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A Shankar IAS Academy Initiative

MAINSTORMING 2020

ECONOMY & INFRASTRUCTURE I

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(JANUARY 2020 TO AUGUST 2020)

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1. GROWTH & DEVELOPMENT

1.1 NSO Advance Estimates

Why in news?

The National Statistical Office (NSO) recently released the first advance estimates of the national income for 2019-20.

What are the highlights?

- NSO projected growth in India's GDP at market prices for 2019-20 at 4.98% in "real" terms.
- This is the lowest since the 3.89% in the global financial crisis year of 2008-09.
- More significantly, the estimated growth in "nominal" terms was 7.53%.
- This is the lowest since the 7.35% for 1975-76.
- Also, this is the first time since 2002-03 that nominal GDP growth has been in single digits.

National Statistical Office

- The National Statistical Office (NSO) forms the Statistics Wing of the Ministry of Statistics and Programme Implementation.
- It consists of the Central Statistical Office (CSO), the Computer center and the National Sample Survey Office (NSSO).
- It is responsible for conduct of large-scale sample surveys in diverse fields on All India basis.

What are nominal GDP and real GDP?

- GDP is the total market value of all goods and services produced in the economy during a particular year.
- This is inclusive of all taxes and subsidies on products.
- The market value taken at current prices is the nominal GDP.
- The value taken at constant prices (prices for all products taken at an unchanged base year) is the real GDP.
- In simple terms, real GDP is nominal GDP without the effect of inflation.
- Real GDP growth thus measures how much the production of goods and services in the economy has increased in actual physical terms during a year.
- On the other hand, nominal GDP growth measures the increase in incomes resulting from rise in both production and prices.

What does this imply?

- In the normal course, real growth is what is ordinarily looked at.
- But, the current fiscal year seems extraordinary because the gap between nominal and real GDP growth is just 2.6 percentage points.
- This is marginally higher than the difference of 2.5 percentage points in 2015-16.
- But in that year, real GDP growth was 8%, which translated into a nominal growth of 10.5%.
- In 2019-20, the real GDP growth is expected to be the lowest in 11 years.
- Also, the implied inflation is just 2.6%.
- [It is also called GDP deflator, or the increase in prices of all the goods and services produced in the economy.]

- In simple terms, producers have not gained from either higher output or higher prices.

What are the concerns?

- In the 2019-20 Budget, Finance Minister had assumed nominal GDP would grow by 12% to Rs 211.01 lakh crore.
- However, the NSO's latest projection of nominal GDP for 2019-20 is only Rs 204.42 lakh crore.
- So, even if the Centre's fiscal deficit is contained at the budgeted numbers, it would be 3.44% of GDP, as against the originally targeted 3.3%.
- This is over and above the slippages in the absolute fiscal deficit itself due to the Centre's revenues turning out to be lower than the Budget projections.
- High nominal GDP growth also makes the government's debt seem more manageable, unlike with low nominal GDP.
- The debt stock (numerator) can keep going up so long as it does not exceed the nominal increase in GDP (denominator).
- This equation changes in a low nominal GDP growth scenario.
- For state governments too, low nominal GDP growth is a matter of concern.
- This is because their budgets normally assume double-digit increases in revenues.
- The Centre's compensation formula to states from the GST also promised to meet any annual revenue shortfall below 14%.
- That again, did not ever factor in the possibility of GDP growth (real GDP plus inflation) falling to 7.5% levels.

1.2 IMF Forecast on Global Economy

Why in news?

The International Monetary Fund (IMF) estimates the global economy to contract by -4.9% in 2020.

How the Indian economy could be revamped?

- As for the Indian economy, **growth has been decelerating** for the past eight quarters.
- The recently announced economic package provides near-term liquidity support and long-pending structural reforms.
- As the economy begins to reopen, there is a need to aid **demand recovery**.
- For aggregate demand to increase, at least one of the **components of GDP needs to expand**.
- Growth in the Indian economy has been dominated by consