may be better placed to enforce the law.

What are the contentions?

- **Calls** - Powers such as tapping phone calls are already vested in the police and investigating agencies. E.g. CBI
- So it might be extreme and tyrannical if extended to financial regulators as well.
- This gains significance in the backdrop of the increasing importance for privacy in recent times.
- **Frauds** - SEBI is set to be granted the power to act directly against "perpetrators of financial statements fraud".
- In essence, this means SEBI can act not only against listed entities under its extant powers.
- Rather, it could also act against those who aid or abet financial fraud, including the accountants and auditors.
- Too much of deterrence could possibly discourage and drive away the genuine investors.

5.3 Stock Market Volatility

Why in news?

Stock indices witnessed an extraordinary swing recently resulting in panic sell-off by investors.

What happened?

- The Sensex moved 1,500 points between its high and low during the day and eventually lost around 280 points.
- The Nifty fluctuated between 370 points and lost around 90 points at the end of the day.
- The overall market breadth was extremely weak with almost 2,200 stocks in the red as against only 542 gainers.
- Also, the Sensex to plunge 1,785 points in the five trading days.

What is the reason?

- Infrastructure Leasing & Financial Services Ltd. (IL&FS) is an infrastructure development company, which provides finance and loans for major infrastructure projects.
- One of the projects is the Chenani-Nashri tunnel — India's longest road tunnel at 9 kilometers (5.6 miles).
- The company describes itself as the pioneer of public private partnerships.
- IL&FS group of companies has a total consolidated debt of close to Rs 1 lakh crore, and it started to miss deadlines on its debt obligations beginning last week of August 2018.
- Fears grew among the investors that the default problem will spread to other NBFCs, leading to a sharp fall in the stocks of housing finance companies (HFCs) and NBFCs (which operate on borrowed funds).
- With this underlying fear, debt papers of DHFL were sold by DSP Mutual Fund, at the discount rate of 11% in the secondary market. (Normal yield was 10%).

Discount Rate

- In finance, discount refers to a situation when a bond is trading for lower than its par or face value.
- For example, if a bond with a par value of $1,000 is currently selling for $990 dollars, it is selling at a discount of ($1000/$990) - 1 = 1%, or $10. The reason a bond will trade at a discount is if it has a lower interest or coupon rate than the prevailing interest rate in the economy.
- In other words, since the issuer is not paying as high of an interest rate to the bondholder, the bond must be sold at a lower price to be competitive, or else no one would buy it. **(Invsetopedia).**

- This was viewed as a precursor to higher borrowing costs for NBFCs.
- Hence investors sold their stocks in housing finance firms, leading to stock market plunge.
- A bunch of algorithmic trades also quickly escalated the magnitude of the fall.

Why IL&FS defaulted?

- Commercial Paper (CP) is an unsecured money market instrument issued in the form of a promissory note with a maximum validity of one year.
- IL&FS have raised a huge amount through CPs.
- But the interest rates have soared to multi-year highs for short-term borrowings.
- Additionally, some of IL&FS's construction projects have faced cost overruns amid delays in land acquisition and approvals.
- Disputes over contracts have locked about 90 billion rupees of payments due from the government.
- These have made IL&FS run short of cash.

How did the IL&FS default play out?

- It has already defaulted on around Rs 450 crore worth of inter-corporate deposits to SIDBI and more defaults are likely in the coming weeks.
- Insurance companies, state-owned banks and their provident funds and pension funds, and mutual funds (MFs) have exposure to the debt papers of IL&FS; state-owned banks have also extended term loans to IL&FS.

- Following the defaults, rating agencies ICRA, India Ratings and CARE abruptly downgraded IL&FS and its subsidiary from high investment grade (AA plus and A1 plus) to junk status, indicating actual or imminent default.
- **Could this spill over into the broader market?**
- Despite the fluctuations, there was a significant recovery from the lows due to strong institutional buying.
- Hence the fall was believed to be a temporary correction in a bull market.
- However, the panic in the fixed income market due to the IL&FS default has led to a liquidity freeze.

5.4 Downgrading IL&FS

Why in news?

IL&FS group of companies recently received a credit downgrade from rating agencies ICRA, India Ratings and CARE.

What does credit downgrade imply?

- **Rating agencies** - The stretched liquidity position of the group was known before.
- But it took an actual default for the rating agencies to revisit their investment grade ratings.
- The rating agencies repeatedly flagged loan book concentration, high debt levels and the dire financial straits of the group's firms in their reviews.
- But they seem to have pinned their hopes on IL&FS' big-name promoters to bail it out of its troubles.
- This exposes the fragility of the 'structured obligation' in the ratings, to actually weak entities but hailing from large industrial groups, on the faith of a possible rebound in future.
- **Mutual Funds** -The mutual funds failed to restrict their exposures to the high-risk paper to their 'credit risk' funds.
- Fund managers instead parked it with their liquid and low duration funds.
- They also marketed them as low-risk alternatives to savings bank accounts.
- **Banks** - The episode again shows the risks of banks in funding long-gestation projects with short-term money.

5.5 Changes in Mutual Fund Regulations

Why in news?

SEBI has unleashed a set of fundamental changes to the regulations governing mutual funds in India.

What are the proposed measures?

- Assets under management(AUM) of the industry are at a record of Rs 25 lakh crore, resulting in a revenue of about Rs 13,000 crore.
- The market regulator has decided to lower expenses paid by investors of equity mutual fund schemes.
- **Total Expense ratio** - TER is a percentage of a scheme's corpus that a mutual fund house charges towards expenses including administrative and management.
- TER for equity-oriented mutual fund schemes were capped at 1.25% and for other schemes at one%.
- The cap for fund of funds will be 2.25% for equity-oriented schemes and two% for other schemes.
- Also, the TER will go down as the AUM slab increases.
- For instance, the TER ranges between 0.8 and 1.05% for the for the highest AUM slab (over Rs 500 billion), whereas it ranges between 2 and 2.25% for the lowest AUM slab (0 to Rs 5 billion).
- **Transparency** - SEBI has mandated that commissions and expenses shall be paid from the scheme only and not by any other route.
- Further, the mutual fund industry has to adopt the full trail model of commission in all schemes without paying any upfront commission.

- **Disclosure** - SEBI requires category-wise disclosure of all schemes' returns with respect to its total returns to be made available on the Association of Mutual Funds of India's website.
- **Borrowings** – Companies with outstanding borrowings above Rs 1 billion shall raise 25% of their incremental borrowings for the year through the bond market.

What could be the effects?

- A mutual fund has a certain fixed cost and after a certain fund size, the extra cost of managing extra money is marginal.
- Hence, Lowering of TER for higher AUM companies avoids the chances of any unfair pricing.
- An upfront commission is an amount that fund distributors receive for getting investors to put money into a fund.
- This means that the distributor's interest lies in getting a transaction done, hence they try to keep moving the money and creating more transactions.
- Hence, SEBI has outlawed it and instead go for trail commission.
- With this, as long as the investor is invested, the distributor gets a steady stream of revenue.
- This avoids the need for switching money merely to get as many transactions as possible.
- SEBI's move to bar mutual funds from paying fees to distributors from their books is also seen as an effort to prevent mis-selling.
- This is because the commissions come from the underlying schemes and not the asset management companies.
- SEBI's move to promote corporate bond market is difficult to implement in the absence of any real reforms.
- This is witnessed by the share of corporate bond market to GDP at around 17%, way lower than the equity market at 80%.
- Also, there are concerns that advisers could push financial products with higher costs and fees on account of lower expenses and commissions.
- Hence it is necessary to ensure that lowering of expenses leads to passing on the benefits of efficiencies to investors.

5.6 SEBI Panel's suggestion on FPI Norms

Why in news?

SEBI appointed panel has made some suggestions to its circular to enhance KYC norms for foreign portfolio investors (FPI).

Who is a BO?

- A beneficial owner (BO) is one, who, directly or indirectly, derives the benefits of ownership.
- The threshold for a BO in a partnership firm or trust is 15% and 25% in the case of companies.
- The threshold is only 10% if the fund is incorporated in high-risk nations with a history of money-laundering and terrorism, etc.
- In case no single entity meets these thresholds, then a senior managing official of the FPI is the designated BO.

What does the circular say?

- **Ban -**It says Resident Indians (RIs), Non Resident Indians (NRIs), Persons of Indian Origin (PIOs) and Overseas Citizens of India (OICs) **cannot be BO** of a FPI investing in India.
- NRIs and OCIs can only obtain an FPI licence on condition that **they limit their roles to investment advisors** and do not invest their money.
- **Conversion -**Any single FPI can only hold a shareholding limited to 10% in an Indian listed company.
- If the limit is breached, the BO must either opt to be treated as a FDI, or divest stake below 10% within five trading sessions.

- The investment limit of different FPIs will be clubbed if they have the same BO and the clubbed limit should also not exceed 10%.
- Category II and III FPIs were asked to disclose the name and address of the BOs, their tax residency jurisdiction along with percentage shareholding capital or profit ownership in the FPIs.
- SEBI has also asked FPIs to determine ownership based on both shareholding and control, in contrast to the prior criteria of whoever owning a majority stake in a fund being considered a BO.
- Though SEBI has not explicitly stated the reason, concerns over money-laundering and round tripping may have prompted this directive.
- In a relief to FPIs, SEBI-appointed panel has made some suggestions to the circular.

What does the HR Khan panel recommend?

- NRIs be allowed to hold stakes of up to 25% in FPI funds.
- In combination, NRIs can hold up to 50% of an FPI fund in concert and PIOs and OCIs can be allowed to invest via the FPI route without any restriction.
- It clarified that the concept of BO should be applied only for KYC norms.
- For additional KYC norms, certain sensitive data (such as the US Social Security number) will not be collected, to alleviate concerns about data security.
- This prevents the possibility of the 10% limit being triggered and the Centre has told SEBI that it need not use beneficial owner definition laid down under PMLA.
- In cases where the 10% limit is exceeded, the FPIs in question will be given 180 days to divest holdings (or opt to be treated as foreign direct investors).
- The same regulations will apply to participatory note investments.

What were the shortcomings?

- **Capital Outflow -** The total portfolio investments in India's financial markets are estimated at $450 billion.
- The SEBI circular disqualifies about $75 billion of portfolio investments into India made by FPIs backed by domestic institutions, NRIs, PIO and OCI card-holders.
- The order may trigger **wholesale selling** since NRIs cannot operate through the FPI route anymore.
- It was originally issued with the intention to enhance the KYC norms for FPIs.
- But it ended up imposing a blanket ban on certain types of investments where NRIs, PIOs or OCIs were investors (beyond a threshold) or even served as senior managing officials of these funds.
- The circular delegates the task of identifying high-risk jurisdictions, with tighter KYC norms, on custodian banks.
- **Definition** – Companies running multiple India-focussed funds might have only a single officer as a BO for all funds from one house.
- In that case, the separate funds may be **forced to sell**, even if those funds are all individually below the 10% limit.
- **Revenue loss** - Loss of investment of funds into India could also result in the country losing the benefit of tax revenues generated by onshore Indian taxpayers.
- **Impact on public enterprises** - Private investment in public enterprises (PIPE) strategy could also be affected
- **Privacy -** Given the lack of data protection laws, information demanded in the KYC like address, date of birth, tax residency number, passport number, etc., of the BO will make many FPIs uncomfortable in sharing information.
- Hence, a group of FPIs openly appeal to the Prime Minister for an urgent intervention in this regard.

5.7 New Guidelines for Credit Rating Agencies

Why in news?

SEBI has come out with new guidelines to improve the quality of disclosures made by credit rating agencies recently.

What does the guidelines say?

- The regulator issued a circular tightening disclosure norms for rating agencies when they rate companies and their debt.
- Experts say rating agencies in India often failed to consider cash flows and ground conditions before assigning a rating.
- Hence rating agencies must now disclose the liquidity position of a company.
- They have to inform investors about a company through parameters such as their cash balance, liquidity coverage ratio, access to emergency credit lines, asset-liability mismatch, etc.
- If the rating is assigned on the assumption of cash inflow to the company they rate, the agencies would need to disclose the source of the funding.
- Thus they would now be required to furnish information on whether the rating is factoring in support from a parent company, its group companies or from the government.
- They are also required to name of such entities, along with rationale for such expectation.
- Rating agencies must also disclose their rating history and how the ratings have transitioned across categories.
- This is to inform clients about how often their rating of an entity has changed over a period of time.
- Also, when subsidiaries or group companies are consolidated to arrive at a rating, list of all such companies, along with the extent (e.g. full, proportionate or moderate) and rationale of consolidation, will have to be provided.
- All rating agencies would require furnish data on its rating actions in investment grade rating category, to stock exchanges and depositories for disclosure on website on half-yearly basis, within 15 days from the end of the half-year.

Why are the norms revised?

- SEBI has been working hard to improve transparency and credibility among rating agencies for some time now.
- It has already issued a circular in November 2016 calling for enhanced standards for rating agencies.
- But the latest disclosure norms seem to be a response to the IL&FS defaults and the ensuing crisis.
- Rating agencies came under the spotlight following the crisis at Infrastructure Leasing & Financial Services Ltd (IL&FS) and its group entities.
- Many mutual fund houses, invested in it, were caught unaware as major credit rating agencies started to cut ratings from high investment grade to default or junk.
- The agencies faced criticism that they had failed to see the financial troubles in the group and adjust its rating of IL&FS only when its debt jumped by 44% at the end of March 2015.
- This prompted the regulator to review the rating standards and whether there is a need for increased accountability, and insist on more disclosures.
- Thus the recent measure mandating the formal disclosure of these facts is welcome.
- The ready availability of information can help investors make better decisions.

What are the concerns?

- However, the latest regulations can only help to a certain extent as a lot of the problems with the credit rating industry have to do with structural issues rather than the lack of formal rules.
- The primary one is the flawed "issuer-pays" model, where a bond's issuer pays the rating agencies for the initial rating of a security, as well as ongoing ratings.
- The public (and investors) can then access these ratings free of charge.

- This often leads to a situation of conflict of interest wherein the entity which issues the bond/debt instrument also pays the ratings agency for its services, with tremendous potential for rating biases.
- Second, the credit rating market in India has high barriers to entry, which prevent competition that is vital to protecting the interests of investors.
- This is not very different from the case in many developed economies where rating agencies enjoy the benefits of an oligopoly.
- Better disclosures can increase the amount of information available to investors, but without a sufficient number of alternative credit rating providers, quality standards in ratings will not improve.
- It is thus no surprise that even after repeated ratings failures in their long history, credit rating agencies continue to remain and flourish in business.
- Structural reform should aim to solve another severe problem plaguing the industry, which has to do with rating shopping and the loyalty of credit rating agencies in general.
- Rating agencies will have to come up with lucrative business models that put the interests of investors above those of borrowers.
- Such a change requires a policy framework that allows easier entry and innovation in the credit rating industry.

5.8 Expansion of Commodity Derivatives Trading

Why in news?

BSE and NSE have received permission from the Securities and Exchange Board of India (Sebi) for commodity derivatives trading recently.

What is a derivative?

- Derivatives are the contract whose value is derived from the underlying asset or the contract where delivery of security or commodity held on specific future date.
- The main purpose of commodity derivative is to reduce the risk of future price uncertainty and provide the industry knowledge as well investment opportunity to a general investor.
- Derivatives could be stocks, indices, commodities, currencies, exchange rates or the rate of interest.
- Till date, commodity derivatives contracts are available only on MCX and NCDEX, the two specialised commodity derivatives exchanges in the country.
- The Bombay Stock Exchange(BSE) became the first stock exchange in the country to launch commodity derivatives contract in gold and silver.
- Both BSE and NSE has plans to launch derivatives trading in non-agriculture commodities in the initial phase, followed by agriculture commodities.

What are the other such initiatives in this regard?

- SEBI has recently redrafted the rules for trading, membership, products and risk management.
- Market surveillance has also improved with tighter supervision and scrutiny.
- Domestic companies with direct exposure to commodity price risk in gold, gems and precious stones have been barred by RBI from hedging in international markets.
- This is likely to result in these companies using the domestic exchanges to take cover, thus helping domestic commodity derivative volumes.
- Also, all listed companies are required to disclose their commodity risk, hedged exposure as well as their risk-management policy.
- This is to make companies take greater cover for their commodity exposures due to the fear of investor displeasure, which could also help improve volumes on exchanges.

What should be done?

- **Agri-contracts** - Both exchanges are beginning their foray in this segment with bullion and energy-based contracts.

- SEBI needs to ensure that both BSE and NSE soon launch agri-contracts that serve farmers and companies in hedging price risks.
- **Pricing** - Exchanges often tend to use predatory pricing or other underhand methods to garner market share and it should be dissuaded.
- Also, SEBI needs to examine ways to bring down the high cost of trading in domestic exchanges.
- **Participation & Monitoring** - Increasing market participation by allowing other investor segments such as mutual funds into commodity markets should be looked out.
- A tight vigil needs to be maintained to ensure that there is no unhealthy competition among exchanges.

Depository Receipts(DR)

- A DR is a type of negotiable (transferable) financial security traded on a local stock exchange but represents a security, usually in the form of equity, issued by a foreign, publicly-listed company.
- The DR, which is a physical certificate, allows investors to hold shares in equity of other countries.
- DRs are created when a foreign company wishes to list its securities on another country's stock exchange and tap those local funds.
- Global Depository Receipts(GDR) and American Depository Receipts(ADR) are amongst the most common DRs.
- IDRs are transferable securities to be listed on Indian stock exchanges, against the underlying equity shares of the issuing company which is incorporated outside India.
- Typically, companies with significant business in India, or an India focus, may find the IDR route advantageous.
- Similarly, the foreign entities of Indian companies may find it easier to raise money through IDRs for their business requirements abroad.

5.9 Share Swap

Why in news?

Hindustan Unilever (HUL) announced the merger of Glaxo SmithKline Consumer (GSK Consumer) with it, in a deal that has been structured as a share swap.

What is a share swap?

- When a company pays for an acquisition by issuing its own shares to the shareholders of the target company, this is known as a share swap.
- The number of shares to be issued in lieu of their existing holdings to the target company is called the swap ratio.
- Swap ratio is determined by valuing the target company after looking into metrics such as its revenues and profits, as well as its market price.
- If the target company is listed, the market value of its shares is often a key consideration to arrive at the right price to be paid.
- Paying a premium linked to a market value usually indicates healthy prospects and high potential, while a discount could indicate a distress sale.

What are the advantages?

- **Sharing risks** - In a cash deal, if the acquirer has paid a premium and the synergies don't materialise, shareholders of the acquiring company alone bear the fallout.
- In the case of share swap, shareholders of the target company will also become shareholders of the merged entity.
- So, the risks and benefits of the expected synergy from the merger will be shared by both the parties.
- **Less borrowing costs** - In a share swap, there is no cash outgo involved for the acquirer, saving the acquirer borrowing costs.
- The acquirer companies, in turn, can put their cash to use for investments in the business or for other buyouts.
- **Creating Goodwill** - Issuing fresh shares could lead to reduction in promoter holding and dilution in earnings for shareholders of the acquiring company.
- However, the acquiring company can benefit from lower taxes, if there is goodwill created out of the merger which it writes off over the years.
- Goodwill arises when the acquisition price is higher than the value of assets and liabilities of the acquired company.

What does the HUL-GSK deal show?

- The merger with HUL values the total business of GSK Consumer Healthcare at ₹ 31,700 crores.
- Shareholders will receive 4.39 HUL shares for each GSK Consumer share held, according to the share swap ratio.
- The valuation is based on a premium of 5% on the 15-day weighted average stock price of GSK Consumer.
- Thus, HUL is paying close to the market price of the GSK Consumer stock whose consumer goods stocks have had a good run in the market.
- HUL too has good long-term prospects with a diversified product portfolio and market leadership in several categories.
- Hence, GSK Consumer shareholders have got a fair deal.
- Earnings per share (EPS) is the portion of a company's profit allocated to each share of common stock.
- From the HUL side, the acquisition will immediately add to the Earnings Per Share despite the equity dilution of about 8% from the share swap.

Are the share swaps taxable?

- In case of a share swap, when shareholders of the acquired company are given shares of the acquirer company as part of the deal, this is not considered a transfer of shares.
- Hence, capital gains tax will not arise in the hands of the shareholders (including minority shareholders) of the acquired company.
- The tax liability will arise only when the shares of the merged entity are sold.

6. EXTERNAL SECTOR

6.1 Weakening Rupee

Why in new?

Rupee crashed to a lifetime low of 69 against US Dollar.

How is the rupee trend?

- Rupee was pushed to a life-time intraday low of 69.10 a dollar.
- The rupee is the worst-performing currency in Asia this year.
- It has lost almost 8% in value since January 2018.
- The rupee's previous historic low was in November 2016 (it plunged to 68.86).
- It is, however, not the only currency to be in the weakening trend.
- Emerging market currencies as a group have witnessed a sharp correction in their value against the dollar this year.

What are the causes?

- The rise in international **crude oil prices** is one of the reasons.
- Importers have had to shell out more dollars to fund their purchases.
- The rise in global trade tensions amidst the ongoing **trade war** is another factor.
- But its impact on the rupee remains unclear as of now.
- But by far the most important reason is the tightening of **U.S. monetary policy**.
- Investors attracted by higher yields in the US have been pulling their capital out of India.
- Also, **China** has been **depreciating** its currency (yuan).
- This is to offset the effect of duties imposed by the US.
- The Indian unit also seems to be moving in tandem with the yuan so that exporters don't lose out.

What will the implications be?

- **CAD** -India's CAD jumped to 1.9% of GDP in the fourth quarter of 2017-18 from just 0.6% a year earlier.
- It is now expected to widen to 2.5% in FY 2019.
- This could impact the rupee as the demand for dollars could turn out to be overwhelming.
- But although current account deficit has widened, it remains modest relative to GDP.
- Also, it is largely financed by equity inflows, including foreign direct investment.
- **External risks** - Moody's Investors Service has ruled out any risk with this development.
- India's large and relatively stable domestic financing base restricts its external vulnerability.
- It will contribute to the economy's resilience by protecting from abrupt changes in external financing conditions.
- **DebtAffordability** - Currency depreciation transmitting into materially weaker debt affordability is limited.
- This is because of India's low dependence on foreign-currency borrowing to fund its debt burden.
- India's significant build-up of foreign exchange reserves in recent years to all-time highs provides a support buffer.
- This will contribute to mitigating the external vulnerability risk.

6.2 Foreign Investments Slows

What is the issue?

- Reports have confirmed that all forms of Foreign Investment in India (including the priced FDI) are slowing down.
- This is despite the positivity in the global economy and the government's strong rhetoric in this domain.

What is the state of FDI flows?

- **What -** Foreign direct investment (FDI) is prized over other forms of capital flows because it directly adds to the productive base of the country.
- As a long-term and patient monetary stream, it is contrasted against the "hot money" that comes as portfolio investments, which is more temporary.
- **Data -** According to recent data from the "Department of Industrial Policy and Promotion" (DIPP), growth rate of FDI hit a 5-year low in 2017-18.
- It grew by only 3%, to $44.85 billion this year, which is despite the big-ticket purchase of Essar by Rosneft, for $13 billion.
- This trend was also confirmed in a report from the "United Nations Commission on Trade and Development" (UNCTAD).
- According to UNCTAD, FDI to India actually fell in the calendar year 2017, from $44 billion the previous year to $40 billion.
- But on the contrast, UNCTAD notes that outward FDI from India more than doubled during the same period.

How does this trend contrast against Modi government's rhetoric?

- The current government has been loudly trumpeting its efforts to make India more investment-friendly and prides its pro-business credentials.
- But statistics suggest that not just foreigners, but even Indian investors are less likely to invest in India presently, as indicated by outward FDI flows.
- More specifically, while FDI flows have declined overall internationally, the developing world at large has largely been able to retain its investment flows.
- As some developing countries have even seen considerable spikes in FDI flows, the government can't state external factors for India's FDI trends.

- Interestingly, India's standing in World Bank's "Ease of Doing Business" ranking has been steadily raising, but it isn't being reflected on the ground.
- This may be because the government is focusing on merely tailoring its policies to improve rankings without actually improving business friendliness.
- The government seems to have given up too soon on "deep structural reforms" that it enthusiastically embraced at the start of its tenure.

What is the way ahead?

- There is no scope for any Indian government to abandon reforms at this point in India's development due to the complex market scenario at play.
- **Structural -** The percentage of permissible FDI has been raised in various sectors, but the processes for investors to enter India remains cumbersome.
- The abolition of the Foreign Investment Promotion Board (FIPB) was intended to simplify processes by removing a bottleneck.
- But the direct ministerial approval regime that is now operational doesn't seem to be having the desired results.
- **Changing Wind -** The impressive 6% plus GDP growth in the previous decade had made India one of the most sought after investment destination.
- But the past record seems have made our policy makers arrogant regarding the potency of India's economy to attract investments.
- Considering the current situation, India would do good to give up arrogance and be more respectful of investor concerns (like dispute resolution).
- It is important to note that, a sustained increase in foreign investments is vital for generating jobs for the millions entering the workforce every year.

6.3 Fall of Rupee & Turkey's Currency Crisis

Why in news?

The value of Turkey's currency, lira, has nosedived since January and has lost more than 34% of its value against the dollar.

What caused this?

- **Construction Boom -** The Turkish economy has been in slow-motion decline for a while, with the lira sliding steadily downhill since 2016.
- A construction boom was happening and it reached its height in 2013 and 2014, as Turkish banks issued low-interest loans.
- This construction frenzy has been at the heart of Turkey's economy, accounting for up to 20% of the country's GDP growth in recent years.
- But this was not accompanied by having enough foreign capital.
- So property developers funded this construction frenzy with cheap loans in foreign currencies. (In a parallel to the 2008 financial crash, the boom was funded by low-interest loans and ballooning debt.)
- Turkey is also heavily reliant on imports for construction materials.
- Much of the properties were built with the expectation that it would be bought by wealthy investors from Gulf countries.
- But the demand from the Gulf failed to rise to the level hoped.
- This lack of demand, alongside rising costs for iron and steel, has caused many projects to stall.
- This was further complexed by poor regulation of this industry.
- These factors affected the exchange rate of lira heavily.

- **Foreign Relations -** The present crash was triggered by a spat with the US government over Turkey's ongoing imprisonment of the American pastor Andrew Brunson, who is accused of involvement with a 2016 coup attempt.
- Lira experienced a further blow when Trump Administration said doubled the tariffs on Turkish steel and aluminium.
- **Central Bank -** In many nations, the central bank is independent of government. This means it can keep control of inflation by raising them when necessary.
- But in Turkey, Mr Erdogan has made sure he controls the reins.

What are the consequences?

- To repay loans in dollars and euros, as the weakened lira means there is now more to pay back.
- Many middle class homebuyers who paid for new apartments upfront are also affected as these apartments are now on permanent hold because the companies can't afford to build them.
- Only upside to this is that the tourism industry has been flourishing due to the fall of lira.

How did this affect Rupee?

- This turmoil has impacted many emerging markets due to deteriorating emerging-market sentiment among investors.
- Rupee faced a huge blow as it was already being affected by lack of FII inflows and growing oil prices.
- Hence the rupee plunged to hit a record low of 70.08 a dollar.
- Central bank intervened to slow the pace of fall but it is unlikely that there could significant intervention as factors impacting the currency are coming from external sources.
- Experts feel that the fall is not so dramatic and so not a time to panic.
- Foreign investors investing in government bonds or fixed income may feel some impact due to this.
- But the fall provides a big opportunity for exports especially at a time when trade wars are happening.

6.4 Dealing with Fuel Price Rise

What is the issue?

Even amidst widespread opposition for petrol and diesel price rise, the government ruled out any immediate reduction in excise duty.

What is the response?

- The Centre has urged the states to take action.
- Andhra Pradesh announced a Rs 2 per litre cut in VAT on petrol and diesel.
- Rajasthan also announced a 4 percentage point cut.
- But states have been largely unenthusiastic in cutting down the excise duty.

How important is taxes on petrol and diesel?

- The Centre has had nearly Rs 2 to 2.5 lakh crore from excise duty on petroleum products in 2016-17 and in 2017-18.
- The states' earnings through sales tax/VAT on petroleum products increased around Rs 1.6 to Rs 1.8 lakh crore from 2016-17 to 2017-18.
- Clearly, taxes on petrol and diesel are a key revenue source for both the Centre and states.
- Any reduction in this would significantly hit their fiscal position.

Will bringing it under GST help?

- LPG, kerosene, naphtha, furnace oil, and light diesel oil attract GST.
- But five other petroleum products lie outside the GST regime.

- These are crude oil, high speed diesel, motor spirit (petrol), natural gas, and aviation turbine fuel.
- But the Centre and the states are not fully ready to include these five petroleum products in the GST regime.
- Even if petrol and diesel are included under GST, prices are unlikely to fall.
- This is because of the GST principle of keeping rates close to the earlier tax rates.
- Also, worldwide trend suggests that if petrol and diesel are included in GST, states levy additional taxes to prop up revenue.

What can states do?

- Rates of state sales tax or Value Added Tax (VAT) vary from state to state.
- Unlike excise duty, VAT is ad valorem, and results in higher revenues for the state when rates move up.
- This is because taxes imposed by the Centre are specific i.e. fixed in terms of Rs per unit.
- On the other hand, the states tax the oil on ad valorem basis.
- This means that the tax is based on the assessed value of the commodity.
- So, with increasing petroleum prices, states' tax collection correspondingly goes up.
- Thus, the states could make a 10-15% duty cut and still get the same amount of tax revenue as budgeted.
- Therefore, the call for reduction in taxes on petroleum products applies more to the states than to the Centre.

6.5 Challenges in Current Account Deficit

Why in news?

IMF recently forecasted India's current account deficit (CAD) to widen to 2.6% of GDP in 2018/19 from 1.9% in the previous year.

What are the recent developments that affected CAD?

- With moderation in CPI inflation and the CAD, alongside sufficient forex reserve buffer, **India scored 25** in **NDI** and was well **within the safety threshold**.
- Yet, higher oil prices, portfolio outflows and a sharper-than-expected domestic growth slowdown still remains as its key vulnerabilities.
- Value of oil imports has risen, even though these have been offset by increases in net factor incomes from abroad.

Nomura Damocles Index (NDI)

- It assesses the risk of exchange rate crisis for 30 emerging market economies.
- A score above 100 suggests a country is vulnerable to an exchange rate crisis in the next 12 months.

- This lead to a balance between balance of trade and balance of invisibles in the current account.
- Stronger dollar growth and the negative events in Argentina and Turkey impacted many such emerging markets due to **deteriorating emerging-market sentiment** among investors.

What are the structural factors surrounding CAD in India?

- India's GDP growth is largely driven by consumption that are largely import-intensive.
- A depreciating rupee should result in a fall in import demand and a rise in export demand through the price effect.
- The situation gets different altogether in India, wherein exports respond mainly to improvements in productivity and to changes in global demand.
- This made our exports highly **inelastic to exchange rate depreciation**.
- Since 1991, import intensity of the Indian economy has risen steadily.
- It has been fuelled by increased elite prosperity and their luxury consumption needs instead of importing food and other items of mass consumption.

- Key growing sectors like defence, aviation, and electronics have failed to secure significant import substitution in recent times.
- New import-intensive sectors have emerged as in cheap clothing from Bangladesh and Vietnam and solar panels from Japan and China.
- India also raised its **import of non-tradeables** wherein forex spent on education and recreational travel abroad raised from $176 million in 2013 to $5.4 billion in 2017.

How should India proceed?

- Encouraging FDI and FPI inflows could be the immediate strategy to arrest the rising CAD.
- But in the long term, India should moderate the CAD by orienting her **domestically driven growth** to foster substitution in imports.
- Hence, India's external account challenge is structural and it requires a **continuing, orderly depreciation of the rupee**, which would eventually reduce the pace of import growth and encourage export growth.

6.6 Indo-Japan Currency Swap Arrangement

Why in news?

Union government recently signed a bilateral currency swap arrangement with Japan.

What is the currency swap arrangement all about?

- A bilateral currency swap is an open-ended credit line from one country to another at a fixed exchange rate.
- The country which avails itself of this loan pays interest to the country which provides it, at a benchmark interest rate such as the Libor (London Inter-bank rate).
- While India has such arrangements with many Asian nations, the arrangement with japan is among the largest of such deals, valued at $75 billion.
- The government hopes that this deal will act as a buffer to shore up the rupee, which has depreciated by 14% against the dollar this year.

How the arrangement will work?

- The currency swap arrangement will allow the Indian central bank to draw up to $75 billion worth of yen or dollars as a loan from the Japanese government whenever it needs this money.
- The RBI can either sell these dollars (or yen) to importers to settle their bills or to borrowers to pay off their foreign loans.
- The RBI can even hang on to the money to shore up its own foreign exchange reserves and defend in the rupee.
- While the RBI had amassed foreign currency reserves of over $426 billion by April 2018, it has had to use up some of this in recent weeks to prop up the rupee.
- Though present forex reserves at over $390 billion are still comfortable, having a $75-billion loan-on-demand from Japan gives the RBI an additional buffer to fall back on, should it need extra dollars.

What is the reason behind such arrangement?

- In recent times, the rupee has been falling against the dollar because of its widening current account deficit (the difference between imports and exports of goods and services).
- This leads to importers upping their demand for dollars far beyond what exporters bring into the country.
- A swap arrangement with Japan provides considerable comfort to India, because Japan is the second largest holder of dollar reserves in the world after China and is sitting on fat coffers of over $1,250 billion.
- Therefore, while Japan is quite unlikely to ask India for a dollar loan, India can make use of such a loan at rock-bottom interest rates.
- Japan may also see this deal as quid pro quo for lucrative investment deals that help Japanese companies set up shop in India.

6.7 Concerns on Anti-dumping duty

What is the issue?

Indian economy continues to be hurt by dumping of products from other countries and there is a need for a clear procedure to levy anti-dumping duties.

Why should an anti-dumping duty be levied?

- Dumping is a process where a company exports a product at a price lower than the price it normally charges in its home market.
- An anti-dumping duty is a protectionist tariff that a domestic government imposes on foreign imports that it believes are priced below fair market value.
- India is one of the largest consumption economies in the world and a potential ground for dumping a wide variety of goods, especially from China, Taiwan and South Korea.
- Thus, India must have strong anti-dumping defences in place.

What are the concerns in dealing with dumping?

- **Under-staffing** - The Directorate General of Trade Remedies (DGTR) that looks at unfair trade practices by exporters from other countries, is inadequately staffed.
- DGTR has just seven costing officers and five investigating officers and the allocation of work is uneven among them.
- This has resulted in delay and arbitrariness in decision-making.
- **Duty Imposition** - Generally, once initial investigation reveals injury on account of dumping, an interim duty is levied for immediate relief.
- A final duty is levied after extensive investigation.
- Every case taken up for investigation had interim duties levied in 2009.
- But this has gradually declined in recent years.
- Imposition of interim and final duties are also invariably delayed.
- This has resulted in shutting down of MSMEs who are unable to compete in the market.
- e.g In many case, getting the case initiated itself takes about a year, which is followed by Finance Ministry taking another 3 months to impose ADD.
- **Sunset review** - ADD is applicable only for a selective period.
- If dumping still continues, the industry can apply for a sunset review at the end of 5 years.
- Globally, once a sunset review is applied for, the ADD is extended for 1 year pending investigation.
- In India, industries has been asked to apply for sunset review 9 months before the expiry of ADD.
- This made the Indian players getting deprived of protection for a year compared to their peers across the world.
- This is critical because the DGTR has been rejecting almost every sunset review application.
- **Difference of opinion -** In 2018, only one of seven reviews was duty extended.
- DGTR is increasingly hesitant to extend ADD beyond 10 years on the grounds that this period is good enough for the industry to become competitive.
- But the industry players argue that as long as dumping continues ADDs need to be in place to protect the domestic industry.
- **Duty calculation** - Dumping margin is the difference between the normal value and the export price of the goods under complaint.
- Lesser dutymeans lesser of dumping margin or injury margin.
- Anti-dumping duty should be either equal to dumping margin or lesser amount, which is sufficient to redress injury.

- India follows a 'lesser duty' rule.
- Also, at times, even when DGTR recommends ADD, the Finance Ministry declines on the ground that low-priced imports are good for the country.

6.8 FDI in e-commerce

Why in news?

Ministry of Commerce & Industry recently reviewed the policy on Foreign Direct Investment (FDI) in e-commerce.

What does the guidelines say?

- E-commerce entities would engage only in Business to Business (B2B) e-commerce and not in Business to Consumer (B2C) e-commerce.
- **FDI Limit** - E-commerce means buying and selling of goods and services including digital products over digital & electronic network.
- 100% FDI under automatic route is permitted in marketplace model of e-commerce.
- Marketplace based model of e-commerce means providing an IT platform by an e-commerce entity on a digital & electronic network to act as a facilitator between buyer and seller.
- However, FDI is not permitted in inventory based model of e-commerce.
- Inventory based model of e-commerce means an e-commerce activity where inventory of goods and services is owned by e-commerce entity and is sold to the consumers directly.
- **Control** - E-commerce entity providing a marketplace should not exercise ownership or control over the inventory i.e. goods purported to be sold.
- If more than 25% of the inventories of an E-commerce entity are linked to a single seller, it ceases to be an intermediary between buyers and sellers.
- Such an E-commerce entity will be treated as an inventory based model rather than a market-place platform.
- **Equity holding** - An entity having equity participation by e-commerce marketplace entity will not be permitted to sell its products on the platform run by such marketplace entity.
- Hence, a product in which, say, Amazon or Flipkart have a stake cannot be sold on their respective platforms.
- **Responsibility** - In a marketplace model, goods/services made available for sale electronically on website should clearly provide name, address and other contact details of the seller.
- Post sales, delivery of goods to the customers and customer satisfaction will be responsibility of the seller.
- Any warrantee/ guarantee of goods and services sold will be the responsibility of the seller.
- Also, e-commerce marketplace entity will not mandate any seller to sell any product exclusively on its platform only.
- **Price** - E-commerce entities providing marketplace will not directly or indirectly influence the sale price of goods or services and should maintain a level playing field.
- Also, cash back provided by group companies of marketplace entity to buyers should be fair and non-discriminatory.
- The above decision will take effect from 01 February, 2019.

What are the possible benefits?

- Under the guidelines, the e-commerce players cannot directly or indirectly influence the price of goods and services.
- Also, e-commerce marketplace entity will not mandate any seller to sell any product exclusively on its platform only.
- Thus, consumers may no longer enjoy the deep discounts offered by retailers that have a close association with marketplace entities.

- However, the absence of large retailer's monopoly will, however, bring relief to small retailers selling on these platforms.
- Traders running traditional brick-and-mortar stores, who now find it difficult to compete with the large e-commerce retailers with deep pockets, could also gain.
- These changes will enable a level playing field for all sellers, helping small retailers, including MSME, to leverage the reach of e-commerce.

What are the concerns?

- The guidelines say that e-commerce companies running marketplace platforms (Amazon and Flipkart) cannot sell products through companies in which they hold equity stake.
- Also, a vendor's inventory will be deemed to be controlled by the e-commerce player if more than 25% of its purchases are from the e-commerce player or its related firms.
- **Business model** - The changes will have a significant impact on the business model of e-commerce majors, as most of them source goods from sellers who are related party entities.
- Going forward, the suppliers will not be permitted to sell their products on the platform run by such marketplace entity.
- This will impact backend operations, as Group entities would have to be removed from the e-commerce value chain.
- Separately, any specialised back-end supportgiven by e-commerce players for some sellers must now be extended to all vendors.
- **Equity restrictions** - E-commerce players, who have their private labels on a product, will not be able to sell them on their platforms if they hold equity in the company manufacturing them.
- For example, Cloudtail India Pvt Ltd is the biggest retailer operating on Amazon, while WS Retail was the biggest seller on Flipkart.
- Cloudtail's ownership shows a clear link with Amazon.
- Hence, under the new rules, Cloudtail, in which Amazon holds equity stake, may not be able to sell products on Amazon's e-commerce platform.
- **Voluntary sale** - An e-commerce marketplace entity will not mandate any seller to offer a product exclusively on its platform under the new rules.
- However, there is no explanation on what to do when a seller voluntarily opts to sell exclusively on one e-commerce portal over another.

6.9 Significance of a Competitive Exchange Rate

What is the issue?

Major economies like China are using the instrument of competitive exchange rates for a stabilized economy, which India can also follow.

What is Rupee appreciation?

- Exchange rate is the price of foreign currency (USD, Yen, Euro, Pound etc) in terms of domestic currency (rupee) i.e. amount of domestic currency needed to buy one unit of foreign currency.
- Exchange rate tells us the value of domestic currency in relation to one unit of foreign currency.
- Rupee prices keep fluctuating all the time. Sometimes we need more rupees to buy one unit of foreign currency and sometimes we need fewer rupees to buy one unit of foreign currency.
- This change in rupee price is known as rupee appreciation or depreciation.
- Rupee appreciation is when value of rupee increases (becomes expensive) and fewer, when Rupees can buy one unit of foreign currency.
- This is also known as strengthening of rupee as now INR is worth more than foreign currency.

What are economic concerns before India?

- India's demographic dividend is on the verge of becoming a curse as it is unable to create new jobs fast enough for its growing young population.
- In the discussion on improving the business case for value addition and job creation in India, the critical importance of the exchange rate hardly gets any attention.
- India is not yet able to take advantage of its low wages and the inherent talent of its young people to get enough investment, both domestic and foreign, into job creation and value addition.
- India has been for years the largest recipient of capital inflows from its expatriate community who send remittances.
- In addition its stock market has been attractive enough for FIIs (Foreign Institutional Investors).
- Such inflows when not matched by higher rates of investment in the economy usually lead to asset price bubbles in the stock and real estate markets, in addition to an appreciation of the exchange rate and decline in competitiveness.
- In India the perception among political and civil society elites has been that a strong currency is a sign of economic strength and depreciation is a sign of economic weakness.

How rupee appreciation will be beneficial for Indian economy?

- The movement of the real exchange rate, the nominal rate adjusted for the differential in inflation rates with major trading partners, has a similar effect as changes in tariff rates.
- A 10% real exchange rate appreciation is equivalent to a 10% lowering of tariffs across the board and a 10% depreciation is equivalent to a 10% increase in tariffs.
- The greater the depreciation the higher is the impact on the business case for domestic value addition.
- This impact is experienced not only by exporters but also by those who serve the domestic market as imports become cheaper with appreciation and more expensive with depreciation.
- India's trade deficit with China is over $60 billion, all that is being imported from China can be made in India.
- Appreciation is beneficial to FIIs as the gains from the increase in the prices of their stocks in India can be taken out fully.
- Similarly, large corporates who have foreign currency debt gain as the real debt repayment burden declines with appreciation.
- The wealthy Indian has to pay less for his holidays, child's education overseas and consumption of imported chocolates and cheeses.

What measures needs to be taken?

- Investments, which need a competitive exchange rate, could be seriously considered only if there is the expectation that henceforth the real exchange rate would not be allowed to appreciate.
- For this, a consensus on the imperative need for maintaining a competitive exchange rate as a necessary precondition for increasing value addition and job creation in the country would be needed.
- This should then become a clearly enunciated policy objective of the RBI with explicit backing of the government.
- The policy instruments that could be used could include building up of reserves, and reviewing the liberal tax regime for FIIs as well as the encouragement of foreign currency borrowings by large corporates.
- This is a necessary condition for improving the business case for value addition and job creation.

7. GENERAL ECONOMY

7.1 Draft "New e-Commerce Policy"

What is the issue?

- Inter-ministerial task force constituted to evolve a "new e-commerce policy" has submitted its report to the government.

- The policy will seek to define e-commerce, strengthen FDI laws in the sector, address regulatory and competition issues and customer concerns.

What are the expected tenets of the policy?

- **Overall -** The policy will seek to define e-commerce, strengthen FDI laws in the sector, address regulatory and competition issues.
- It will also focus on consumer interests, including data protection and privacy.
- **Data privacy -** The task force has recommended the local storage of data generated by users in India from various sources.
- Data sources include e-commerce platforms, social media and search engines.
- The policy is likely to tow a nuanced approach on data localisation in order to balance the free flow of businesses with privacy concerns.
- **Structures -** Development of a suitable framework for sharing the data within the country has also been recommended.
- An online grievance redressal mechanism is also on the cards and division of powers between the Centre and States is being worked out.
- Further, a single central e-com regulator is also likely to be established on the lines of the Telecom Regulator TRAI.
- **Competition -** The draft policy has recommends tightening the scrutiny of mergers & acquisitions in the sector.
- Further, it also seeks to ensure fairness in the market place and prevent predatory pricing by imbibing aspects of competition principles.

How does the future look?

- India's e-commerce market, currently valued at about $ 27 billion, is one of the fastest growing in the world.
- A comprehensive e-commerce policy would encourage further investments in the sector that has immense potential for growth.
- A clear policy framework would also help in taking a well-informed stand on issues concerning e-commerce at global forums.
- Notably, India is under immense international pressure to start negotiations for liberalising the Indian e-commerce sector.

7.2 Pension Fund Regulatory Development Authority

What is the issue?

- PFRDA completes five years of functioning,
- It is imperative at this juncture to reflect on its success and its shortcomings.

How has the NPS evolved?

- The National Pension System (NPS) was introduced in 2003.
- Concerns of inadequate coverage and fiscal unsustainability of traditional civil-servant pensions led to NPS's creation.
- The NPS was visualised as a defined-contribution pension scheme.
- It had features including individual pension accounts, multiple pension funds, etc.

PFRDA

- The interim PFRDA was established in 2003.
- This was to oversee the National Pension System (NPS), and regulate India's pensions sector.
- The interim PFRDA transitioned into the PFRDA with the passage of Pension Fund Regulatory Development Authority (PFRDA) Act, 2013.
- PFRDA has come a long way, but there are still some gaps in India's pension regulatory framework.
- **Significance** - The PFRDA Act is the linchpin of India's pension regulatory framework.
- The Act is being supplemented by regulations issued by the PFRDA.
- They regulate the functioning of key intermediaries under the NPS framework.
- These include the NPS Trust and the Pension Funds and Points of Presence (PoPs).

- Initially, NPS covered only government employees.
- It was extended to all citizens by 2009, barring members of the armed forces.
- Subsequent reforms focused bringing India's vast unorganised sector workforce into the NPS net.
- In this line were introduced a simpler variant of NPS, 'NPS-Lite' in 2010.
- Likewise, the 'Swavalamban' scheme was introduced in 2010.
- Under this, the government co-contributes to the pension corpus of unorganised sector workers not covered by social security schemes.
- Similarly, the 'Atal Pension Yojana' was introduced in 2015.
- In this, the government guarantees a minimum post-retirement monthly pension.
- It also extends co-contribution benefits to unorganised sector workers.

What are the concerns with PFRDA?

- **NPS** - A major concern in India's pension regulatory framework is a widespread lack of clarity.
- E.g. being a regulator of the pensions sector, PFRDA is also responsible for promoting and developing the NPS
- This gives rise to concerns of a potential conflict of interest.
- It thus requires a clearer delineation of the PFRDA's role, for greater regulatory accountability.
- **NPS Trust** - NPS Trust is a critical intermediary in the NPS framework which -
    i. holds subscriber funds and assets in its custody
    ii. implements PFRDA's regulations
    iii. supervises and monitors other intermediaries
- It does these all remaining under the PFRDA's supervision.
- At present, the NPS Trust and the PFRDA possess overlapping and concurrent powers.
- The powers are in relation to inspecting other NPS intermediaries.
- This again lacks clarity, leading to accountability and conflict of interests concerns.
- **Act** - The foreign shareholding limits for Indian insurance companies are currently 49%.
- Also, the foreign exchange regulations cap foreign shareholding in the pensions sector at 49%.
- But PFRDA Act caps foreign shareholding in Indian pension funds to be one of the higher from the following two -
    i. 26% of the pension fund's paid-up capital
    ii. the limits specified for Indian insurance companies under the provisions of the Insurance Act
- The choice from dual percentages as specified in the Act creates unnecessary confusion.
- **Consumer protection** - NPS serves as a universal product securing citizens' retiral incomes.
- But there is an inadequate emphasis on financial consumer protection.
- E.g. the web-based grievance portal for NPS subscribers allows complaints registration only in English.
- There are similar concerns with the PFRDA (Redressal of Subscriber Grievance) Regulations, 2015.
- It fails to specify clear grounds for approaching the office of the Ombudsman, functioning as the grievance redress authority.
- Inadequate attention to consumer protection also reflects in the recent PFRDA (Points of Presence) Regulations, 2018.
- PoPs are intermediaries and help in on-boarding subscribers to the NPS.
- The Regulations require PoPs to maintain confidentiality of subscribers' personal information.
- But the regulations fall short of

i. detailing specific standards of care required of PoPs
ii. expressly penalising PoPs who fail in protecting confidentiality

- The absence of such safeguards undermines the protection of subscribers' personal information.
- Addressing these gaps and strengthening the underpinnings of India's pensions framework should be a priority.

7.3 Pradhan Mantri Shram-Yogi Maandhan

Why in news?

The Interim Budget 2019 announced Pradhan Mantri Shram-Yogi Maandhan (PMSYM), a pension scheme for the unorganised sector workers.

What are the key provisions?

- PMSYM is a mega co-contributory pension scheme for unorganised sector workers with monthly income of up to Rs 15,000.
- It promises to provide assured pension of Rs 3,000 per month from the age of 60 years, in return for making a monthly contribution of a nominal sum during the working age.
- The scheme will cover 10 crore workers in the unorganised sector in the first 5 years, making it one of the largest pension schemes in the world.
- The benefits and the design spelt out in PMSYM are much in line with the Atal Pension Yojana (APY).

How does PMSYM compare with APY, and what are the concerns?

- The Atal Pension Yojana (APY) launched in 2015 also targets the unorganised sector.
- The government's estimate that the scheme would cover 2 crore workers in a year is uncertain, given the similar target group and similar design as APY.
- The five-year projections on coverage are less likely to be materialised as even APY had only about 1.34 crore subscribers in the 3 years (a mere 3.2% of the total unorganised sector workforce).
- APY has not been attractive for the unorganised sector -
    i. due to its contributory nature
    ii. the inflation-adjusted future benefits are too small to meaningfully serve any purpose in the old age
- By fixing Rs 3,000 per month, PMSYM has limited the options for a worker to choose the level of benefits as is currently possible under APY.
- In effect, it is said that the APY has been merely rechristened as PMSYM as there are no big changes in terms of design or real benefits.
- It is also unfair to allocate scarce financial and regulatory resources on duplicate schemes for the same target group.
- So in reality PMSYM may not make a big impact in serving a vast majority of the unorganised class.

7.4 Improvising the 59-minute Loan Scheme

What is the issue?

The concerns on poor loan disbursements persists even after the introduction of the 59-minute loan scheme.

What is the 59-minute loan scheme?

- The government announced the '59 minute' loan schemefor MSME sector in 2018.
- The scheme promises loans of up to Rs. 1 crore from public sector banks (PSBs) through an online lending marketplace called 'psbloanin59minutes'.
- This portal approves a loan in 59 minutes and connects the borrower to the bank branch for sanction and disbursal.
-

What is the need?

- According to 'MSME Pulse', the MSME loan market (under Rs. 25 crore) is estimated to be around Rs. 25 lakh crore, of which, PSBs hold almost 50% share.
- Further, PSBs have a dominant share of over 75% for loans under Rs. 10 lakhs, highlighting their critical role in financial inclusion.
- The biggest advantage of a PSB loan is its low cost, which could be 5-7% lower than that of NBFCs.
- For a small borrower looking for a collateral-free loan under Rs. 1 crore, PSB loans are critical, as both private banks and NBFCs mostly lend against security.
- PSB loans are also an important source of funding for the manufacturing sectors such as food processing, textile, chemicals, and auto components.
- As such, this policy measure may be a sincere attempt to reduce the time and effort required to secure credit from PSBs, thus easing the life of an entrepreneur.

What are the concerns?

- The demand for such a portal is validated by both the large number of applications (around 1.31 lakh) received within two months of its launch, and their total loan value.
- However, unless these applications translate into loan disbursals, the portal would remain just another channel for PSBs to generate qualified leads.
- The difficulties in getting a loan from PSBs stem from unwillingness of the ground-level staff to even accept the loan application.
- Even after a loan is approved, the high turnaround time for the disbursal remains a challenge.
- Therefore, the portal is a good first step to at least reduce the number of branches to be visited.
- In addition, the MIS behind the portal would make it easier for the banks to monitor loan rejections.
- Thus, the scheme's success depends on the ability of PSBs to quickly disburse the loans that are approved by the portal.
- According to official data, the portal received 1.31 lakh applications during the first 50 days of its launch, of which, around 1.12 lakh applications were approved, with a strike rate of 85%.
- However, of these 1.12 lakh applications, sanctions were accorded for just 40,669 cases, indicating that just over a third of the approved loans were sanctioned.

What should be done?

- High approval ratio by this scheme suggests that either most of the SMEs that are applying through the portal have good credit quality or the portal's credit approval norms are not strict enough.
- Also,low loan sanction ratio indicates that the turnaround time for loan sanction is more than two to three weeks and a number of applications are still undergoing due diligence and, thus, do not reflect in the sanction data.
- Addressing these issues would require deeper integration of the portal with banks' processes.
- The credit approval process should capture the existing liabilities of the borrower so that there are no disputes on quantum of credit to be sanctioned.
- Also, it should assess the availability of other resources such as land/technology with the borrower before sanctioning term loan for a new asset.
- On the policy front, the norms for takeover of loans among lenders should be relaxed.
- For example, under the current set-up, obtaining additional working capital loan from a different lender would be difficult.
- This is because banks would not be inclined to share security on equal footing with the fellow lenders for such small exposures.
- These concerns have to be addressed to make the portal serve its intended purpose.

7.5 New Procurement Policy

Why in news?

Cabinet Committee on Economic Affairs approved the implementation of "Pradhan Mantri Annadata Aay Sanrakshan Abhiyan" (PM-AASHA) recently.

What does the scheme contain?

- It aims to provide minimum support price (MSP) assurance to farmers.
- The new scheme has three components —
    1. Price Support Scheme (PSS)
    2. Price Deficiency Payment Scheme (PDPS)
    3. Pilot of Private Procurement & Stockist Scheme (PPPS).
- It **clubs together** the existing procurement schemes with newly introduced options.
- PDPS has been framed on the lines of the Madhya Pradesh government's Bhavantar Bhugtan Yojana (BBY) to protect oilseed farmers.
- Under this, farmers will be compensated to the extent of difference between MSP and market price subject to a ceiling price which may not exceed 25% of the MSP.
- Under PPPS, the selected **private agency** shall procure oilseeds at the MSP from the registered farmers whenever prices in the market fall below the notified MSP.
- A maximum service charge of up to 15% of the notified MSP will be payable to the agency as an incentive.
- This is similar to PSS in the **physical procurement** of the notified commodity, it will only substitute PSS in the pilot districts.

What are the challenges?

- Under the MSP policy, the government fixes the rates for 23 notified crops grown in kharif and rabi seasons.
- MSP was set at 50% higher than the farmers' production costs this year, including labour cost to give remunerative prices to the farmers.
- However, most of the 21 other crops are sold at market prices, often below the MSP, as the government's **procurement operations are temporary**.
- Though the government has increased the procurement of pulses and oilseeds at MSP under the existing PSS, it was way below the production target.
- For example, NAFED procured 31.9 lakh tonnes of pulses and oilseeds at the MSP in 2017-18, though the total production of pulses and oilseeds was estimated at 240 and 300 lakh tonnes respectively.
- Also PDP experiment in Madhya Pradesh shows, **cartelisation** was witnessed, wherein traders forced farmers to take lower prices from them on account of compulsory compensation from the government.
- It also ends up helping traders and lower level mandi functionaries more than the farmers, despite best intentions of the government.

What holds the key in successful implementation of the scheme?

- Registration of all the farmers, especially small and marginal ones, must be ensured so that they receive their compensation on time.
- Proper monitoring of the marketing system should be ensured, as in e-NAM, so that it will check rich farmers from exploiting the system.
- It also depends on how effective the states will be in checking the manipulative practices of the traders.

7.6 Dispute Settlement in WTO

What is the issue?

- The World Trade Organisation is now amidst a crisis for ensuring a legitimate dispute settlement mechanism.

- The changes in the global trade regime and the multilateral institutions necessitate a greater role for the developing world.

Why a trade organisation?

- The new financial trade order with the coming of Bretton Woods institutions (World Bank and IMF) demanded a trade organisation at the international level.
- It became necessary for the regulation of the international monetary system.
- It was also needed to establish multilateral rules for the settlement of trade disputes.
- Adherence to the rules was expected to serve as an important domestic incentive for governments.
- It would allow them to resist protectionist demands and provide for greater legal certainty.
- The World Trade Organisation (WTO) was created primarily to address these demands.

How has the US's role been?

- The US's push for the creation of WTO was mainly to pursue its own commercial interests.
- The U.S. has never truly embraced the idea of a multilateral system in which its leadership could be contested.
- Evidently the US is isolating itself from NAFTA, TPP, NATO and UNESCO in the recent times.
- In the trade negotiations too, the U.S. put forward excessive demands that countries are unprepared to meet.
- So the current crisis with the WTO dispute settlement system largely follows this unequal power formula.

What is the crisis with WTO?

- The nature of the trade disputes is now increasingly getting hypertechnical.
- Despite this, the WTO currently faces a trade dispute settlement crisis.
- The U.S. has systematically blocked the appointment of new Appellate Body members (judges).
- This has impeded the work of the WTO appeal mechanism.
- It is under great stress with only four working members out of seven normally serving office.
- If no appointment is made, the mechanism would be destroyed by December 2019.
- It would be left with only one remaining member to tackle a massive number of disputes.
- But the Appellate Body requires a core of three members to decide a dispute.

What are the other concerns?

- It is to be noted that the WTO dispute settlement mechanism is not a world trade court.
- So logically, the process remains political and diplomatic.
- WTO members are thus concerned over the politicisation of the Appellate Body appointment and reappointment process.
- There is also a concern with the quasi-attribution of permanent Appellate Body seats to the U.S. and the European Union (EU).
- Besides, there is concern over the possibility of China finding its way to have a permanent seat.
- **Cases** - Some Appellate Body members continue to hear cases which have been assigned to them during their tenure.
- The U.S. has persistently attacked this practice.
- However, the blame lies on the U.S. itself, for delay in filling up of vacancies and reappointment of members.
- This is indicative of the fact that the US is deliberately pushing the WTO legal mechanism for deterioration.

How is China's prospect?

- Despite limitations ensured by US and EU, China has largely benefited from the rules-based WTO system.
- It might well be the new WTO leader in the coming future.

- China's growing assertiveness, in fact, may be the reason for the U.S.'s hard measures.
- Its emerging power and the impact of its commercial domination on other economies are evident.
- But how far will China's legitimacy be, among other trading members, remains largely uncertain.

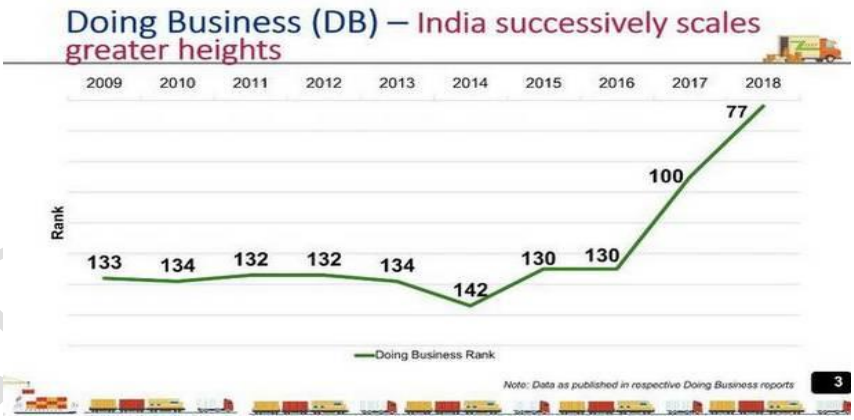
7.7 Ease of Doing Business Index

Why in news?

World Bank has released the Ease of Doing Business Index recently.

What does the report contain?

- The Index ranks 190 countries across 10 indicators ranged across the lifecycle of a business from 'starting a business' to 'resolving insolvency'.
- The top 10 economies in the index are New Zealand, Singapore and Denmark, which retain their first, second and third spots, respectively, for a second consecutive year.
- It was followed by Hong Kong SAR, Republic of Korea, Georgia, Norway, United States, United Kingdom and FYR Macedonia.
- India jumps 23 spots to **77th rank** in World Bank's latest report, while it was ranked 100th last year, moving up from 131th position that it recorded in 2016.



- India has improved its rank by 53 positions in the last two years, and 65 positions in the last four years (2014-18).
- India in the 2019 edition stands well ahead of South Africa (82) and Brazil (109), and is fast closing the gap on China (46) and Russia (31).
- India is now the best-ranked country in South Asia and has almost caught up with other competitors such as Indonesia (73) and Vietnam (69).
- The report also recognises India as one of the top 10 improvers in this year's assessment, for the second successive time.
- India is the one of only nine countries around the world and only one in BRICS to feature in this list.

What are the contributing factors?

- India has improved its rank in six out of the 10 indicators and has moved closer to international best practices on seven out of 10 indicators.
- The six reforms recognised in this year's report are starting a business, getting electricity, dealing with construction permits, getting credit, paying taxes and trading across borders.
- The most dramatic improvements have been registered in the indicators related to 'Construction Permits' and 'Trading Across Borders'.
- In the 'Grant of Construction Permits'

Indicator	Rank in 2017	Rank in 2018	Improvement in ranking
Construction permits	181	52	129
Trading across borders	146	80	66
Starting a business	156	137	19
Getting credit	29	22	7
Getting Electricity	29	24	5
Enforcing contracts	164	163	1
Overall rank	100	77	23

indicator, India's ranking improved from 181 last year to 52 in this year's report—**a jump of 129 ranks** in a single year.

- India has implemented an online single window system, introduced deemed approvals and reduced the cost for obtaining these permits in dealing with construction permits and this has provided a major boost in the ranking.
- India reduced the time and cost to export and import through various initiatives, including the implementation of electronic sealing of containers, the upgrading of port infrastructure and allowing electronic submission of supporting documents with digital signatures.
- As a result, India's rank improved by 66 positions, moving from 146 in 2017 to 80 in 2018 in the 'Trading Across Borders' indicator.
- On the "distance to frontier metric", a measure to gauge how far an economy's policies are from global best practices, India's score improved to 67.23 from 60.76 last year.
- This means last year India improved its business regulations in absolute terms, indicating that the country is continuing its steady shift towards global standards.
- In the electricity sector, the time taken for obtaining a new connection has reduced from 105 to 55 days.

- For resolving insolvency, India has put in place a new Insolvency and Bankruptcy Code and time bound reorganization procedure for corporate debtors.
- During the past year, India made Starting a Business easier by fully integrating multiple application forms into a general incorporation form.
- India also replaced the value added tax with the Goods and Services Tax (GST) for which the registration process is faster in both Delhi and Mumbai, the two cities measured by the Doing Business report.
- In addition, Mumbai abolished the practice of site inspections for registering companies under the Shops and Establishments Act.
- As a result, the time to start a business has been halved to 16 days, from 30 days.
- All these measures have resulted in India's ranking in the top 25 on three indicators such as getting electricity, getting credit and protecting minority investors (Rank 7).

What are the concerns?

- India's sustained rise in the rankings is perhaps the best answer to questions about the credibility of India's reform momentum.
- Also, since the World Bank sets May 1 as the deadline for measurement, several initiatives taken by the government will reflect in next year's rankings including the full effects of IBC and GST.
- However, this is not to turn a blind eye to what still ails at the ground level.
- Despite all-round improvements, there are key areas where India continues to lag.
- For instance, enforcing contracts is an aspect of traditional weakness, where India continues to falter and it stands at 163.
- Further, despite the GST and the IBC, India's overall score on paying taxes and resolving insolvency stays at an unacceptably low level.
- This shows the extent to which the actual implementation of these reforms needs to be made more effective.
- Moreover, it must be underscored again that these rankings are based on improvement in two of the main cities, Delhi and Mumbai, both of which benefit from being the political and financial capitals of the country.
- The reality in other prominent cities and smaller towns is most likely worse.

7.8 Insights from NABARD's Survey Findings

Why in news?

NABARD has released the All India Rural Financial Inclusion Survey (NAFIS).

What is the NAFIS about?

- NAFIS is based on a sample of 40,327 rural households in 29 states of which 48% are agriculture households (agri-HHs), 87% are small and marginal farmer households.
- The survey combines the strengths of the NSSO's Situation Assessment Survey (SAS) and RBI's All India Debt and Investment Survey.
- Among other things, the survey estimates 2015-16 farmers' income levels.

What are the significant findings of the survey?

- **Doubling Farmers Income -** The vision of doubling farmer incomes by 2022-23 had no assessment of the base (2015-16) aggregate income levels, the estimates from NAFIS fill that gap.
- **Benchmark Income Levels -** The Dalwai Committee set up in 2016, to advice on the strategy to double farmers' incomes by 2022, did not have any benchmark income levels for 2015-16.
- So, the committee derived them by applying yearly growth rates of state-wise net-state-domestic-product (NSDP) to the NSSO estimates of 2012-13 income levels.
- In terms of sources of income, NAFIS offers interesting insights, particularly for the Dalwai Committee.
- **Agri and Non- Agri Incomes -** NAFIS estimates that in 2015-16, 35% of farmers' income came from cultivation, 8% from livestock, 50% from wages and salaries and 7% from non-farm sectors.
- The survey also estimates income of non-agri rural HH at Rs 7,269/month, more than half of which comes from working as wage labourers.
- **Insights based on Climate -** NAFIS data finds that working as labourers is a fall-back option for average farmers in drought years.
- Besides, the increasing pressure as a result of shrinking average holding size is presumably forcing farmers to work as labourers to meet their needs.

7.9 2018 Nobel Prize in Economics

What is the issue?

The ideas of this year's Nobel Memorial Prize in Economic Sciences are relevant for India in terms of handling its growth.

What were the prizes awarded for?

- The Nobel Prize for this year has been awarded to two economists in two different fields.
- William Nordhaus has worked on climate change and economic growth.
- It is more on the 'negative spillover' of emissions and damage to the environment as a result of growth.
- Paul Romer had worked on innovation and growth and is on the 'positive spillovers' of knowledge and technology.
- Notably, both works were related to economic growth.

What are the key ideas of Nordhaus?

- **Observation** - As the world strives to bring about high growth, it tends to damage the environment.
- This, in turn, comes back to haunt people and retard future growth.
- E.g. land gets less fertile due to excessive use of fertilisers and overgrazing
- Carbon emissions affect health, damage the ozone layer, cause erratic rainfall, affect ocean life, etc.
- **Measures** - Nordhaus hence spoke of 'DICE' ('Dynamic Integrated model for Climate and Economy') as the way forward.

- The obvious solution is a carbon tax, which is now quite popular in the world.
- It discourages emissions or makes entities use better technologies that lower such emissions.
- **Concerns** - The problem here is that countries, at times, make such compromises for short-term gains.
- Also, the externalities caused by damaging the environment are often assumed to be everyone's problem and not just that of the nation.
- Given this, carbon tax is a softer option that may not really bring an end to the polluting process.
- It only increases the cost of damaging the environment, which will be passed to the consumer.
- **Way forward** - Outright bans are the only way out.
- There should ideally be ban on the use of certain material or technology that damages nature.
- Importantly, this should be agreed upon by all the countries.
- It is important here for government intervention as the market system is less likely to ensure such a solution.

What are the key ideas of Romer?

- **Argument** - Romer talks of a positive stimulus to growth, which is based on knowledge or technology.
- This is logical because across countries technology has been the differentiating factor in the strategies pursued for higher growth.
- Evidently, going by this, the African countries remain slow-movers in terms of growth.
- The East Asian economies were able to gallop on the back of innovation.
- In fact, a lot of progress in India can be attributed to innovation.
- E.g. the Green Revolution in agriculture, the IT revolution, etc
- An interesting observation by Romer is that when technology brings about growth, it is non-exclusive.
- This is because the benefits do percolate to other companies and countries.
- **Measures** - There is thus the need for Research & Development subsidy to be given by governments.
- The power of new ideas is quite supreme and cannot be contested.
- So here, one can leave it to the market to drive such innovation as it is intrinsic to the business models that focus on growth.

What are the apprehensions?

- The works of the two winners raises a key question regarding the link between technology and climate change.
- For innovation to succeed, it is hard to ensure that such technology is consistent with sustainable growth.
- E.g. the technology of mobile phones has brought in a broader debate of radiation emissions
- Here the tenets of Nordhaus and Romer would collide.
- Another concern is that if technology which becomes labour-displacing can really lead to meaningful higher growth.
- Addressing this is crucial especially in labour-surplus economies.
- Also, the practical feasibility of innovations in several countries in Africa and South Asia where there is power shortage is uncertain.

What could be done?

- For India, the ideas of both these economists are very relevant.
- Innovation must be tailor-made to suit local requirements so that it does not disturb the ecosystem.
- When talking of inclusive growth and creation of jobs, the focus has to be on using innovation in a balanced manner.
- The climate change issue is more challenging; there needs to be internal rules to ensure that environment is protected.

- Laws need to be in place to ensure that there is a proper balance of technology with carbon emissions.

7.10 RBI's Stance on Data Localisation Rules

Why in news?

The government and the RBI are firm on the October 15 deadline for compliance on data localisation standards.

What was RBI's order on data storage?

- Data localisation is storing of data on a device physically present within the borders of the country where the data was generated.
- RBI, in April, 2018, gave 6 months time to global payment companies to store transaction data of Indian customers within India.
- The data should include the full end-to-end transaction details, information collected/carried/processed as part of the message/payment instruction.
- The requirements apply as those mentioned in the draft data protection bill and draft national e-commerce policy framework.

What was the demand?

- Global financial technology companies have reportedly sought an extension to the October 15 timeline, with demands to adopt a soft stance on data localisation.
- But the RBI and the government did not favour any extension of the deadline.
- The government has also ruled out data mirroring as an option.
- Foreign payment companies had asked the RBI to allow data mirroring which would allow them to store a copy of the data overseas as well.

Why is it being opposed?

- Any move to restrict all cross-border data flows could be counterproductive, on becoming a trade barrier.
- The norms could have negative impacts on the ability of companies to do business in India.
- Especially, the U.S. warned that India's policy on the issue will adversely affect American businesses in the country.
- It may undermine India's own economic goals and may not likely improve the security of Indian citizens' data.
- It could also break up the Internet if every country in the world insists on keeping data within its territory.

What is RBI's rationale?

- The move was to ensure better monitoring of payment service operators.
- Data localisation would offer supervisory access to data stored with these system providers.
- It also gives access to data stored by their service providers/ intermediaries/third party vendors and other entities in the payment ecosystem.
- National security and data sovereignty are other reasons for data localisation rules.
- As, it is possible that data could be indicted if it is stored on American servers and India faced US sanctions.

What are the limitations to data localisation?

- **Global players** like banks, e-commerce majors, fin-tech service providers and credit card companies prefer to store and process data at one or two global centres.
- So moving processes implies higher costs and disruption for them.
- New teams must be hired and trained, and security procedures have to be reviewed and modified.
- **Local infrastructure** in India suffers from severe deficiencies.
- Indian data-transmission speeds are slow by global standards.
- Server capacity is low and costs are high, and likely to rise as demand is artificially boosted.

- So RBI's insistence may lead to a situation where smaller payment companies stop offering services in India.
- It will also impose higher costs on the start-up ecosystem since any Indian start-up will pay higher costs to include payment options.
- **Legal** - The Srikrishna Committee recommendations on data protection are now only open for public feedback.
- So as of now, India neither has a functioning data protection law nor adequate security standards in practice.
- Evidently, there have been instances of massive leaks and hacks of sensitive information, including payment records.
- **Surveillance** - Law and order departments and security agencies currently operate in a legal vacuum, making surveillance another grey area.
- They can search and survey all sorts of digital data without any checks or balances.
- Indeed, there is evidence that foreign intelligence agencies also collect a massive amount of Indian data and meta-data.

How is it elsewhere?

- Data localisation is not a new concept but has picked up pace after 2013.
- It is when America's National Security Agency contractor Edward Snowden leaked classified documents.
- It showed how the US government had accessed data to conduct surveillance on foreign allies.
- Since then, countries like Germany have taken steps to ensure that sensitive data stay within their borders.
- Many other countries like Russia and China have very stringent laws around data localisation.
- It is largely driven by the fear of losing critical data to hackers and spy networks of rival countries, as well as systemic risks during times of conflict.

7.11 Global Hunger Index

Why in news?

Global Hunger Index prepared by Welthungerhilfe and Concern Worldwide has been released recently.

What is the report based on?

- The report defines "hunger" by using four specific parameters –
    1. prevalence of undernourishment
    2. child stunting (low height compared to their age) < Age 5
    3. child wasting (low weight for their age) < Age 5
    4. Under-5 child mortality i.e who did not live to be five-years-old.
- The higher the score of a country on the list, the lower it was ranked.

What does the report say?

- The world has made gradual, long-term progress in reducing overall hunger, but there is an **uneven progress**.
- GHI scores for South Asia and Africa south of the Sahara reflect **serious levels of hunger**.
- Areas of severe hunger and undernutrition stubbornly persist which reflects the human misery for millions.
- Since the number of forcibly displaced people is on the rise, and hunger is often both a cause and a consequence of displacement, co-ordinated actions needs to be taken by international community, national governments, and civil society.
- Around 124 million people suffer acute hunger in the world.
- About 151 million children are stunted and 51 million children are wasted across the globe.

- Hard-won gains are being further threatened by conflict, climate change, poor governance, and a host of other challenges.
- It further warned that at least 50 nations all over the globe were on a path to miss their SDG target of achieving low-levels of hunger by the year 2030.

What is the case with India?

- India has been ranked at the 103rd position among 119 countries and is among the 45 countries that have "serious levels of hunger".
- The proportion of undernourished population in India has come down from 18.2% to 14.8%.
- The prevalence of stunting in children below the age of five has gone down sharply from 54.2% to 38.4%.
- The Under-5 child mortality rate has declined from 9.2% to 4.3%.
- India is ranked below many of its neighbouring countries, including China (25), Nepal (72), Myanmar (68), Sri Lanka (67) and Bangladesh (86).

What are the concerns?

- India continues to stay in the "serious" category of the GHI.
- There are still way too many children suffering from stunting, which reflects chronic undernourishment.
- The biggest worry is the level of wasting in Indian children, which has actually gone up over these years from 17.1% to 21%.
- Wasting reflects acute malnutrition and the fact that it has gone up sharply in the past 5 to 10 yearsis a massive blot on India's growth story.
- As the report claimed that children aged 0-5 months were at the most risk of child wasting, attention to birth outcomes and breastfeeding should be an important priority for India.
- There were numerous policy attempts were made both at the central and state levels such as hunger missions launched by Maharashtra to directly attack the problem of widespread hunger.
- This is also coincided with the rights-based approach where mid-day meals and nutrition of mothers were also improved.
- Thus the solution lies in adequately distributing nutritious food and health care services to children and lactating mothers.
- Though the government was working to achieve zero hunger by 2030, it focusses on higher farm output as a tool to achieve it.
- But, as various researchers have shown, child undernourishment does not go away by merely having more food grain output.
- It is the distribution, along with timely availability of food that matters.

What does the report recommend?

- The international community should focus resources and attention on the regions of the world where the majority of displaced people are located.
- It should also provide stronger political and humanitarian support to internally displaced people.
- Prioritized actions to address the special vulnerabilities and challenges of women and girls should be taken.
- Certain long-term solutions, like strengthening the resilience of displaced populations by providing access to education and training, employment, healthcare, agricultural land, and markets have also been proposed.

7.12 India and Human Capital Index

Why in news?

The World Bank has launched a first-of-its-kind index called the Human Capital Index (HCI).

What is HCI all about?

- Human Capital Index (HCI) is been brought out by World Bank, which is first of its kind index.

- The HCI is based on five parameters child survival, school enrolment, quality of learning in schools, healthy and safe environment for growth, and adult survival for each of the 157 countries it mapped.
- These parameters were chosen because studies show that they are closely linked with a population's productivity.
- For each country, the HCI value ranges between 0 and 1 and shows how far below its potential a country performs.

What are the findings of the report?

- Singapore topped the list with an HCI score of 0.88, followed by the Republic of Korea and Japan, jointly at 0.84.
- India was ranked a lowly 115 with an HCI score of 0.44.
- India also lags other comparable countries and neighbours such as Bangladesh, Indonesia, Nepal and Malaysia.
- HCI ranked India behind regions such as West Bank and Gaza, which have been suffering conflict for decades.

What are the concerns spotlighted on India?

- The HCI report stated that India's score is lower than the average for its region and income group.
- As a result, be it health variables such as stunting and wasting or enrolment in schools and quality of academic achievements, India lags most of its peers.
- The report points out that the productivity of India's population is just 44% of what it could be.
- From a policy perspective, it means that business-as-usual will cost India 56% of its income in the long run.
- Thus India's human capital is not properly developed is a fact that has been revisited by numerous reports and surveys, both national and international.

7.13 Addressing Rising Oil Prices

What is the issue?

Global oil prices are surging to phenomenal high, India need to act smart in this regard.

What are the concerns with global oil prices?

- Global crude oil now at almost $80 a barrel, petrol and diesel prices back home have climbed up rapidly in recent months.
- It has not helped at all that the oil price rise has coincided with the steep fall of the rupee.
- Petroleum products contributed 24% of the Centre's revenue receipts and 8% of the States' revenue receipts in 2016-17.
- However, the union though under pressure to keep prices in check, seems disinclined to cut excise duties.

What were the actions of the government in this regard?

- Union government hiked these nine times between November 2014 and January 2016 when the oil prices were declining and cut just once in October 2017.
- Faced with uncertain revenues on the GST front in particular, it possibly does not want to risk a fiscal slippage at a time when the current account deficit too is slated to expand.
- States too are reluctant to cut their sales tax on fuels, although Rajasthan and Andhra Pradesh have done so already.

What is the petroleum pricing mechanism in India?

- In India oil marketing oil marketing companies fix petroleum prices based on trade parity price (TPP).
- The TPP is based on product prices in the international market, assuming that 80% of the petrol and diesel is imported and 20% is exported.
- It is high time the oil marketing companies started pricing their products independently and transparently based on market principles, depending on their distinct cost structures and margin profiles.

What measures needs to be taken?

- Union government must direct oil marketing companies to change their pricing mechanism from trade parity price (TPP) to one based on market realities.
- Union government must engage with the States with respect to bringing petrol and diesel under GST.
- Improved GST collections will give States the confidence to allow these products into the net.
- The maximum GST rate is much lower than the effective tax rates being charged by the Centre and States together on petrol and diesel.
- The Centre can consider higher GST on these fuels for revenue-neutrality.
- Lower costs and the benefit of input tax credit under GST could help oil companies reduce fuel prices.
- Reduced reliance on petroleum revenues would go well with the overall emphasis to improve the tax base and formalise the economy.
- The easier option of asking public sector oil marketing companies to go slow on price hikes in the run-up to the polls should be avoided.

7.14 Pricing mechanism behind Petroleum

What is the issue?

Petroleum prices are rising and there are considerable demands to the centre to reduce its excise duties on the product.

How the sector was deregulated?

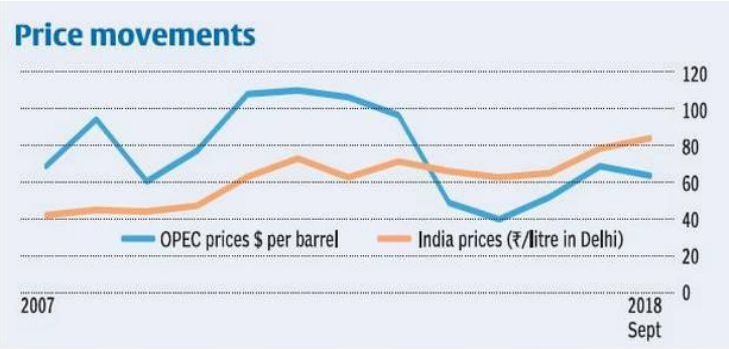
- Being a basic intermediate good, it is operated through a special oil pool account funded by the surplus of ONGC and the refining companies, as well as direct government subsidies.
- Being an ideal commodity for indirect tax, high Central excise duty and high sales tax rates by the states at the retail level were levied.
- With the rising trend in international crude oil prices the subsidy burden of the oil pool account began to mount.
- There were demands that the oil market should be deregulated.
- But the excise revenues from oil was substantially larger than the subsidies provided by the centre.
- Also, the surpluses of petroleum mining and refining companies were substantial enough for cross subsidisation of the loss-making retail oil companies.
- But the entry of private players like Reliance and Essar into the retail trade made cross-subsidisation untenable.
- Thus the administered Price Mechanism for petroleum was dismantled and market pricing mechanism was allowed.

What was the consequence?

- The Centre chose to increase the excise duty on petrol and diesel, although OPEC prices showed a downward trend.
- The hike in excise duty was 380% for diesel and 120% for petrol between 2014 and 2017.
- The **C&AG Report** has observed that the huge increase in central excise collection from petroleum products (2015-16) was due to a sharp increase in per unit tax on petrol and diesel.
- The excise duty revenue of the central government from petroleum products which was Rs.88600 crores in 2013-14 peaked to Rs.2,53,254 crores in 2016-17.
- Never has indirect tax on any commodity witnessed such a sharp escalation as on petroleum products.

What is the present scenario?

- The international prices crude oil began to rise from late 2016.
- Yet the Centre refused to reduce the excise duties and prodded oil companies to raise their retail selling prices.
- The Centre fears an adverse impact on fiscal deficit, if any additional revenue from petroleum productsgets lost.
- The depreciating rupee also added to their woes.
- However, rising fuel prices are stoking an inflationary fire and imposing an unbearable burden on the people.



Should the states be held responsible?

- States are benefiting from petroleum price escalation through higher devolution after the 14th Finance Commission award in the share of central excise duty.
- However, **only basic excise duty** on petrol and diesel is shareable with the States and others are outside the divisible pool of taxes shareable with the States.

Duty structure (₹ per litre)

Item	Basic excise duty	Special excise aduty	Additional excise duty	Total	Share of basic excise duty in total (%)
Petrol	7.66	6	7	20.66	37.07
Diesel	10.69	6	1	17.69	60.42

- Also, VAT rates has been hardly increasedin recent years and even some states have already reduced VAT rates to moderate the current price escalation.

What should the centre do?

- The centre argues that it keeps a substantial portion outside the shareable pool for its obligations on social sector spending.
- There is no established connection between higher duties on petroleum products and social sector spending.
- A demand has also been made that petroleum products be included in the GST.
- But before it gets into reality, a compensation package has to be finalised as per the GST compensation law.
- This would make the present compensation cess to be inadequate.
- Thus the solution is for the Centre to immediately roll back its excise duty spikes.

7.15 Trust model in state sponsored insurance

What is the issue?

There have been recommendations to government to avoid insurance companies for state-sponsored insurance schemes and instead to follow a trust model.

What is a trust model in insurance?

- Insurance works on the principle of pooling the risk of policy holders.
- In case of the trust model, the state government sets up a trust to perform the role of an insurance company and the government fixes the price, hence there is no price discovery.
- The premium to be paid by the Centre/states is put into a trust and payments for medical treatment are paid out of this.

- The trust is run by the state government.
- In the insurance model, the state floats a tender and the insurance company is selected on the basis of the ensuing bidding process.
- The Centre had given both options to the states in the case of Ayushman Bharat scheme.
- Some like Gujarat and Chhattisgarh have opted for a mixed model in which claims up to Rs 50,000 are dealt with by an insurance company and those above this by the trust.
- However, Uttar Pradesh and Bihar, had first opted for the insurance model, but later switched to the trust model.

What is the need for a trust model?

- **Costs** - The costs for a typical insurance company costs include –
  1. Designing insurance products to suit customer needs
  2. Actuarial input to assess and manage risk
  3. Advertising and marketing
  4. Empanelment of approved service providers such as hospitals
  5. Administrative expenses to provide prior approval of claims
  6. Processing, which includes functions such as fraud detection.
- However, of these, the first three are not applicable to programmes such as Ayushman Bharat which will be fully funded by the government as a blanket scheme.
- The last three functions are commonly outsourced to third-party administrators (TPAs) even by insurance companies.
- **Premium** - Governments continue to pay hefty sums in premium to insurance companies in India.
- A Study on the Aarogyasri scheme introduced in undivided Andhra Pradesh showed that the bid by insurance companies on such health schemes included a 20% margin for administrative expense and profit.
- By avoiding insurance companies and using TPAs instead, governments can save about 15% or up to ₹6,000 crores per year.
- These savings will continue to rise due to rising premiums from the schemes.
- **Profits** - Premiums paid to the insurance companies are transferred at the beginning of the year from the government.
- Thus, there is an opportunity cost for these companies from this, which at current interest rates could amount to around ₹2,000 crores a year.
- The study also found the claim-to-premium ratio and customer satisfaction to be better in the trust mode than the insurance mode.
- It would also prevent exorbitant profits accruing to insurance companies in good cropping seasons as in 2017-18.
- **Re-insurance** –A reinsurer is a company that provides financial protection to insurance companies.
- Reinsurers handle risks that are too large for insurance companies to handle on their own and make it possible for insurers to obtain more business than they would otherwise be able to.
- However, it is getting difficult to find reinsurers for government insurance schemes by the insurance companies, because of high claims.
- This is a problem that is being encountered by companies on schemes like the Pradhan Mantri Jeevan Jyoti Bima Yojana.
- All these have created the need for a trust based model in India.

7.16 RBI notification on MSME loans

Why in news?

RBI has recently issued norms on restructuring loans of MSMEs.

What is the recent notification on MSME lending?

- RBI has recently decided to permit one-time restructuring of existing loans to MSME enterprises that are in default but 'standard' as on January 1, 2019, without an asset classification downgrade.
- To be eligible for the restructuring, the aggregate exposure to a GST-registered MSME borrower should not exceed ₹ 25 crores as on January 1, 2019.
- Only a provision of 5% of the total outstanding loan, in addition to the money already set aside to cover potential losses, will have to be made for such borrowers by the lenders.
- Under-provisioning, banks have to set aside funds to a prescribed percentage of their bad assets.
- The banks have to make a larger provision if the asset quality of MSME borrowers gets deteriorated.
- Thus, restructuring without an asset classification downgrade will save the lenders from higher provisioning burden.
- This will encourage banks and non-banking finance companies (NBFCs) to take up restructuring in the case of MSMEs.
- Accordingly, each bank/NBFC should formulate a policy for this scheme with the board approval.
- The plan should include the framework for viability assessment of the stressed accounts and regular monitoring of the restructured accounts.
- This restructuring process has to be implemented by March 31, 2020.

What is the need?

- Majority of MSMEs are owner-funded with promoters' fortunes closely intertwined with the business.
- However, despite contributing to 30% of India's GDP, MSMEs get only 14% of bank credit.
- MSMEs are mostly victims of usurious interest rates and inordinate payment delays by clients rather than wilful funds diversion.
- Also, banks have sharply reduced the share of MSME loans, two years prior to demonetisation.
- Though banks increased lending in late 2017, MSMEs were faced with the twin shocks of demonetisation and GST implementation.
- Hence, multiple events beyond the control of MSME have affected MSME finances warranting restructuring of existing loans.

What are the concerns?

- MSMEs form an important component of the Indian economy and contribute significantly to the country's GDP, exports, industrial output, and employment generation, among others.
- However, permitting restructuring without any asset quality downgrade is in danger of undoing some of the good work done by the RBI with regard to big borrowers.
- Loans to MSME segments are getting more stressed with the NPA ratio for public sector bank lending to MSMEs going above 15%.
- Thus this move could undermine India's credit culture, already weakened by corporate loan write-offs and farm loan waivers.

8. INFRASTRUCTURE

8.1 Concerns in Achieving Renewable Energy Targets

Why in news?

Union Power Ministry announced it would overshoot the target of installing renewable energy sources by 2022.

What is the actual status of renewable energy installations?

- In 2015 Union government has announced 175 GW of renewable energy installations, recently the target has been increased to 225 GW.
- If India hits the 175 GW target, it stands to meet its greenhouse-gas emission goal under the Paris climate agreement.
- Of the current goal of 100 GW from solar energy by 2022, 40 GW is to come from rooftop installations, and 60 GW from large solar parks.
- But India has missed several interim milestones since it announced its 175 GW target.
- The obstacles have capped capacity addition to 69 GW till date, with India missing its 2016 and 2017 milestones.
- The misses happened despite renewable capacity being augmented at a blistering pace.

What are the challenges in achieving the ambitious target?

- **Lower Margins -** Wind and solar tariffs have hit such low levels that suppliers are working with wafer-thin margins.
- Rooftop solar clocked a compound annual growth rate of 117% between 2013 and 2017 India only hit 3% of its goal by the end of 2017.
- **Policy Lacunas -** In the solar sector alone, which the government is prioritising, policy uncertainties loom large.
- Homeowners aren't warming up to the idea of installing photovoltaic panels on their terraces because the economics does not work out for them.
- **Practical challenges -** Technological and financial challenges remain, both wind and solar generation could be erratic.

What measures needs to be taken?

- India's creaky electricity grid must be modernised to distribute such power efficiently.
- To hit its 2022 target of 175 GW, 106 GW will have to be added in four years, more than twice the capacity added in the last four.
- Manufacturers of photovoltaic (PV) cells have demanded a 70% safeguard duty on Chinese PV imports, and the Directorate General of Trade Remedies need take a call on this.
- Policies favouring homeowners to sell electricity back to the grid, needs to be incorporated with a nationwide "net-metering" policy.

8.2 Recent Developments in HFA Project

What is the issue?

To realise the target of creating Housing for all (HFA) by 2022, the union government needs to focus on promoting housing for the weaker sections in urban areas.

What is the Housing for all by 2022 project about?

- The Housing for All project was launched with an aim to provide affordable housing to urban poor by 2022.
- It is proposed to build around 2 crore houses for urban poor including Economically Weaker Sections and Low Income Groups, with central assistance in the range of Rs.1 lakh to Rs.2.30 lakh.
- This Mission has four components namely:

1. In-situ Slum Redevelopment with private sector participation using land as resource.
2. Affordable Housing through Credit Linked Subsidy.
3. Affordable Housing in Partnership with private and public sector.
4. Beneficiary led house construction/enhancement.

What are the recent developments in this project?

- Union government has decided to increase the carpet area under the project to cater the aspirations of the present generation for 3 bedroom apartments.
- People earning up to ₹ 18 lakh per annum can now avail up to ₹ 2.3 lakh as subsidy upfront which is a substantial benefit, especially for those in Tier 2 and Tier 3 towns.
- The RBI recently revised the limit for a housing loan to be classified as priority sector from ₹ 20 lakhs to ₹ 25 lakhs in cities other than metros.
- The objective behind these initiatives are two-fold - increase the housing coverage and in the process give a push to employment in the construction sector and create demand for cement and steel.
- These developments with the initiatives by Pradhan Mantri Awaas Yojana (Urban) has seen an upward revision in size of dwelling units in the Middle Income Group segment.

What are the concerns with the HFA project?

- There seem to be more attention on only certain like affordable housing through credit linked subsidy.
- The focus is on the segment which has more demand as well as the ability to invest rather than the economically weaker sections who are in greater need of support.
- There is also not much progress on slum redevelopment and in promoting large projects jointly with PSUs or private developers using government land, due to the lack of coordination between the Union, States and local bodies.

8.3 Strategic Petroleum Reserves

Why in news?

Union government approved the construction of two more strategic petroleum reserves in the country.

What is Strategic petroleum reserves?

- Strategic petroleum reserves are essentially huge stockpiles of crude oil to keep the wheels of the country running in crunch situations.
- This is because the government has to stay prepared with emergency stores of crude oil to tide over severe supply shocks of this critical fuel.
- Many major global oil consumers such as the US, China and Japan have built massive strategic reserves of oil over the years, and India too embarked on the path in the last decade.

What is India's Plan on strategic Petroleum reserve?

- Indian Strategic Petroleum Reserves Ltd, has constructed three strategic petroleum reserves in huge underground rock caverns at Visakhapatnam on the East Coast, and at Mangaluru and Padur on the West Coast.
- These facilities, with total capacity of 5.33 million tonnes, can meet about 10 days of India's crude oil requirements.
- The new facilities approved recently can provide additional supply for about 12 days.

Why is the need for such structures?

- India is the world's third largest energy consumer after the US and China.
- The trouble is India produce very little oil of its own and are dependent on imports for more than 80% of its needs.
- The chunk of this is from West Asia which is often in the midst some geo-political face-off or the other.

- Added to this, there's always the risk of supply disruption from natural disasters, war or other calamities.
- Thus strategic petroleum reserves add much-needed heft to the country's energy security.

8.4 Status of "Real Estate Regulatory Act"

What is the issue?

- Many states are yet to comply with the provisions mandated in the Real Estate Regulatory Act (RERA), 2016.
- Parliamentary Committee on Subordinate Legislations has recently submitted its report with recommendations for bettering the situation.

What is the status of "Real Estate Regulatory Act"?

- Real Estate (Regulation and Development) Act, 2016, which seeks to regulate construction sector, received the Presidential assent in March 2016.
- The act sought to make each state governments establish a "Real Estate Regulatory Authority" (RERA) and "Real Estate Appellate Tribunal" (REAT).
- Subordinate rules under the act were supposed to be subsequently notified by states/UTs for their respective jurisdictions, but the progress has been limited.
- As of April 2017, only 12 states/UTs notified the rules, while draft rules were prepared by 16 states/UTs and 7 states hadn't made any progress.
- While 4 states (Sikkim, Arunachal Pradesh, Meghalaya & Nagaland) cited constitutional issues, others (Manipur, West Bengal & Goa) had not provided any information.

What has the parliamentary report stated?

- Parliamentary Committee on Subordinate Legislation looked into the Real Estate Act, and recently submitted its report to the Lok Sabha.
- It has expressed concern over issues such as delay in notifying rules by various states, establishment of RERA/ REAT as customers are being affected.
- Dilution of rules to favour builders, absence of registration of ongoing projects and ineffective implementation are other issues that have been flagged.
- The committee also asked the "Ministry of Housing and Urban Poverty Alleviation" to ensure that the act takes effect across states in letter and spirit.
- It further recommends that the provisions of the RERA Act should be uniformly applicable across the country.
- Also, till the time RERA/REAT is constituted, it has been recommended to constitute a temporary authority for the intended purposes.

What is the status of ongoing projects?

- RERA Act says that the ongoing and under-construction projects are required to be registered with the Authority.
- But some states like Uttar Pradesh, Haryana and Gujarat are not adhering to this and developers are resorting to taking partial completion certificates.
- They are hence handing over the flats to the applicants without fulfilling the obligatory requirement of handing flats in complete shape.
- The committee has called for redefining ongoing projects to overcome the current ambiguities and has demanded strong penalties for non-compliance.

8.5 MSME Bill 2018

Why in news?

- The Centre has tabled the MSME Development (Amendment) Bill 2018 in Parliament.

What are the key provisions?

- The Bill amends the Micro, Small and Medium Enterprises Development Act, 2006.

- Under the Act, manufacturing units are defined depending on their investments in plant and machinery as:
  - micro enterprises (below Rs.25 lakh)
  - small enterprises (Rs.25 lakh to Rs.5 crore)
  - medium enterprises (Rs.5 crore to Rs.10 crore)
- The thresholds were lower for services units.
- Under the Bill, all MSMEs will be classified on the basis of their annual turnover.
- This is irrespective of whether they are manufacturing or service-providing enterprises.
- Now, the units will be
  - 'micro' enterprises if their annual sales turnover is less than Rs.5 crore
  - 'small' if they fall in the Rs.5-75 crore range
  - 'medium' if they are in the Rs.75-250 crore band
- The central government may change these annual turnover limits through a notification.
- The maximum turnover may be up to three times the limits specified in the Bill.

What are the benefits?

- **Starters** - MSMEs are offered a range of incentives and tax benefits, to promote them.
- Under the current definition, the newer units often face disadvantages.
- As, their higher investments, as part of the industrial modernisation efforts, keeps them out of MSME definition.
- Hence, the turnover criterion is a more pragmatic way to incentivise industry.
- It facilitates fairer comparisons between older and newer ventures and helps starters in utilising MSME sops.
- **Sectors** - Turnover-based sops may be friendlier to technology-intensive sectors.
- These include engineering, auto components or pharmaceuticals.
- Substantial capital investments are needed to ensure even minimal scale in these.
- Here again, turnover, instead of investment criterion, would be more beneficious.
- **Procedure** - The annual turnover criteria can be directly verified from the GST Network.
- It thus puts an end to physical inspections necessitated by the investment-based regime.
- **Efficiency** - Turnover criteria will allow a unit to graduate from its MSME status on reaching a fair size.
- It will discourage the proliferation of inefficient units created mainly with an eye to utilise sops.
- The Centre should consider a sunset clause on MSME benefits to encourage small units to climb up the value chain.

8.6 India's CSR Landscape

What is the issue?

- There has been a culture of insincerity towards the envisioned provisions of "Corporate Social Responsibility (CSR)" mandate.
- Revamping the regulatory provisions and addressing the anomalies in the "Companies Act" are critical to ensure better CSR compliance.

What is the overall appeal of the CSR mandate?

- Companies Act stipulates that companies with a "net worth of Rs 5 billion, or turnover of Rs 10 billion or net profit of Rs 50 million per annum" must spend 2% of net profits on CSR.
- Notably, "net profit" is derived accounting number that companies can tinker with, and "turnover" could've been a better metric for CSR calculations.

- Even if this irrationality is overlooked, there are several other inefficiencies in the CSR mandate which needs to be scrutinised.
- Data shows that "Indian companies" aren't spending as much on "Corporate Social Responsibility" (CSR) as mandated by law.
- Presently, the government is already looking into the records of top 1,000 companies, and prosecutions have been launched against 254 companies.
- **What are the financial ambiguities in the act?**
- **Taxation -** The rules stipulate that that CSR spending excludes "activities undertaken in pursuance of the normal course of business of the company".
- In other words, the amount a company spends on CSR cannot be claimed as business expenditure and be offset from taxable income.
- Tax experts say this creates room for ambiguity as business expenditure is vaguely defined, thereby resulting in several court cases.
- **Tokenism -** There are many schemes like "PM's Relief Fund, Rural Development and Skill Development projects" that enjoy tax exemptions.
- Hence, the bulk of CSR spending is merely cheque-writing activity, which defeats the spirit of the act, which is to get corporate entities to go social.
- **Carry Over -** Presently, unspent CSR money is allowed to be transferred to the next financial year, which is causing stagnation in this domain.
- Notably, only revenue and tax expenditure is allowed to be carried over, and as CSR is neither, it is not prudent to allow this accumulation unchecked.
- A provision for the unspent amount must be spent within a year is needed to avoid this clause becoming an excuse for companies.
- **Dedication -** CSR spending of many companies focus on aligning their philanthropic programmes to their image-building exercises alone.
- Consequently, their CSR wings are mere arenas for forwarding their brand and remain institutionally weak to sustain initiatives to effectuate actual change.

8.7 Kaleshwaram Irrigation Project

Why in news?

The Kaleshwaram lift irrigation project in Telangana has attracted considerable national attention.

What is Kaleshwaram project about?

- Kaleshwaram is a town on Godavari right bank about 300 km downstream of major dam, Sriram Sagar project (SRSP).
- At Kaleshwaram, the major tributary Pranahita, which merges with Godavari brings large quantity of water, the place is also known as Sangam and Dakshin Ganga.
- The project proposes to lift about 180 TMC (about 5 billion cubic meters) of water.
- It includes construction of barrages, high speed pumps for transport of water upstream for providing for irrigation.
- Besides, it involves constructions of network storage dams, series of tunnels, canals water passing through several stages of pumping and reverse flow into Godavari River.

What are the concerns with the project?

- **Feasibility concerns -** Various civil society organisations involved in water management and resettlement of evictees have questioned the proposed benefits accruing to farmers, they argue that

1. The 180 TMC water is not enough for 26 lakh acres for any meaningful irrigation.
2. The crop yields have been grossly inflated almost 10 times as compared to the current levels for projecting highly favourable benefits/outcomes.
3. The complete omission of social and ecological costs in the report.

- **Financial concerns -** The estimated project cost is ₹ 80,450 crore and the annual maintenance costs including interest payments will be around ₹ 13,923 crore.
- In short, this project is unlikely to generate benefits of more than ₹ 4,000 crore while the State would spend ₹ 13,000 crore every year.
- The Telangana government is going to spend four times more on the operation and maintenance costs than all the benefits that would accrue to farmers.
- **False Claims -** The benefits from the agriculture sector in the report are based on three assumptions, such as irrigation to 24 lakh acres, increases in the yield of 12 crops will be of 500-900% more than current reported yields and all the produce will be getting higher prices.
- But normally when production of a crop like chilli increase by 20% more than the average of the previous year, prices tend to slump to historic lows with few buyers in the market.
- Even the data on the projected increase in the area of irrigation, yields, and profit margins in the DPR are based on questionable assumptions which fail to reflect the current realities of costs of products and prices of the products at the market place.
- **Ecological and livelihood concerns -** The project will displace at least 30,000 people in 19 villages.
- Further, the project is going to affect the total land of around 100,000 acres (40,015 hectares).
- Considering all other costs, this project is going to be a major burden for Telangana people and farmers for generations to come.
- One thing the DPR clearly proves is that the project is not about sustainable development of the State.

8.8 Resolving Power Sector NPAs

Why in news?

The Allahabad High Court hears petition by power companies against RBI's February 12 circular.

What was the circular on?

- It requires banks to finalise a resolution plan in case of a default on large accounts of Rs 2,000 crore and above within 180 days.
- Failing this would result in insolvency proceedings being invoked against the defaulter.
- This would be as per the Insolvency and Bankruptcy Code (IBC) provisions.

What is the ongoing case?

- By RBI's circular, the unresolved accounts would undergo IBC process by the end of August, 2018.
- However, the power sector producers sought relief from the court.
- Power sector is one of the most financially stressed ones.
- It has potential non-performing assets (NPAs) of Rs 2.6 trillion.
- Hence, the Centre called for regulatory relief for the power sector.
- It also sought an extension of the deadline for the sector.
- The issue has thus led to a stand-off between the Central government and the RBI.

What are the centre's views?

- There is evidently lack of structural reforms in the power sector.
- So there is a good chance that power sector assets may not attract reasonable bids.
- Hence, strict adherence to the IBC for power sector can force banks to accept deep haircuts.

- Moreover, power sector has some issues that are unlikely to disappear in a short time.
- These include low power demand, lack of reliable coal supply, etc.
- Given this, the existing power capacity will also be destroyed if liquidation happens.
- On the other hand, recovery rates in the IBC have hovered just around 25%.
- So liquidation will not be desirable in the power sector either for the promoters or the government.

What are the alternatives?

- The government as well as other related agencies have suggested various ways to deal with power sector NPAs.
- The government has come up with the Sashakt scheme which is likely to bring relief to banks.
- Banks can get rid of the NPAs from their books quickly while hoping for better recovery rates in the future.
- State Bank of India and Power Finance Corporation, with the highest exposure to the power sector, have suggested the *Samadhan scheme*.
- The Rural Electrification Corporation has suggested the *Pariwartan scheme*.

What is RBI's stance?

- The RBI is not convinced with the proposed alternatives.
- It relies on the two key promises that IBC holds when it comes to NPAs resolution.
- One, IBC provides the framework for getting the best possible price of assets.
- Secondly, its application ensures a speedy resolution of assets that would have been otherwise stuck in litigation for decades.
- Given these, RBI asserts that nothing should be done to dilute the IBC process.
- So the central bank says that the law should be applied equally to all.
- Accepting exception for the power sector would invite more such requests.
- This is especially true, given the rising mountain of NPAs across different sectors.

8.9 Dams and Flood Control

What is the issue?

- The recent Kerala floods have highlighted the dangers of excess water accumulation in dams.
- It is essential, in this context, to understand the role of dams in flood control.

Why are dams dangerous?

- Dams store millions of tonnes of fresh water in large reservoirs.
- However, this is only after submerging prime forests, villages, farms and livelihoods.
- The 4,700 large dams built since 1947 have cumulatively displaced 4.4 million people.
- This makes dams the single largest cause for displacement post-Partition.
- These dams take decades to come up, but only a fraction of their output is for the household sector.
- Over 85% of them are used in agriculture for producing cash crops such as sugarcane.
- Dams have displaced the poorest of India's people in favour of richer farmers and urban residents.
- Notably, this often comes with little or no compensation.
- Worryingly, dams are far more hazardous than any other infrastructure project, except nuclear plants.
- Moreover, many dams in India are over a century old, and so have major defects.
- There is also a case for reservoir-induced seismicity (RIS) from the weight of the reservoir.
- This has resulted in earthquakes in various parts of the country.

How should dams be managed?

- The water level of a reservoir should be kept below a certain level before the onset of the monsoon season.
- This is an internationally accepted practice.
- This ensures that there is enough space to store the excess rainwater when the monsoon rains come.
- This also facilitates releasing water in a regulated manner.
- It thus prevents floods downstream when there is heavy inflow to the dams.

What is the concern?

- The roles of dams in irrigation and power generation are acknowledged.
- However, its role in flood control has always been underestimated.
- It is unfortunate that in both irrigation and hydel projects, flood control is completely ignored.
- Authorities always look to store the maximum amount of water in reservoirs during the monsoon season.
- It is then used for irrigation and generation of electricity during the summer months.
- Despite the extra quantity of electricity produced and area of land irrigated, excess storage is risky.
- It leads to loss of human lives, infrastructure and agricultural land, in times of heavy rains as in Kerala.
- The estimated loss to Kerala runs into thousands of crores and it will take years to rebuild the state.

What should be done?

- **Dams** - The meteorological department can predict rains or cyclones only a few days in advance.
- So keeping space in reservoirs is must, whether or not there are heavy rains.
- It is essential that at least 30% of the storage capacity of dams is kept free before the monsoon.
- This is crucial to ensure that the flood control purpose of dams is met.
- This allows discharge of water as well as increase of storage slowly as the monsoon progresses.
- There is also a task of critically reviewing every dam in the country.
- Decommissioning those that are at end-of-life, stopping building new ones and establishing sound safety protocols are essential.
- **Policies** - It is high time that government formulate water management policies for reservoirs.
- This should be in such a manner that dams are used to control floods, and not cause them.
- There is also a need to act on decentralised alternatives involving water recycling and reuse.
- **Electricity** - The over-dependence on hydel projects to produce electricity is another driving factor.
- So enhancing non-conventional sources for electricity generation is important in this context.
- **Authority** - Dam and water management is vested with the Public Works Department, Electricity Board, and Irrigation Department.
- But even in normal conditions there are contradictory opinions among these.
- This poses implementation hurdles to the decisions taken.
- So, the State Dam Security Authority, if competent, should be entrusted with the task of water management in reservoirs.
- It should also be empowered to take decisions in emergency situations.

8.10 Collapse of Flyover and Bridge

Why in news?

Majerhat Bridge, one of the busiest flyovers of Kolkata, collapsed, which was constructed in 1965 connecting Behala to southern Kolkata.

What are the other such instances?

- Recently a portion of an under-construction flyover on a highway at Uttar Pradesh's Basti district collapsed.
- Similarly in 2016 an under construction flyover collapsed in central Kolkata.

What are the reasons for collapse of structures?

- The state forensic report team that investigated the Majerhat Bridge collapse stated the lack of maintenance of the bridge over the years as the reason.
- Further, ad hoc and temporary steps to fix the problems in the bridge also contributed for the collapse.
- For instance, additional bitumen to Majerhat Bridge without assessing the load carrying capacity of the structure added to the load of carriage deck.
- The other reasons for the Engineering Structures to collapse are,
    1. Use of faulty and substandard material for construction
    2. Lack of maintenance
    3. Unsuitable design with respect to the area.

What are the steps to ensure the structure safety?

- Engineering structures are to be inspected at a regular interval.
- Based upon the inspection maintenance work and strengthening of the structure are to be done.
- Reinforcement work is needed in ensuring the safety of the bridge.
- Expert points out that quality design, standard material and consistent maintenance work are the prerequisite for a better and safe engineering structure.
- The most important point is to use the allocated funds and not to cut corners in such Repair, renovation and maintenance works.

8.11 Promoting Waterways

Why in news?

The Shipping Ministry has allowed foreign flagged vessels to transport fertiliser between Indian ports by easing the cabotage law.

What does a cabotage law imply?

- It specifies that only Indian flagged vessels are allowed to carry cargo between Indian ports.
- Foreign vessels can ply in Indian waters only after obtaining a licence and only if an Indian vessel is unavailable.
- The norms to ply without license for foreign vessels has been relaxed earlier this year to transport agriculture, horticulture, fisheries and animal husbandry cargo.
- Fertiliser is the seventh item that has been freed from restriction imposed by the cabotage law.

What are the competitive advantages?

- The Golden Quadrilateral and Goods and Services Tax have helped move goods faster and easier within the country.
- But transporting goods through road still costs Rs.1.5 per tonne kilometre.
- Also, the 3,228 km dedicated railway freight corridor that the government is building will reduce both the time and cost of transportation.
- Currently, it costs Rs. 1 per tonne kilometre to transport goods by rail.
- But the waterways serve as both the cheapest mode of transportation costing as low as 30 paise per tonne kilometre and also less polluting.
- Also, with its natural advantage of a 7,500 km coastline and 14,500 km of potentially navigable waterways, India can take a lot of pressure from the road and rail infrastructure, which are costly to build and expand.

- For instance, the 3,228 km dedicated rail corridor under construction costs over Rs. 81,000 crores.
- Countries like china and Japan moves over 40% of goods over water while a little over 5% of the goods are moved over water in India
- India is still looking towards road transport (over 60%) and rail (over 30%) to shoulder most of the load.
- Hence, the relaxation of the cabotage law will increase the supply of ships for coastal shipping.
- This should push industries and others to move goods such as cement, fertilisers, agriculture and horticultural produce through sea at lower cost.
- This could be complemented by port connectivity and modernisation of existing ports through the Sagarmala project.
- Along with that, two barges carrying 1,233 tonnes of fly ash were recently flagged off on river Ganga (National Waterway-1) from Kahalgaon power plant.
- The barges will travel 2,085 km across multiple waterways to reach Pandu Inland Port in Assam.
- This could make our waterways establish themselves as possible for cargo transportation and make compete with other sectors.

What are the challenges ahead?

- The government has identified 106 more waterways for navigation apart from NW-1.
- But even NW-1 makes water transportation possible for only a few vessels and only during daytime.
- Also, only in monsoon months when the water levels are high, transportation could be made possible in such rivers.
- Hence measures that need adequate focus are -
    1. Dredging of rivers
    2. Building new ports
    3. A proper river information system
    4. Digital GPS for night navigation
    5. Need for better berthing facilities
    6. Ensuring quick evacuation of goods from the port
    7. Leveraging technology to offer single document for multi-modal transportation
    8. Lower port charges
- India's logistics cost is currently at 14% of GDP, way above the 8-10% levels in evolved economies.
- High logistics costs blunt India's competitive advantage, especially when it comes to the 'Make in India' initiative.
- The government is right in focussing on water-based transportation to sharply reduce logistics cost.
- It should be followed by internal reforms, so that Indian shipping companies will not be forced to under-invest in this rising sector.

8.12 Boosting Electronics sector

What is the issue?

Electronics imports of India is raising and it deems necessary to boost indigenous manufacturing in the sector.

What was the scenario before?

- In the mid-1980s, India with an annual export of $70 million was ahead of China in electronics and computers hardware sector.
- Firms such as Wipro and HCL had end-to-end capabilities in hardware design, manufacturing, sales and services.

- But the import duties on components remained high and clearance for it stayed as a big hassle, making it difficult to expand operations.
- This was done because the government was more concerned about the misuse of imported components and future revenue losses.
- It also did not allow import of Printed Circuit Board, the most critical element for computers.
- These measures continued in the following decades which made India lag behind in the manufacturing of the electronics and hardware sectors.
- On the other hand, China with an incentive-driven strategy reached $600 billion in annual exports, which also became the world leader in the same period.

What was the Nokia story?

- Nokia decided to set up manufacturing facilities at Sriperumbudur SEZ in Tamil Nadu in 2006, attracted by India's vast market.
- Nokia moved to India along with its seven component suppliers and in the next few years, it started selling phones on a large scale.
- Exports rose to exceed $2 billion during 2010-13, but the local leaders tried to subvert the Nokia worker's union, demanding scrap contracts and free phones.
- There were also allegations of showing domestic sales as exports on part of the company and it has also received a bigger tax notice from the Income-Tax Department in the later period.
- Both the tax department and the company have differently interpreted Finland-India Double Tax Avoidance Agreement, which ultimately ended in the plant shutting down in 2013.
- This made India's mobile phone exports collapsed from $2 billion in 2013 to $200 million in the following year.
- All 7,000 direct and 10,000 indirect employees including 70% women lost jobs.
- China was the only gainer as most imports of mobile phones came from China.
- The Nokia story dented India's image as a robust investment destination.

What should be done?

- **Focus** - India needs to promote deep manufacturing and not superficial assembly of components.
- For example, lower import duty on components and higher on mobile phones made mobile phones assembled in India cheaper than the imported mobile phones.
- This made many firms to set up units to take the benefit, but they import ready-to-assemble kits from China.
- **Investment** - Although India's mobile phone imports came down in 2017, the combined import of mobile phones and components rose from $15 billion in 2015 to $20 billion in 2017.
- Thus India has to invest in semiconductor fabrication plants which build semiconductor chips and mobile phones, computers, or telecom products.
- The focus should also be on the manufacturing of critical parts like Mother Board/Printed Circuit Board (PCB) assembly and Integrated Circuits.
- These components serve as the heart of a computer, laptop, tablet, mobile and most electronic devices.
- **Model** - India could also follow a Chinese model of attracting MNC's through incentives like low-cost land, power, water, labour, tax exemptions and an efficient customs administration.
- This model made China the lead exporter of electrical machinery, electronic and telecom equipment by 2005.
- **Measures** - India could offer a robust incentive package to few anchor firms to set shop in India along with their dedicated component manufacturers.
- These may include low corporate tax at 10% and a 30-year lease of land lying unused at many SEZs.
- We must also allow the creation of a component hub that should ease bulk import where duty should be charged only at the time of clearance.

- This will ensure quick supply of components to meet an export/domestic order.
- The electronics story of the past four decades has suffered from bureaucratic short-sightedness and ambiguous tax regime.
- Thus, clearly worded tax laws that leave nothing on interpretation, freedom from interference in day-to-day operations and an attractive tax concession package could attract large investments into this sector.
- It would also kick-start investment-production-exports cycle in critical sectors like electronics, computer, and telecom, which will also pave the way to manage the rising current account deficit.

8.13 National Small Savings Fund for Air India

Why in news?

Funds with the National Small Savings Fund (NSSF) will now be used to help the struggling state-owned airline, Air India.

What is the decision?

- Reportedly, an estimated Rs 10 billion is to be allocated to the airline.
- Air India recently failed to pay salaries and also missed payments to various creditors.
- These include oil companies, aircraft leasing agencies and mechanical contractors.
- It already has a debt of over Rs 500 billion and the government's efforts to privatise it have not materialised.

What is the government's rationale?

- The government wants to keep the liabilities like funding an ailing airline off the Budget balance sheet.
- It is also focussed at meeting the fiscal deficit target.
- Recently, the government also permitted the NSSF to start lending to central agencies in addition to Air India.
- E.g. the Food Corporation of India and the National Highways Authority of India
- For the current financial year, the NSSF plans to invest Rs 1.3 trillion in these and other agencies.
- Notably, these are areas that would otherwise have required budgetary support.
- In other words, instead of the government directly lending to these agencies, it will have the NSSF directly lend to them.
- The impact on the overall public sector balance sheet will in effect be the same but the fiscal deficit will appear smaller.

Is it justifiable?

- The pool of small savings being used to finance a struggling airline's working capital raises some concerns.
- Certainly, this is not tax revenue and the government is just the custodian of this money.
- The government thus has the duty to ensure that this money is invested safely and wisely.
- So the decision largely appears to be an irresponsible use of funds.
- Even the fiscal deficit target would only be met in name.
- It's because the government would still be spending more in excess of its revenue than it had targeted.
- The effect on private sector borrowing would largely be the same as additional crowding out would occur.

What are the concerns?

- The government seeks to meet its disinvestment target through buyback of shares by public sector undertakings (PSUs).
- There is also a suggestion that the RBI reserves be tapped for government expenditure.
- These make it clear that the government is relying heavily on sources other than taxes to fund its spending.
- This is problematic for two reasons:

1. it is often a less productive use of the funds in question and involves a violation of fiduciary duties
2. using such off-balance sheet methods undermines the effort towards fiscal consolidation

- The finance ministry must thus reconsider its approach towards managing the financial resources and meeting the targets.

8.14 Rising Water Demand of Energy Sector

What is the issue?

The water demand for the energy sector is projected to rise and makes it necessary to report its water consumption in the coming years.

What is the situation of water crisis in India?

- The Composite Water Management Index (CWMI) by the NITI Aayog shows that 600 million people face high to extreme water stress in India.
- The water quality index report places India at a dismal 120 among 122 countries.
- It predicts that a persistent water crisis will lead to an eventual 6% loss in the country's GDP by 2030.
- A significant key to this stress is the vast gulf that has been predicted between the demand [1498 billion cubic metres (BCM)] and supply [744 BCM] of fresh water, by 2030.

How far is the power sector, water dependent?

- In its 2015 projections, the Central Water Commission (CWC) reported that the sector-wise requirement of water (drinking and domestic use, industry and energy) will rise steeply between 2030 and 2050.
- This is especially true in the energy sector, whose share of water consumed was 0.62% in 2010.
- This is pegged to rise up to 1.37% in 2030 and 8.98% in 2050.
- Thermal electricity accounts for more than 86% of India's total power generation.
- Analysis shows that 77% of these thermal power plants that are dependent on freshwater sources.
- Around 40% of them are installed in areas with high or extremely high water-stress.
- By 2030, more than 70% of India's existing thermal power utilities are likely to experience an increased level of water competition from agricultural, urban, and other industrial demands.
- As the power sector consumes more water, competition between power and the other thirsty players is only likely to increase.

What should be done?

- The CWMI raises three main issues related to data such as limited coverage, unreliable data and limited coordination and sharing between line departments.
- To rectify this, daily water withdrawal and consumption reporting should be mandated.
- These can be measured with existing technology and added into this reporting framework.
- Such information will also help in the implementation of the MoEFCC Notification, which mandates specific water consumption norms for existing and new thermal power plants.

How does the CWMI help in this regard?

- CWMI is expected to establish a public, national platform providing information on key water indicators across states.
- The platform will help in monitoring performance, improving transparency and encouraging competition among the states.
- This will, in turn, boost the country's water achievements by fostering the spirit of competitive and cooperative federalism among the states.
- Further, the data can also be used by researchers, entrepreneurs, and policymakers to enable broader ecosystem innovation for water in India.

- The CWMI noted that water-scarce States such as Gujarat, Madhya Pradesh, Andhra Pradesh, Karnataka, Maharashtra and Telangana are leaders in the Index.
- It notes that this is likely driven by necessity in the face of looming water shortages.
- Thus, water-energy nexus linkages, especially the metrics around power plant water withdrawal and consumption, have to be factored in while calculating the Index.
- This will help make the Index better and also the States to be better prepared on managing their water and power resources.

8.15 Relook at the BharatNet Project

What is the issue?

- Telecom Secretary recently asked the states to utilise the Bharat Net project's rural broadband infrastructure.
- Notably, Bharat Net has largely failed to deliver on its objective, calling for redressal of the shortfalls.

How has the progress been?

- Seven years have passed since the National Optical Fibre Network (rechristened BharatNet) project was first envisaged.
- The objective was to connect over 2.5 lakh gram panchayats through high-speed broadband.
- Already, 1.15 lakh gram panchayats have been connected.
- The physical execution of the project is scheduled to be completed by March 2019.
- However, when it comes to actual connectivity and utilisation, BharatNet has achieved little.
- This is despite thousands of crores of taxpayers' money having already been spent.

What are the shortfalls?

- The onus of preventive and corrective maintenance of the optical fibre portion connecting gram panchayats is with BSNL (Bharat Sanchar Nigam Ltd).
- The responsibility of remaining network elements lay with other agencies.
- Bharat Broadband Nigam Ltd was the special purpose vehicle created to execute the project.
- The lack of ownership by BSNL and inability of BBNL in ensuring timely project implementation has cost the nation a great deal.
- Though a clear utilisation target has already been set, the actual utilisation on the ground is well less than 10% of the target.
- Poor planning, lack of monitoring and co-ordination between the two organisations lead to ineffective implementation.
- It points to the lack of professionalism on the part of BBNL and BSNL.

Why is BharatNet crucial?

- Indian users are among the top consumers globally when it comes to adopting digitisation and online platforms.
- At the centre of this transition to a digital world is the availability of a reliable and affordable data network.
- Private telecom companies, including Reliance Jio, have announced plans to connect over 1,100 cities with optical fibre, which will cater to the urban consumers.
- But BharatNet is critical to ensure that rural India also benefit from the digital dividend.
- Besides this, BharatNet project is expected to -
    i. attract billions of dollars in investments
    ii. help train a million youth for new-age jobs
    iii. facilitate delivery of e-governance, e-health, e-education, e-banking and other such services

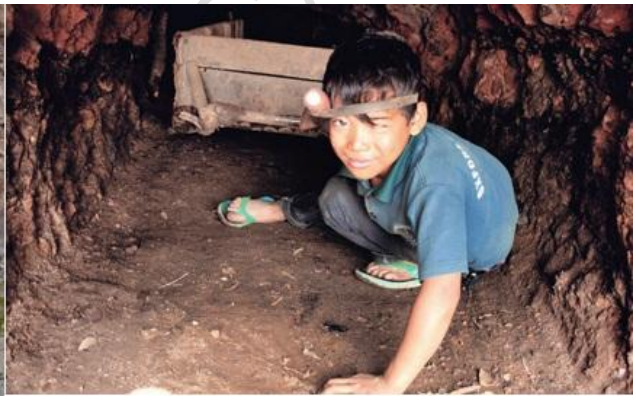
8.16 Rat-Hole Mining in Meghalaya

What is the issue?

- A coal mine in Meghalaya's East Jaintia Hills collapsed recently, trapping at least 15 workers who are feared dead.
- It has thrown light on a dangerous procedure known as "rat-hole mining".

What is rat-hole mining?

- It involves digging of very small tunnels, usually only 3-4 feet high, which workers (often children) enter and extract coal.
- The rat-hole mining is broadly of two types - side-cutting and box-cutting.
- In side-cutting procedure, narrow tunnels are dug on the hill slopes and workers go inside until they find the coal seam.
- The coal seam in hills of Meghalaya is very thin, less than 2 m in most cases.
- In the box-cutting type, a rectangular opening is made, varying from 10 to 100 sq m.
- Through this, a vertical pit, 100 to 400 feet deep, is dug.
- Once the coal seam is found, rat-hole-sized tunnels are dug horizontally through which workers can extract the coal.

Why is it very prevalent?

- In Jharkhand, the coal layer is extremely thick, where open-cast mining can be done.
- But no other method would be economically viable in Meghalaya, where the coal seam is extremely thin.
- Removal of rocks from the hilly terrain and putting up pillars inside the mine to prevent collapse would be costlier.
- So despite a ban, rat-hole mining remains the prevalent procedure for coal mining in Meghalaya.
- Rat-hole mining is the locally developed technique and the most commonly used one.
- It is not regulated by any law, and coal extraction has been made by unscrupulous elements in a most illegal and unscientific manner.
- Meghalaya's annual coal production of nearly 6 million tonnes is mostly said to have come through rat-hole mining.

What are the impacts?

- **Ecology** - Rat-hole mining in Meghalaya had caused the water in the Kopili river (flows through Meghalaya and Assam) to turn acidic.
- The entire roadsides in and around mining areas are used for piling of coal.
- This is getting to be a major source of air, water and soil pollution.
- Off road movement of trucks and other vehicles in the area causes further damage to the ecology of the area.

- **Risk to lives** - Due to rat-hole mining, during the rainy season, water flood into the mining areas resulting in death of many.
- If water has seeped into the cave, the worker can enter only after the water is pumped out.

What are the shortcomings?

- **Ban** - The National Green Tribunal (NGT) has banned rat-hole mining in 2014, and retained the ban in 2015.
- The ban was on grounds of the practice being unscientific and unsafe for workers.
- The NGT order bans not only rat-hole mining but all "unscientific and illegal mining".
- But orders of the Tribunal have been violated without exception.
- The State Government has failed to check illegal mining effectively.
- It has also not framed the mining policy, mining plan and the guidelines as directed under the orders of the Tribunal.
- The state has in place the Meghalaya Mines and Mineral Policy, 2012; but the NGT finds it inadequate.
- **Protection** - Constitution's 6th Schedule intends to protect the community's ownership over its land and autonomy and consent over its nature of use.
- Coal mining currently underway in Meghalaya was a corruption of this Constitutional Provision.
- Private individuals with interests in earning monetary benefits from minerals vested under the land are engaging in coal mining.
- They are attempting to legitimize this act by claiming immunity through tribal autonomy over land ownership.

8.17 Significance of Bogibeel Bridge in Assam

Why in news?

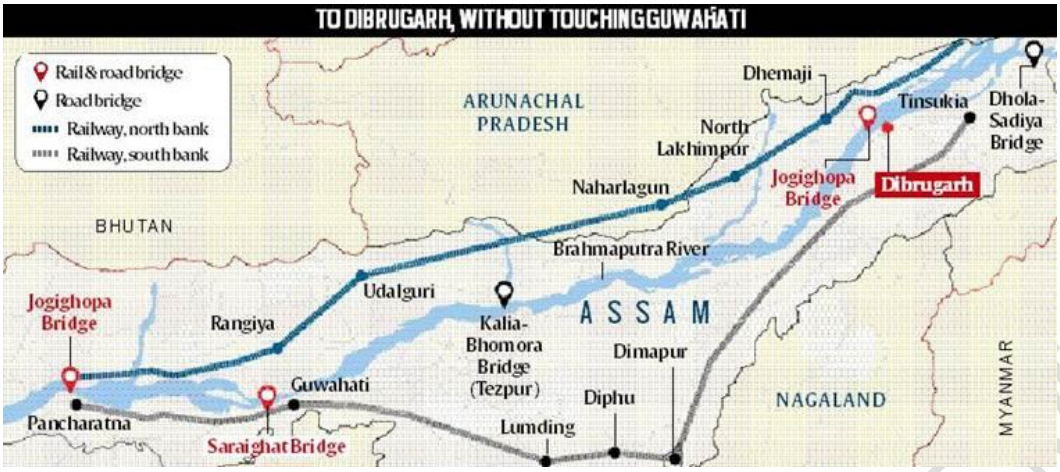
Bogibeel, the longest rail-road bridge of India, was recently inaugurated by the Prime Minister.

What is it?

- The Bogibeel Bridge, inside Assam, is 20 km from the border with Arunachal Pradesh.
- Itspans nearly five-km across the Brahmaputra river.
- It connects Dibrugarh on the Brahmaputra's south bank to Dhemaji on the north bank.
- It will link Dibrugarh with North Lakhimpur district of Assam and parts of eastern Arunachal Pradesh.
- It is the country's longest road-cum-rail bridge, and its fourth longest of any kind above water.

Why is it so significant?

- **Dibrugarh** - Dibrugarh is seen to be reclaiming its lost glory 68 years after being ravaged by a devastating earthquake and the ensuing floods.
- It used to be a thriving centre of the plantation industry during the colonial times.
- It remains a hub of higher education and medical treatment in the region.
- However, for decades, the only recourse for people to cross the Brahmaputra is a diesel propelled ferry.
- So commissioning the bridge has reduced the journey time across the river to less than five minutes.
- **North-East** - The single biggest factor which has hampered the development of the Northeast region is the absence of robust connectivity.
- A maze of river systems across Arunachal Pradesh, with their confluence in Brahmaputra, has posed an enormous challenge.



- The bridge has the potential to infuse economic dynamism in the region.
- It could provide opportunities for the expansion of tourism, industrial development and trade.
- **Infrastructure** - Bogibeel must be viewed alongside other infrastructure developments in neighbouring Arunachal Pradesh.
- The iconic Bhupen Hazarika bridge (Dhola–Sadiya Bridge) over the Lohit river was commissioned recently by the Prime Minister.
- A 7.5 km long bridge over the Dibang river was also dedicated to the nation recently.
- The Trans Arunachal Highway has seen considerable progress, especially in the eastern part of the state.
- An airport has been commissioned at Pasighat, barely two hours away from Dibrugarh.
- **Tourism** - The region has now become more accessible to the rest of the world.
- This could give a fillip to tourism, given the region's abundant wildlife and ideal condition for river rafting and angling.
- But a roadmap of tourism development, promotion and branding needs to be crafted, which is centred on the region's tribal ethos.
- **Industries** - Dibrugarh lies at the heart of a crucial oil and gas axis in Assam, given its proximity to Digboi and Duliajan oilfields.
- Further east lie the Kharsang gas fields and Kumchai oilfields of Arunachal Pradesh.
- The district also has significant coal deposits. There are more than 200 tea factories as well in Dibrugarh.
- So the bridge has raised the prospects of industrial development and employment opportunities, especially in the mining and plantation sectors.
- **China** - Bogibeel is the gateway to the historic Stilwell Road.
- The road connects Ledo in Assam to Kunming in China, passing through Myanmar's Kachin state, via Arunachal Pradesh.
- The 1,800 km long route was used for transporting arms to the Chinese by the Americans during World War II.
- From a strategic standpoint, movement of troops has become a much quicker, efficient and reliable proposition.
- The road beyond Dibrugarh leads to the frontier parts of Arunachal Pradesh, with a fully functional advanced landing ground of Air Force at Walong, barely 100 km from the Chinese border.
- **Trade** - The route could now well become the centrepiece of the ambitious Act East Policy. It could boost trade across the region.
- Infrastructure in Myanmar would need to be strengthened and the land customs station at Nampong in Arunachal Pradesh revived.

- Importantly, the advantage of connectivity must be accompanied by an imaginative blueprint of economic development.

8.18 Concerns with Jaitapur Nuclear Power Plant

What is the issue?

Indian government has to be transparent on the project details of the Jaitapur nuclear power plant.

What is the project about?

- The EPR (European Pressurised Reactors) is a third generation pressurised water reactor, capable of achieving around 1,650 MW of power output with a higher yield than previous models.
- It can supply electricity to up to 1.5 million people, yet requires 17% less fuel and produces less long-term radioactive waste.
- India has initiated the idea of importing 6 nuclear EPRs more than a decade ago, but made little progress due to economics and safety concerns.
- In March 2018, the French company Électricité de France (EDF) and the Nuclear Power Corporation of India (NPCIL) signed an "industrial way forward" agreement.
- Recently, EDF submitted a proposal to the Indian government for the Jaitapur nuclear power project in Maharashtra using EPR design, along with a proposal to start the project ASAP.
- It will become the largest nuclear power plant in the world on completion.

What are the risks associated with the project?

- **Cost** - Electricity from the Jaitapur project will be more expensive than many other sources of electricity, including solar and wind power.
- It was estimated in 2013 that first year tariffs from the Jaitapur project would be around Rs. 15 per kilowatt-hour.
- This figure must be revised upwards to account for the construction experience with EPRs over the past five years.
- While nuclear costs have been rising, other low-carbon sources of electricity, especially solar energy, have become cheaper.
- In recent auctions for solar PV projectsunder the National Solar Mission, winning tariff bids in the range of Rs. 2 to Rs. 2.50 per unit have become routine.
- **Delay** - Across the world, EPRs have experienced delays and cost increases and has also locked consumers into a risky and expensive project with uncertain strategic and economic benefits.
- **Debt** - Power-generating capacity in India has grown faster than demand causing projects to run into financial difficulties.
- The parliamentary standing committee on energy listed 34 "stressed" projects, including NPAs and "those which have the potential to become NPAs", with a cumulative outstanding debt of Rs. 1.74 lakh crore. (2018)
- Since the NPCIL's debts would ultimately be underwritten by the Indian government, if the project encounters financial difficulties, the costs would fall on Indian taxpayers.

What are the concerns on safety measures?

- In addition to the high costs, safety problems with the reactor design and construction have emerged in several EPRs.
- The most serious of these pertained to the pressure vessel, which is the key barrier that prevents the spread of radioactive materials from the reactor.
- There are cases of substandard welding in the reactor's pipes or high carbon in the reactors' steel in EPR design as reported the French nuclear safety regulator.
- These safety concerns are further exacerbated by India's flawed nuclear liability law.
- In the event of an accident, the nuclear liability law would require the public sector NPCIL to compensate victims and pay for clean-up, while largely absolving EDF of responsibility.

- However, under the law, NPCIL can obtain compensation from EDF for the supply of equipment with defects or for sub-standard services.
- But the joint statement issued by the two countries might limit the operator's (NPCIL) right to obtain compensation.
- This is because, the statement promises that the "enforcement of India's rules" would be in accordance with the International Convention on Supplementary Compensation for nuclear damage.
- This might prevent the NPCIL from exercising its right to claim compensation from EDF as allowed by Indian law.
- If that is the case,then EDF can escape with limited or no consequences even after a severe accident.
- Thus, without any responsibility, EDF will look more towards lowering operational costs for the plant than maintaining the highest safety standards for it.

What should be done?

- Jaitapur
- Both the countries emphasized the need for the project to generate cost-effective electricity.
- To ensure that, the government should clarify on –
    1. The entire project cost
    2. Accountability for cost increases and delays
    3. Agreement on sharing liability
- Unless it is transparent about these details, the implementation of the nuclear power plant will become difficult to materialise.

9. AGRICULTURE

9.1 Rise of "Farmer Producer Organisations"

What is the issue?

- Farmer producer companies are growing by the day.
- They can prove a vital interface between the farmers and markets and might help in reducing the dependence on MSP.

Why FPCs?

- Effective price realisation has eluded India's farmers for long, despite increasing production levels and massive outputs (275 million tonnes in 2017).
- This indicates that the fault might lies not in our production output, but our market ecosystem, which is highly regulated.
- The recent re-jig for doubling farmers' income has thrown light on the importance of sound market institutions for agriculture.
- **Institutionalisation -** In this context, Farmer Producer Companies (FPC), a relatively new institutional architecture is gaining traction.
- These are institutions that are both farmer-led and farmer owned and is fast becoming an effective interface between farmers and markets.
- Many FPCs have been created under the Companies Act of 2002, and this has led to the mobilisation of over 2 million farmers under the umbrella.
- Presently, over 3,000 FPCs have been registered and are supported by agencies like NABARD, Small Farmers Agribusiness Consortium (SFAC).
- Many other resource institutions also support the initiatives to organise farmers arrange themselves into this new co-operative order.

What is the modus operandi of FPCs?

- The foremost requirement to set up a FPC is having a compelling business model, a process that is organically driven by local leadership from farmers.
- FPCs are 'for-profit' enterprises fully owned by farmers, and they have successfully experimented with institutional and market led innovations.
- They've also demonstrated a positive impact on price realisation, cost saving, and local employment and are of great support to small farmers.
- Such institutions will help in facilitating farmers to own, greater parts of the agricultural value chain rather than just their farm produce.
- These organisations are hence a crossover between market and a social function, and the collective is ultimately fairly independent of the state.
- However, challenges in tackling forward markets and access to credit have been serious challenges for budding FPCs.
- Nonetheless, many FPCs have been trading measurable quantities for hedging, which are contributing to 15-20% higher prices owing to lesser uncertainty.

What are the key structural aspects of FPCs?

- Despite its effectiveness FPCs are not an alternative to APMC due to their limited reach and scale.
- Clearly, these institutions demand a specific kind of incubation support that facilitates collective businesses.
- The nature of state support for viable FPCs is being deliberated on multiple forum — access to capital, organisational governance, and technical training.
- While support from public corpuses is enough for starting an FPC, their long-term competitiveness depends on their ability to raise capital from markets.
- Provisions for limited shares (up to 24%) to private entities will give FPCs access to private capital without compromising on collective ownership.
- Further, these firms can integrate into the post-harvest segments of the value chain, and gain favourable economies of scale.
- While the start-up culture is presently an urban phenomenon, through FPCs start-ups will move rural and help the village level entrepreneurial landscape.

9.2 Dealing with Agrarian Surpluses

What is the issue?

- Whenever there is surplus productivity in the farming sector, the wholesale prices of perishables seems to crash hard.
- To safeguard our farmers, we need to devise innovative policies to deal with unexpected market gluts.

What are the trends in agro-prices in recent years?

- When the National Democratic Alliance (NDA) government took charge in 2014, it had to deal with almost double-digit inflation (primarily food inflation).
- Hence, the government naturally give priority to allaying the concerns of the consumers and made efforts to contain food inflation.
- To this end, the government resisted announcing any sharp increases in Minimum Support Prices (MSP) for various agricultural commodities.
- It also tweaked the trade policy to ensure that there was enough agricultural produce to contain any sharp increase in retail prices.
- Consequently, excessive supply in agro-produce has become a recurring and common market phenomenon in recent times.
- This has caused regular price crashes, leading growing farmer unrest across the country, which is now making the government take note of the plight of farmers.

- Notably, there have been multiple incidences of farmers throwing away their produce to express dissent and vent their anger at the unfair prices being offered.

What are the reasons for higher productivity?

- Multiple reasons has caused production across a whole range of agricultural commodities in India to go up year on year.
- There have been productivity gains due to improvements in the quality of seeds available because of better plant breeding and genetics.
- Added to this is the sustained improvements in scientific farming practices, such as high-density cultivation and use of drip irrigation.
- Investments in associated infrastructure, such as better road connectivity and improved access to electricity, have also helped in raising overall productivity.
- Also, with improvements in information technology and more inter-connectedness, demand signals are penetrating more rapidly than ever.

What has been the government response?

- **Actions -** As the growing anger could have electoral repercussions, the governments at various levels has promised higher MSPs and loan waivers.
- But these measures are mere painkillers, and a sustained solution is needed to address the current crisis comprehensively.
- Notably, the promise of higher MSP would only incentivize the greater production of certain commodities than sustainably securing farmer incomes.
- **The problems -** Government seems obsessed with supply-side management measures such as imposing stock-holding limits and allowing easier imports.
- Also, government policy has largely been biased against farmers to favour consumer needs by ensuring that prices are sustained at low levels.
- For instance, government tends to block exports when there are better international prices, in order to ensure that domestic prices doesn't spike.
- Contrarily, when there is a spike in domestic prices, the government opens up for cheap imports to ensure safeguard the consumers from price rise.
- Hence, it can be said that farmers are indirectly subsiding consumers for long, which needs to correction in order to ensure economic justice to our farmers.

9.3 Zero Budget Natural Farming

What is the issue?

- Andhra Pradesh CM announced that the State would fully embrace Zero Budget Natural Farming (ZBNF).
- India could consider replicating the model for the country.

What is ZBNF?

- Zero Budget Natural farming (ZBNF) is said to be “do nothing farming”.
- It involves the application of nature’s principles in farming.
- It practises no-till, no chemical use in farming.
- Alongside, dispersal of clay seed balls to propagate plants is done.
- The key aspects integral to it and which require locally available materials are:
    i. seeds treated with cow dung and urine
    ii. soil rejuvenated with cow dung, cow urine and other local materials to increase microbes
    iii. cover crops, straw and other organic matter to retain soil moisture and build humus
    iv. soil aeration for favourable soil conditions

- These methods are combined with natural insect management methods when required.
- *The ZBNF is a technology of the future with a traditional idiom.*

What are the benefits?

- In ZBNF, **yields** of various cash and food crops have been found to be significantly higher.
- E.g. yields from ZBNF plots were found on average to be 11% higher for cotton than in non-ZBNF plots.
- The yield for Guli ragi (ZBNF) was 40% higher than non-ZBNF.
- **Input costs** are near zero as no fertilizers and pesticides are used.
- **Profits** in most areas under ZBNF were from higher yield and lower inputs.
- Model ZBNF farms were able to **withstand drought and flooding**.
- Notably these are the serious emerging concerns with regard to **climate change**.
- Planting multiple crops and border crops on same field provides **varied income and nutrient sources**.
- Overall, there is
    i. reduced use of water and electricity
    ii. improved health of farmers
    iii. flourishing of local ecosystems and biodiversity
    iv. no toxic chemical residues in the environment
    v. improvements in soil, biodiversity, livelihoods, water
    vi. climate resilience
    vii. women's empowerment and nutrition

How is ZBNF better than organic farming?

- Organic agriculture often involves addition of materials required in bulk and have to be purchased.
- These are large amounts of manure, vermicompost and other materials.
- These turn out to be expensive for most small farm holders.

What is the Andhra Pradesh model?

- **Initiatives** - Successful pilot programmes were initiated in 2015 and partnerships for gaining inputs were taken up.
- With this, Andhra Pradesh has become the first State to implement a ZBNF policy.
- **Coverage** - This year, 5 lakh farmers will be covered, with at least one panchayat in each of the mandals shifting to this new method.
- By 2021-22, the programme is to be implemented in every panchayat, with full coverage by 2024.
- **Strategies** - Tenant farmers and day labourers are being trained.
- This ensures that through the ZBNF, livelihoods for the rural poor are being enhanced.
- Farmer-to-farmer connections are vital to the success of the programme.
- Establishment of farmer's collectives such as Farmer Producer Organisations are encouraged.
- **Funding** - The Government of India provides funding through the Rashtriya Krishi Vikas Yojana and Paramparagat Krishi Vikas Yojana.
- Additional resources have been made available through various philanthropic organisations.
- **Participation** - Andhra Pradesh has supported and learned from its many effective civil society organisations.
- This include Watershed Support Services and Activities Network, Centre for Sustainable Agriculture, Deccan Development Society.

- The scaling up relies primarily on farmers and local groups; in all, very much a bottom-up process.
- Open-minded enlightened political leaders and administrators have been fundamental in this process.
- **Geography** - Andhra Pradesh has a combination of delta regions, arid and hilly tribal areas.
- Thus the districts in Andhra Pradesh are similar to those in other parts of the country.
- It could therefore serve as a workable model for replication.
- The drought-prone Rayalaseema region (Andhra Pradesh) is reportedly seeing promising changes in farms with the ZBNF.

9.4 Taking Forward Contract Farming

What is the issue?

- The government recently came out with a Model Contract Farming Act, 2018.
- Better Centre-State co-operation on land lease will ensure that both farmers and sponsors gain.

How is the growth scenario?

- Agriculture growth is under stress at 3.4% in 2017-18 compared with 6.3% in 2016-17.
- This is largely attributed to
    i. declining soil fertility
    ii. fragmentation of landholdings
    iii. increasing restrictions to commercialisation and modernisation of farming and farm-related activities

What is contract farming?

- It refers to a system in which bulk purchasers enter into contracts with farmers.
- It includes agro-processing, exporting and trading units.
- They purchase a specified quantity of any agricultural commodity at a pre-agreed price.
- The contracting firm/company is also known as the sponsor.
- As, it provides all production support to the contacted farmers.
- This includes the extension services with full protection of land rights.

What are the benefits?

- **Income** - The idea is to increase farmers' income by creating an alternative market mechanism.
- It would provide linkages between national and international markets.
- Prior to this, several States have been hesitant to allow contract farming.
- With the Act being notified, the focus has shifted to the operational aspects.
- **Middlemen** - Agricultural markets invariably remain in the clutches of the middlemen.
- The Act allows farmers and farmer producer organisations (FPOs) to directly link with companies.
- It thus enhances market linkage and removes dependence on middlemen.
- **Price** - 86% of total landholdings in the country belong to the small and marginal category.
- The Act will have an indirect effect on farmers forming FPOs.
- It helps pooling their land for a better say in determining the prices of their produce.
- **Cost** - Farmers no longer have to transport their produce to the mandis.
- As, sponsors usually collect the produce from the farm gate.
- It thus reduces farmers' cost and thereby translates into increased incomes.
- **Land** - Fear of losing land has always inhibited farmers from embracing new policy.

- The Act does well to insulate land ownership rights of the farmers.
- It prevents them from any potential infringement from the sponsors or the buyers.
- **Market** - Contract farming creates new markets for farmers' produce.
- It facilitates better access to technology, crop diversification, and extension services.
- It can thus positively impact the production process.
- **Financing** - Lack of formal financing mechanism and lower penetration of crop insurance are prime causes of farmer distress.
- Contract farming facilitates financing and crop insurance as well.

What are the shortcomings?

- **Board** - The Act mandates the formulation of a contract farming board.
- This is to guide several aspects of the contract, including pricing of produce.
- The intent is to provide a cushion against possible exploitation of the farmers.
- However, if not exercised judiciously, the board may set high price, deterring sponsors.
- **Quality** - The sponsor is mandated to buy the entire contracted amount of produce.
- This is even if the quality parameters are not met, though at a lower price.
- This affects the sponsors, as, they enter into agreement to procure a specific grade of produce.
- **Insurance** - The spirit of providing insurance support to the farmer is good.
- But the sponsor is burdened with this additional cost.
- The government can instead consider covering this cost.

9.5 Assessing Agri-Pricing Policies

What is the issue?

- Excess supply, depressed market prices and mounting farmer losses are more a consequence of shortfalls in agri-pricing policies.
- It calls for providing income support to at least the most vulnerable farmers.

What is the existing scenario?

- Good rains, excessive sowing and bumper harvest last year produced excess supply in the market.
- It resulted in a decrease in the prices of many crops and thus in farm incomes too.
- Market prices for major kharif crops fell below the Minimum Support Prices (MSP).
- The current farm crisis is largely due to the shortcomings in the pricing policies.

What is the policy shortfall?

- Agri-prices, and therefore farm incomes, are not free-market driven.
- They are kept artificially low, through use of pricing policy instruments.
- This is done so that inflation does not erode the rest of the population's purchasing power.
- The economic tools for protecting farm incomes were not employed to the best advantage.
- These include -
    i. the price support scheme
    ii. price stabilisation fund
    iii. market intervention scheme
- Appropriate adjustments to the export and import rules could have arrested the price fall.

- It would have diverted the excess supplies to overseas markets.
- But imports were allowed as usual, which worsened the price situation.

What is the policy on MSP?

- The Budget promised that Minimum Support Prices (MSPs) would be at least 150% of production costs.
- Even if market prices fall below MSP, government will procure the produce on MSP.
- If it does not procure, it will provide a mechanism to ensure payments reach farmers.
- That would be equal to the gap between the MSP and the market price.
- Assuring 50% profit margin over the cost of production is to make farming remunerative.

What are the concerns with MSP?

- Farmer groups and government differ on the **formula** for calculating production costs for plugging into the MSP formula.
- But besides this, simply announcing higher MSPs will not raise farmer incomes.
- As, the **system** is not geared for scaling up **procurement** in the first place.
- MSPs are announced for more than 20 crops.
- But, noteworthy procurement is conducted just for three - paddy, wheat and sugarcane.
- For several crops, last year, the **quantitiesprocured** were small portions of the total produce.
- Further, procurement frequently takes places at **prices** below the MSP, according to reports.
- Also, **small and vulnerable farmers** usually do not get paid MSPs at all.
- This is because they sell their produce to aggregators, not directly in mandis.

What is the demand-supply mismatch?

- MSP of Paddy for the 2018-19 kharif season will have to be raised 11-14%, cotton 19-28%, and jowar 42-44%.
- These are the projections if the MSP pricing formula of 1.5 times the cost is employed.
- A rational response of farmers would be to sow more jowar in the next season.
- But there is no reason that the demand for jowar would also rise.
- A demand-supply mismatch would be inevitable in this case.
- It would send the market prices for jowar way below the announced MSP.
- It would in turn call for significantly expanded jowar procurement at MSP.
- Thus, clearly, pricing policies distort market prices of crops.
- It sends the wrong signal to farmers on what to produce and how much.
- The policy system fails to correct such situations, which then goes out of control.

9.6 Shortfalls in Crop Insurance Schemes

Why in News?

Recent reports by the CAG and CSE has highlighted the shortfalls in various crop insurance schemes.

What are the reports on?

- The CAG report examined the following crop insurance schemes:
- Modified National Agriculture Insurance Scheme (MNAIS)
- Weather Based Crop Insurance Scheme (WBCIS)
- These were implemented during 2011-12 through 2015-16.

- The Centre for Science and Environment (CSE) study analysed the new Pradhan Mantri Fasal Bima Yojana (PMFBY).
- Notably, PMFBY replaced all the above schemes from Kharif 2016 onwards.

What are the concerns highlighted?

- **Low claim** - There were shortcomings in implementation of the crop insurance scheme in the 2011 to 2016 period.
- As a result, a huge sum was released to private insurers without proper verification of the beneficiaries.
- Notably, there was low claim in relation to the premium charged.
- This led to the insurance companies making in huge profits.
- **Delay in subsidy** - Under PMFBY, claims must be paid to farmers within 3 weeks of yield data by insurance companies.
- But on ground, claims made for Kharif 2016 were not fully settled even a year after.
- A major reason for this is the delay by states in releasing their share of the subsidy.
- Also, delay on part of the states to take up requisite number of *crop cutting experiments* (CCE) is another major failure.

Pradhan Mantri Fasal Bima Yojana

- The Pradhan Mantri Fasal Bima Yojana (Prime Minister's Crop Insurance Scheme) was launched in 2016.
- It envisages a uniform premium to be paid by farmers at only 2% for Kharif crops and 1.5% for Rabi crops.
- The premium for annual commercial and horticultural crops will be 5%.

Crop Cutting Exercises (CCE)

- States are mandated to conduct crop cutting experiments (CCE) for assessment of yield losses or crop damage.
- Standing crops in five square metre would be harvested, thrashed and the quantum of grains and straw would be weighted to assess the loss.
- Crop loss assessment has to be timely and also be reasonably accurate, to inspire

- **Crop value** - The value of the crop is based on the average yields of the last 3 years.
- The sum insured does not represent the real value in an area where yields are growing, or for farmers who have higher yields.
- **Coverage** - Most districts tend to have just one or two notified crops.
- So most vegetables/fruit tend to be uninsured if they are not the major crop of the district.
- The share of small and marginal farmers was very low under the NAIS scheme given their proportion of 85% of the total farmers.
- Coverage of non-loanee farmers under the crop insurance schemes has been particularly low.
- Farmers receiving crop loans are mandatorily enrolled in crop insurance schemes.
- Unlike these loanees, non-loanee farmers are those who sign up for these schemes willingly.

9.7 GM Regulations in India

What is the issue?

- Despite the ban on local production and import of foods having genetically modified (GM) content, GM food has widely penetrated the Indian markets.
- But this has led to no real health or environmental consequences, which only supports the assertion that GM food is safe.

What are the shocking regulatory lapses?

- "Centre for Science and Environment" (CSE) study indicated that as much as 32% of the processed foods marketed in India carry GM ingredients.
- As GM imports are banned, importers have to currently make a declaration that their goods are free of GM components at the customs.
- Yet, nearly 80% of the marketed foods that tested GM-positive in the CSE study were imported in contravention of the ban.

- More significantly, some of the GM products falsely claimed on their labels to be GM-free, which is a clearly spiteful violation to deceive consumers.
- All this reflects poorly on the country's GM regulatory systems.

What is the GM crop scenario in India?

- Currently, BT cotton is the only approved GM crop for commercial cultivation in India and it accounts for 90% of the cotton acreage now.
- While no GM food crop has been permitted thus far, GM foods have already deeply penetrated into the Indian markets.
- Notably, Cottonseeds (of BT-cotton), which bear GM DNA, are routinely fed to cattle whose milk is part of regular human diet.
- In recent years, even cottonseed oil has begun to be used as a cooking medium individually or admixed with other edible oils.
- This oil, if not properly refined, can retain remnants of GM DNA.

What the differing opinions on GM?

- The fundamental issue really is the impact that the genetically tweaked foods can have on health and environment.
- If the vociferous anti-GM lobby argues that "GM Food" can pose wide-ranging hazards but most scientists disagree on this.
- In fact, there has been no detectable incidence of health or environmental hazard due to GM crops in the past 2 decades (since GM trials began).
- Also, several scientific studies conducted in the countries where GM crops are extensively farmed and consumed have not found any adverse effect.

What is the way ahead?

- Poor regulations in India have resulted in careless sowing of BT-Cotton and the extensive penetration of GM foods into the markets.
- Despite these serious lapses, hardly any harmful fallout has been observed until now, which is hence a vindication of safety of GM crops.
- The government should, therefore, take note of these facts and lift the ill-advised embargo on the approval of new GM seeds.
- The cutting-edge technology of genetic manipulation needs to be put to gainful use for the benefit of farmers, consumers and biotech-based industries.

9.8 Storing Foodgrains in the Open

What is the issue?

- India stores millions of tonnes of foodgrains in the open under tarpaulins.
- It has notable health effects and is a cause for other losses.

Why is foodgrains storage important?

- In India, at the height of the rainy season, growth of fungi overnight is a serious concern.
- Humidity in the air and warmth of summer are conducive for fungi growth.
- All fungi need is something to feed on, and grains are more susceptible to it.
- Eating mouldy grain causes a variety of illnesses.
- Mycotoxins, found in mouldy grain/foods, are associated with human disease.
- They produce aflatoxins (cancer-causing), and other such toxins.
- Aflatoxicosis causes abdominal pain, vomiting, hepatitis.

- They sometimes even cause death after acute exposure to high concentrations in food.
- Chronic low dose exposure to aflatoxin can result in impaired growth in children.
- So healthy foodgrains storage conditions are essential to avoid possibilities for the above.

How is storage done elsewhere?

- In other parts of the world, grain is stored in silos (a tall tower or pit on a farm used to store grain).
- Here, stored grain is kept dry and aired so as to prevent fungal and insect attacks.
- The time North American mid-west came under plough, large grain silos and a railway system to export the grain were built.
- Today, the U.S. has a permanent storage capacity nearly equivalent to its annual grain production.

What are the concerns in India?

- **Storage** - India handles about 30.52 million tonnes of rice, wheat, maize, gram and sorghum.
- These are stored in structures at Food Corporation of India godowns and hired spaces.
- Most procured grain is stored using the CAP, or cover and plinth method.
- Under this, grains are piled up on the floor and covered with a tarpaulin.
- This is very cheap and easy to make, but not healthy.
- **Silos** - India has only four silos located each in Kolkata, Chennai, Mumbai and Hapur-Ghaziabad.
- A recent one, in Uttar Pradesh, is the most modern with a storage capacity of 500 tonnes.
- The remainder of government-procured grain is stored in poor conditions.
- To export basmati rice, Punjab has built modern, temperature-controlled grain silos with a storage capacity of 50,000 tonnes.
- However, this is not for the Indian market.
- **Loss** - It is estimated that there is a 10% loss of harvested grain.
- Of this, 6% (around 1,800,000 tonnes) is lost in storage.
- These grains become so damp, fungus-ridden and unfit for consumption.
- **Impact** - Grains are stored outdoors under tarpaulins through the rainy season.
- After this, grain is ground (grind) and converted to flour or flour-based products or de-husked.
- However, mycotoxins are already present from the time the flour was stored in the form of grain.
- **Awareness** - The government is aware of the deadly consequences of grain with mycotoxins.
- There are regulations in place to prevent the purchase of mouldy grain from farmers.
- However, there are no published studies on the extent of mould infection in grain stored using the CAP method.

9.9 Significance of Bamboo Cultivation

Why in news?

The theme of World Bamboo Day 2018 is bamboo as a tool for achieving economic and social sustainability.

What is the status of bamboo cultivation in India?

- Bamboo is grown on 10 million hectares in India and covers almost 13% of the total forest area.
- The total production of bamboo is five million tonnes per year.
- About 8.6 million people depend on bamboo for their livelihood, the value of bamboo in India is estimated at $4.4 billion.

- Though Madhya Pradesh has the largest area under bamboo forests, bamboo culture thrives in the North Eastern region.
- India is second only to China in terms of bamboo diversity.
- The North-Eastern States are a storehouse of bamboo diversity, home to 58 bamboo varieties.

What are the significant characteristics of bamboo?

- The advantage of bamboo is manifold compared to monoculture tree plantations.
- After planting, bamboo clumps start yielding after 4-7 years,it can become part of agro forestry practice in small land holdings.
- New bamboo plantations may curb the pressure from deforestation by serving as wood substitutes.
- It can be planted to reclaim severely degraded sites and wastelands.
- It is good soil binder owing to its peculiar clump formation and fibrous root system and hence also plays an important role in soil and water conservation.
- It is the fastest growing canopy, releasing 35% more oxygen than trees.
- There are studies reporting that bamboo stands sequester 12 tonnes of carbon dioxide from per hectare.

What is the role of Bamboo in Indian lives?

- From the tender shoots as a delicacy food item to the rice cooked in the hollow of raw bamboo, it is part of everyday life.
- Due to its versatile nature and multiple uses, it is also called 'poor man's timber'.
- From house construction to flooring, agricultural implements, bamboo pervades all aspects of life and culture, artistic skills in bamboo weaving is also found in north-eastern region.
- Apart from this Bamboo is an integral part of North-east India's life and culture, as it is used in religious ceremonies, art and music.

What are the initiatives taken by India to promote Bamboo?

- India launched the National Bamboo Mission in 2007, it has failed to address the enormity of the issues related to bamboo.
- Realising this lacuna, the Finance Ministry has allocated $200 million in the 2018 Budget to provide new impetus to the bamboo sector, with huge support to the North-Eastern States.
- In November 2017 the Centre relaxed the restrictions on harvesting, transit and trade of bamboo to boost the bamboo economy across the country.

What India can learn from China in this regard?

- China has achieved great success in growing and showcasing bamboo forests and products.
- The headquarters of International Bamboo and Rattan Organisation (INBAR) is located in China.
- It is a multilateral development organisation which promotes environmentally sustainable development using bamboo and rattan.
- It has been making a real difference to the lives of millions of people and environments around the world with achievements in areas such as: raising standards; promoting safe, resilient bamboo construction; restoring degraded land; capacity-building; and informing green policy and sustainable development objectives.
- Following the footsteps of China, India needs to support farmers to establish bamboo plantations in barren slopes.

9.10 Issues with Cotton Production

What is the issue?

The requirement of cotton for the textile industry is projected to grow and it needs improvement in agronomic practices.

What are the benefits?

- Cotton has been successfully used as a multiple purpose crop as –
  1. Edible oil for human consumption
  2. de-oiled cake as an animal feed
  3. Fabric making fibre.
- 65 lakh farmers in India cultivate more than one crore hectares of cotton annually, mostly under rainfed conditions.
- India's share in global cotton production is a whopping 25% and an estimated 6 crore people depend on cotton for their living.
- Cotton seed industry forms about 20% of the total seed industry in India.
- The cost of cotton seed is less than 5% of the revenue of the cotton farmer and has remained very affordable.

How does it influence textile industry?

- Availability of good quality cotton throughout the year at an internationally competitive price is essential to achieve a sustained growth rate in the textile industry.
- The Indian textile industry is predominantly cotton based with almost 75% of the spun yarn in the country being produced from cotton.
- The cotton seed industry has played a pivotal role here by continuously investing in research, developing new hybrids, developing and introducing Bt cotton technology.
- This has played a huge role in making required quantity and quality of cotton available to the textile industry.
- The size of the textile industry grew six times to Rs. 10 lakh crore, exports more than tripled to Rs. 2.5 lakh crore and spun yarn production almost doubled since 2000.
- India has become largest exporter of cotton yarn in the world with its value chain holding the potential to achieve 12% CAGR as against 6% CAGR achieved so far.

What are the concerns?

- The textile industry projects their cotton requirement as between 570 lakh bales and 940 lakh bales by 2028.
- This requires introduction of next generation traits like Bt3, Bt4, Herbicide Tolerance, Water Use Efficiency, Nitrogen Use Efficiency, High density planting system, mechanical harvesting system etc.,
- But the flow of new technologies into cotton seed research has been affected by –
  1. stalemate in the regulatory approval process
  2. price control on GM seeds
  3. confusion on the intellectual property situation of traits
  4. hostile environment towards using modern science technology in seed.
- This has made technology providers completely discouraged with the direction in which the biotechnology policy of the government is progressing.
- Many companies have either scaled down or closed down their technology development centres in India or have deferred their plans.

What will be its impact?

- **Effectiveness** - Farmers will have to go back to heavy use of chemical pesticides to control the dreaded bollworms, once the technologies currently used in cotton will lose their effectiveness.
- This will increase the cost of production and makes him uncompetitive.
- **Cost** - Labour scarcity will make farmers unable to manage the weeds in their fields and will not be able to pick cotton, affecting yields and economics.
- The cost of picking cotton has already touched 10% of the revenue of the farmer and will go up further.

- Stagnation in cotton production can jeopardise the commercial prospects, employment generation and export potential of the textile industry.
- It can lead to a huge increase in imports of cotton at increased cost, which could affect both the farmers and consumers of India.
- **Effect on states** - The States which dominate textile manufacturing like Tamil Nadu, Andhra Pradesh, Maharashtra will see a huge loss of economic opportunity.
- The States which dominate cotton crop cultivation like Maharashtra, Gujarat, Andhra Pradesh will lose heavily in terms of farmers' welfare and rural prosperity.
- It could also threaten the prominent position India holds in the global cotton exports.
- Thus a comprehensive review regarding the policy directions involving the Ministry of Textiles, cotton growing states and the textile manufacturing states is the need of the hour.

9.11 Mitigating Farmers' Distress

What is the issue?

Poor earnings of the farmers result in an unending distress in the agricultural sector and there is need for an appropriate policy response.

What is the current scenario?

- Agricultural prices are rising less than others and as a result, the rural wages are depressed.
- 70% of India's recent disinflation has been led by the fall in rural inflation.
- When incomes are low, the demand for some food items such as milk and protein tends to be weak, leading to a fall in their prices.
- Chronic income crunch is pushing farmers into a debt trap, leading to a clamour for loan waivers and higher MSPs.

What are the concerns?

- **MSP calculation**–The National Commission for Farmers had recommended that MSP for crops be fixed at 50% above the C2 cost.
- But the government is still using 50% margin of Cost A2 or maybe cost A2+FL, which is lower than cost C2.

MSP Calculation

- The Commission for Agricultural Costs and Prices (CACP), gives three definitions of production costs: A2, A2+FL and C2.
- A2 costs - It basically cover all paid-out expenses, both in cash and in kind, incurred by farmers on seeds, fertilisers, chemicals, hired labour, fuel, irrigation, etc.
- A2+FL costs - It cover actual paid-out costs plus an imputed value of unpaid family labour.
- C2 costs - These costs are more comprehensive, accounting for the rentals and interest forgone on owned land and fixed capital assets respectively, on top of A2+FL.
- The M.S. Swaminathan Committee report had recommended a minimum support price of 50% profits above the cost of production classified as 'C2' by the CACP.

- **Pricing** - The arbitrarily fixed pricestend to cause distortion in production, perpetuating a glut and depressing prices to the detriment of producers.
- Efficient, transparent, competitive and hassle-free marketing is a must to ensure reasonable prices to the growers.
- This will ensure demand-driven production, thereby, restricting surpluses and shortages to manageable levels.
- **Focus on productivity** - Most of the agricultural development schemes aim largely at boosting crop productivity and production.
- It disregards the negative impact of higher output on prices in a surplus situation.
- **External trade policy** - These are focused more on managing inflation than on maintaining the price line to safeguard the farmers' interests.
- An export window is usually denied for farm products by imposing import and export curbs, which makes it difficult to mitigate domestic surplus.
- Frequently modifying duties and minimum export prices on the pretext of controlling inflation add to the woes.

What should be the future course of action?

- The focus has to be shifted from farm income to farmers' income.
- A recent discussion paper brought out by the **NITI Aayog** reveals that about two-thirds of rural income now comes from non-agricultural sources.
- Also, **70th round of NSSO** finds that wage employmentis the principal source of income for 56% of small and marginal farmers.
- Clearly, expanding job avenues in and around rural areas is imperative to boost farmers' earnings.
- Promoting relatively lucrative allied activities of agriculture such as horticulture and floriculture also helps boost farm incomes.
- Thus, amultifaceted income-generation plan, rather than MSP hikes and loan waivers, can mitigate farmers' disquiet.

9.12 Reforming Agri-Credit System

What is the issue?

Agriculture in India should be made profitable, in addition to reforming the credit system in the sector.

What are the existing concerns?

- The NSSO Situation Assessment Survey of Agricultural Households (2013) shows that 52% of farming households are indebted, with rates as high as 89-92% in some States.
- The quantum of debt has increased enormously, especially from informal sources.
- Tenant farmers who lease land from other land owners are especially vulnerable.
- A study showed that 75% of farmer suicides in Telangana are by tenant farmers.
- The NSSO Situation Assessment Survey (2013) also showed that the average debt from institutional sources for small and marginal farmers was only Rs. 17,570 per household, and Rs. 1,41,804 for medium and large farmers.
- Though the RBI issued guidelines (2014) for extending loans to landless farmers and for a debt-swapping scheme to convert informal loans of farmers into bank loans, they have remained merely on paper.
- However, many state governments push for a loan waiver which is only an element of immediate and temporary relief.
- The burden on farmers lies elsewhere inthe -
    1. Lack of compensation during drought and disasters
    2. Failures of the crop insurance scheme
    3. Deficit due to prices falling below the announced MSP
- Thus, any immediate relief should be accompanied by a long-term systemic solution to indebtedness.
- Accordingly, a Bill has been developed by the All India Kisan Sangharsh Coordination Committee recently to provide freedom from indebtedness.

What does the bill contain?

- It incorporates two key elements of reform - a functional institutional credit system which is accessible and accountable to all cultivators, and protection from debt trap in bad years.
- Access to institutional credit covers not only land-owning farmers but also sharecroppers, tenants, Adivasi and women farmers, and animal-rearers.
- It requires the registration of all cultivators and providing them Kisan credit cards.
- This is critical because marginal and landless farmers are mostly excluded from institutional credit, thereby putting them at the mercy of predatory lending by moneylenders and input dealers.
- The Bill also establishes farmers' distress and disaster relief commissions at the national and State levels, based on the model of Kerala's Farmers' Debt Relief Commission.

- The commission can recommend declaration of certain areas or crops as distress-affected in any particular year, based on incidences of natural disasters, extensive pest attack and such calamities.
- It has the power to order measures of debt relief, which may include loan rescheduling, interest waiver, one-time settlement, discharge of debt in instalments, or even an immediate discharge of debt.
- The State-level commission is also empowered to pass orders regarding non-institutional loans of distress-affected farmers.

What are the advantages?

- The bill ensures that farmers who suffer losses due to circumstances entirely out of their control deserve to be protected.
- Given that agriculture is a key national enterprise, the concepts of limited liability and bankruptcy protection need to be adapted to the farming sector.
- Thus the bill provides targeted protection to distressed farmers when they require it, rather than allowing debt, distress and suicides to accumulate until an election year.
- Also, the problem of inadequate coverage and payout faced by crop insurance schemes will be included and covered under the distress relief provided by these commissions.

What more should be done?

- In addition to reforming the credit system, agriculture should be made profitable by –
    1. Ensuring fair remunerative prices
    2. Lowering the cost of cultivation
    3. Promoting viable farmer collectives
    4. Engaging in sustainable models of agriculture.
- Thus the challenge before political parties and governments is to implement these institutional solutions demanded by farmers.

9.13 Ending the APMC Monopoly - Maharashtra Ordinance

Why in news?

The Maharashtra government intends to bring back the Ordinance on Agriculture Produce Market Committee (APMC), after withdrawing the Bill from the upper house.

What is the ordinance on?

- Earlier, the Maharashtra government passed an ordinance to amend the Agricultural Produce Marketing (Development and Regulation) Act, 1963.
- The Ordinance sought to remove all farm produce (including livestock) from the purview of the APMC.
- It also proposed to grant 'Markets of National Importance (MNI)' status to the large mandis in Maharashtra.
- [Currently, only the Azadpur fruit and vegetables mandi in Delhi has MNI status.]
- The objective was to facilitate exports and easy inter-State trade.
- But the state government then withdrew the Ordinance from the Upper House, following protests by APMC markets.
- Now, a committee has been formed to listen to the concerns of different stakeholders.
- Accordingly, changes would be made to the ordinance and would be presented before the State Legislative Assembly.

Why is it a concern for APMC markets?

- De-listing agri commodities from the purview of the APMC would threaten the dominance of the APMC markets.
- It would snatch away their power to levy a 1% fee on virtually all wholesale trade in farm produce, even on trades that take place outside their defined areas.

- There are a total of 307 APMC markets in Maharashtra. These charge a cess of 1% of the trade value.
- The Vashi APMC, the largest mandi in Maharashtra, collects about Rs. 60 crore in cess in a year.
- Notably, 14 States, including Maharashtra, have removed fruit and vegetables from ambit of APMCs.
- But even today, farmers in Maharashtra who sell fruits and vegetables in a private market are forced to pay the cess to the APMC.
- So the APMC markets fear loss of income if the Ordinance is passed in its original form.

How will it benefit farmers?

- By acting as moneylenders as well as buyers, commission agents or arthiyas extract a high price from farmers.
- Today, farmers are forced to sell their produce at the price quoted by the commission agents in the APMC in their area.
- Meanwhile, the APMCs have done little to improve their infrastructure.
- The government move would thus break the monopoly of APMC yards.
- It will give farmers the freedom to sell wherever and to whomsoever they desire.
- All farm items can then be sold in bulk either by way of contract farming, direct selling or in private wholesale markets.
- It would also help bring private investment for setting up markets and creating the infrastructure needed for agriculture marketing.

9.14 MSP for Minor Forest Produce

Why in news?

Union Cabinet recently approved a centrally sponsored scheme for providing Minimum Support Price (MSP) to forest dwellers for minor forest produce (MFP).

What is the decision?

- The Centre has notified a varied hike in MSP ranging from 200% to 5.6% for 19 MFPs.
- The government has also added 17 more items (exiting 23) to the forest produce covered under the market support scheme.
- [These include mahua flowers, dried tejpatta, jamun dried seeds, dried amla pulp (deseeded), soap nut (dried), Arjuna bark and Giloe among others.]
- A total of 52 items is proposed to be brought under the MFP for MSP umbrella.
- The notification puts out prices for 40 items for now.
- The Central government plans to spend around Rs. 960 crore while states would contribute about Rs. 250 crore.
- The ministry of tribal affairs (MoTA) issued the notification and it is now for the states to implement this.
- Tribal Cooperative Market Development Federation of India Ltd. (TRIFED) has also been given directions.
- They are to develop market linkage between state agencies (through State Nodal Department), and bulk users and buyers to enable implementation.

What is the objective?

- The scheme for providing MSP for minor forest produce comes on the lines of support price for agricultural products.
- The decision is being taken in view of the general cost escalation on all fronts.
- The objective is to ensure fair and remunerative price to MFP gatherers.
- According to the ministry, nearly 5 crore tribals are expected to directly benefit from this revamped scheme.

What are the concerns?

- **Funds** - MSP system for minor forest produce had been introduced by the previous government as well.
- The centre has earmarked nearly Rs 1,100 crore for this programme in the past 5 years.
- But hardly 25% of this has been released to the states.
- The bulk of even the disbursed funds has remained unutilised.
- Moreover, none of the major forested states has submitted the audited report on funds utilisation.
- **Remuneration** - The minor forest resources have been made freely accessible to forest-dwellers under the Forest Rights Act.
- These include mahua, tejpatta, wild honey and similar others that have several industrial, therapeutic and cosmetic uses.
- However, the tribals, who gather them from the woods, do not get the fair remuneration for these articles.
- It's because they normally have to sell them at meagre rates at local haats dominated by cartelised traders and contractors.
- **Middlemen** - Some state governments have acquired monopolistic marketing rights on the much sought-after forest products.
- E.g. tendu leaves, bamboo, tamarind
- But, the state agencies nominated to lend price support often prefer to buy the stuff from middlemen.
- They fail to create the infrastructure for procuring it directly from individual collectors.
- Thus, for all practical purposes, the collectors of the minor forest produce are at the mercy of middlemen.
- **MSP** - States also do not pay the MSPs even though the Centre is supposed to bear 75% of the losses incurred on such operations.
- Odisha is one of the few states which have opted to implement the MSP scheme for selected forest products.
- But it is reported to be considering to discontinue the scheme because of the heavy financial burden.

What is required?

- The government has largely failed to realise the futility of raising the MSPs of crops without their effective enforcement.
- The need, therefore, is for well-advised marketing reforms in this sector.
- This should be aimed specifically at ending the middlemen's role over the minor forest produce trade.
- Equally important is to encourage direct linkages between forest produce gatherers and end-users of these products.
- E.g. the pharmaceutical, cosmetic and food-processing industries
- These are essential to meaningfully complement the move to fix MSPs for the minor forest produce.

9.15 Addressing Tenant Farming

What is the issue?

It is vital to cover the vulnerable section of tenant farmers with credit and insurance, alongside other farming issues, for an inclusive policy outlook.

How prevalent is tenant farming?

- Tenant farmers are those who undertake farming on rented land.
- Tenant farming was 20.6% of the operating area according to 8th round of NSSO Report in 1953-54.
- In 2002-03, it fell sharply to just 6.6% of the operating area.
- Policymakers focused on abolition of feudal/semi-feudal agrarian structure, with tenancy reforms aimed at conferring ownership right to tenants.
- But post liberalisation, during 2003-13, tenancy increased to 10.4%.

- Andhra Pradesh (35.7%), Bihar (22.7%), Haryana (14.8%), Odisha (16.9%), TN (13.5%) and WB (14.7%) lead the tenancy league, far above the all-India average of 10.4%.

What are the policy shortfalls?

- Tenant farmers account for 80% of farmers' suicides in the country.
- Tenant farmers rarely get bank credit and they do not get any subsidies.
- Even with Kisan Credit Cards (KCC) and JLGs (Joint liability groups-'BhoomiHeenKisan') in place, tenant farmers receive barely 3% of total farm credit.
- Loan waivers have not helped tenant farmers as a significant number of crop loans are availed by the land owners even when they are not the actual cultivators.
- Tenant farmers with no documentary evidence become ineligible for crop insurance under PM FasalBimaYojana.
- State level panel data of NABARD indicates that a 10% increase in agricultural growth leads to a 2.1% rise in GDP.
- But uneconomic holdings, lack of adequate credit flow and poor insurance cover to the tenant farmers prevent such growth.

What are the notable state models in lending?

- **Kerala** is the only State that enacted the Money Lending Act, protecting borrowers from high rates of interest and tenants from excesses in private debt.
- The **AP** government has adopted and refined the implementation process under the AP Licensed Cultivators' Act 2011.
- It undertook digitisation of land records and created a webland portal.
- Loan Eligibility Cards (LEC) or a Certification of Cultivation (CoC) is issued by the designated authority of revenue or agriculture department.
- A standard operating procedure has been put in place for the banks to record the crop loans issued to all farmers including tenants, on the webland portal.
- **Telangana** did not annul the AP law, but took up a massive drive for digitisation.
- It revised the land records under the Dharani project (Telangana Land Records Management System).
- This is being implemented for direct transfer of Rs. 4,000 per owner-farmer per acre per crop season to meet the input needs.
- Besides, farmers are entitled to Rs. 5 lakh insurance with the LIC, with the State paying the same.
- Tenant farmers are, however, not eligible.

How does the future look?

- As the Indian economy becomes mature and inclusive, tenancy is likely to increase further.
- Urbanisation has made inroads into the rural landscape, and with land being scarce there is severe demand for it.
- Tenancy and sharecropping have become livelihood options in agriculture, to supplement incomes arising out of lesser availability of land.

What could be done?

- An inclusive growth agenda requires that tenant farmers' issues of both debt and insurance be tackled.
- Agricultural insurance needs to be decoupled from crop loans.
- Farmers' assets (crop husbandry, animal husbandry, poultry, horticulture and family assets) need to be insured irrespective of owned or leased-in.
- Other relevant measures for tenant farming may include -
    i. creating a legal framework for the States

ii. issuance of loan eligibility cards
iii. ensuring that banks lend to cultivators and not owners
iv. creation of web-based land portals after digitising land records
v. setting targets for short-term production credit for tenant farmers
vi. formation of JLGs

- Direct cash transfer to tenant farmers following an affidavit of self-declared tenancy conditions and crop(s) grown can help significantly.
- NABARD can set up a Tenant Farmers Development Fund to refinance short-term credit.
- It can also assist JLGs, SHGs, FPOs (Farmer Producer Organizations), and pay crop insurance premium for crop loans less than Rs. 1 lakh, besides providing skilling and calamity relief.

9.16 Inter-State Agri Trading via e-NAM

What is the issue?

- Inter-state trade of farm products in mandis (wholesale markets) through the e-NAM (electronically linked national agriculture market) is gathering pace.
- But it calls for agri-reforms on part of the states, for the platform to function as intended.

What are the recent developments with e-NAM?

- Under the eNAM, launched in 2016, agri-trading was initially allowed within a mandi and later inter-mandi within a state was permitted.
- So far, 10 states are offering inter-mandi trade within their states.
- Now, inter-state trading via e-NAM mandis has started, and 8 states are now offering this via 21 e-NAM platforms so far.
- Rajasthan is the first state to start inter-state trade with more than one state, establishing trade link with Gujarat, Maharashtra and Madhya Pradesh through e-NAM.
- Over 14 commodities like vegetables, pulses, cereals, oilseeds, spices among others have been traded in a short span of time, and volume is also picking up.
- Inter-state trade on e-NAM aims to remove barriers of movement of agriculture produce and to increase income through appropriate monetisation of farmers' produce.
- The details on logistic providers are also being provided on the e-NAM portal to traders from outside the state, to facilitate transportation after trading.

Why is it welcome?

- 585 mandis operated by Agricultural Produce Marketing Committees (APMCs) in 16 states and 2 Union Territories have been linked with e-NAM.
- But the platform has been used so far only to transact business within the same mandis or, in some cases, between the mandis of the same states.
- This had denied the farmers the opportunity to earn a higher income by selling their produce at the best prices available anywhere in the country which was the prime objective of e-NAM.
- So the inter-state trade through the e-NAM platform can go a long way in addressing these concerns.

What are the shortfalls to be addressed?

- The pre-requisites for the success of e-NAM were clearly spelt out in the proposal for establishing a common agricultural market for the country.
- But most of these are yet to be fulfilled by the states by suitably amending their agri-marketing laws.
- **Licensing** - The foremost among the pre-conditions is a single trading licence valid throughout the country.
- Only a handful of states have agreed to recognise the trading licences issued by other states.
- In many cases, the trading licences are merely mandi-specific.

- As a result, even within the states, online inter-mandi transactions are permitted only in 10 states.
- **Levy** - Single-point payment of mandi charges by harmonising the marketing levies of all the states is needed.
- Most states are unwilling to alter market levies because that would entail loss of revenue.
- **Quality** - There is no uniformity in the quality standards of farm goods in different states.
- Also, only few mandis have put in place appropriate sorting, grading and assaying (quality testing) facilities that would enable informed bidding by buyers.
- There is also lack of proper warehouses for the safe upkeep of the sold items.
- **Mechanism** - e-NAM mandates the business to be conducted only through the APMC markets' electronic platforms.
- These markets are known for their inefficiencies and malpractices, which may tend to creep into e-marketing as well.
- Besides, the APMC mandis are dominated by middlemen who could manipulate even online trading in the absence of an effective market regulator.
- The APMC monopoly over the marketing of all the agricultural produce needs to end to ensure fair price discovery.
- Online trading through the e-NAM platform should also be permitted from any public or private sector market that meets the necessary conditions.

9.17 Pradhan Mantri Kisan Samman Nidhi

What is the issue?

- The 2019 budget announced the Pradhan Mantri Kisan Samman Nidhi, guaranteeing direct income support for farmers.
- This has renewed the debate on the idea of a universal basic income (UBI).

What is the PM Kisan Samman Nidhi?

- Vulnerable landholding farmer families, having cultivable land of up to 2 hectares, will be provided direct income support of Rs. 6,000 a year.
- This is to help them meet farm input and other costs during the crop season.
- The programme would be made effective retrospectively from December 1, 2018.
- It would be fully funded by the Union Government. The interim Budget provides Rs. 75,000 crore for the present and the next year.

What is the UBI concept?

- The idea of universal basic income (UBI) is essentially transferring some income to every citizen.
- This is built on the twin principles of universality and a notion of minimum basic income to those living at the poverty line.
- The principle of universality is at the core of it given the problems of targeting.
- Although the idea of universal basic income (UBI) has been in discussion for decades, no country has implemented it.
- While a proposal for UBI was rejected by a three-fourth majority in Switzerland, Finland which started a pilot has now discontinued it.
- But even in Finland, the pilot was not a strict UBI but a social protection scheme aimed at only the unemployed.
- There have been some pilots by NGOs in developing countries in Asia and Africa.
- But they have varied in content of transfer and coverage with only few being fully universal.

What about targeted support?

- The proposals in the Indian context have mostly been for a targeted income transfer scheme and not UBI.
- Some form of income support to those who are unable to participate in labour market has been there in most countries in some form or other.
- E.g. in India, the National Social Assistance Programme (NSAP) pensions for widows, elderly and the disabled

How does India's UBI proposal differ?

- In developed countries, the UBI is supposed to supplement existing social security provisions.
- So it would be over and above the universal provision of health, education and so on.
- But in the Indian context, the arguments in favour of UBI are centred on the inefficiencies of existing social security interventions.
- Essentially, UBI in India seeks to replace some of these interventions with direct cash transfers.

Why are cash transfers flawed?

- The targeted cash transfer scheme envisions the role of the state to only providing cash income to the poor.
- This approach seeks to absolve the state of its responsibility in providing basic services such as health, education, nutrition and livelihood.
- Besides, it is unfair, as it seeks to create demand for services without supplying the services, leaving the poor to depend on private service providers.
- Evidently, privatisation of basic services such as health and education leads to large scale exclusion of the poor and marginalised.
- In any case, India is among the countries with lowest expenditure to GDP ratio as far as expenditure on health, education and so on are concerned.

How are in-kind transfers a better option?

- Cash transfers are not encouraging in terms of leakages compared to other schemes of in-kind transfer such as the public distribution system (PDS).
- A move towards universalisation and use of technology enabled Chhattisgarh and Tamil Nadu to reduce leakages in the PDS.
- It shows that universalisation is the key to efficient delivery of services against targeting proposed by the cash transfer schemes.
- Also, the cash transfer proposals claim that it would address everything from agrarian crisis, malnutrition, educational deficit to job crisis.
- But again the PDS shows that in-kind transfers are twice as effective in increasing calorie intake compared to equivalent cash transfer.
- Similarly, the crisis in agriculture is unlikely to be resolved by income transfers, where addressing pricing, procurement and other structural issues are essential.
- Likewise, there are different reasons for persistence for some of the above problems which cash transfer may not wholly address.

What is to be done?

- An appropriate way to address poverty is to enable the citizens to earn their living by providing jobs.
- For those who are willing to work, schemes such as the Mahatma Gandhi National Rural Employment Guarantee Scheme should be strengthened.
- Nevertheless, cash transfers would be relevant for those who are unable to access the labour market or are marginalised due to other reasons.

9.18 Comparing MGNREGA and PM-KISAN

What is the issue?

Strengthening the MGNREGA would be more prudent than a targeted cash transfer plan like PM-KISAN.

What is the PM-KISAN scheme?

- The government recently announced a cash transfer scheme called Pradhan Mantri Kisan Samman Nidhi (PM-KISAN).
- According to the scheme, vulnerable landholding farmer families, having cultivable land up to 2 hectares, will be provided direct income support at the rate of Rs. 6,000 per year.
- The Ministry of Agriculture has written to State governments to prepare a database of all eligible beneficiaries along with their Aadhaar numbers, and update land records "expeditiously".
- The letter further states that changes in land records after February 1, 2019 shall not be considered for this scheme.
- Thus, the success of the PM-KISAN depends on reliable digital land records and reliable rural banking infrastructure.
- However, comparing with the MGNREGA scheme, the PM-KISAN scheme is less likely to address farmer distress in the country.

What does the comparison show?

- **Wage rate** - A month of MGNREGA earnings for a household is more than a year's income support through PM-KISAN anywhere in the country.
- For example, if two members of a household in Jharkhand work under MGNREGA (picture) for 30 days, they would earn Rs. 10,080 and a household of two in Haryana would earn Rs. 16,860 in 30 days.
- These are lower than what the direct income support under PM-KISAN scheme could offer. (Rs.6000 per year)
- **Coverage** - PM-KISAN is a targeted cash transfer programme and MGNREGA is a universal programme.
- Any rural household willing to do manual work is eligible under the Act.
- According to the 2011 Socio-Economic and Caste Census, around 40% of rural households are landless and depend on manual labour.
- The landless can earn through the MGNREGA but are not eligible for the PM-KISAN scheme.
- Further, it is unclear how tenant farmers, those without titles, and women farmers would be within the ambit of the scheme.
- **Targeting issues** - There is also substantial evidence to demonstrate that universal schemes are less prone to corruption than targeted schemes.
- In targeted programmes, it is very common to have errors of exclusion, i.e., genuine beneficiaries get left out.
- Such errors go unrecorded and people continue to be left out.
- **Payment delay** - Funds will be electronically transferred to the beneficiary's bank account by the centre through State Notional Account on a pattern similar to MGNREGS, under PM-KISAN scheme.
- However, lessons from the MGNREGA implementation shows that the Centre has frequently tinkered with the wage payments system in the MGNREGA.
- Though timely generation of pay-orders have improved, less than a third of the payments were made on time.
- **Implementation** - Repeated changes in processes result in a hurried bureaucratic reorientation on the ground, and much chaos among workers and field functionaries.
- For example, during Aadhaar – MGNREGA linkage, several MGNREGA payments have been rejected, diverted, or frozen due to technical errors such as incorrect account numbers or faulty Aadhaar mapping.
- There have been no clear national guidelines to rectify these.

- In a recently concluded survey on common service centres in Jharkhand for Aadhaar-based payments, it was found that 42% of the biometric authentications failed in the first attempt, compelling them to come later.

What should be done?

- On the other hand, the MGNREGA is neither an income support programme nor just an asset creation programme.
- It is a labour programme meant to strengthen participatory democracy through community works.
- It is a legislative mechanism to strengthen the constitutional principle of the right to life.
- Also, the MGNREGA works have demonstrably strong multiplier effects are yet another reason to improve its implementation.
- Along with that, work demand has been 33% more than the employment provided this year, which underscores the desperation to work among the people.
- Despite all this, the MGNREGA wage rates in 18 States have been kept lower than the States' minimum agricultural wage rates, which acts as a deterrent for the landless.
- Thus, strengthening an existing universal programme such as the MGNREGA would have been a prudent move instead of introducing targeted cash transfer programme.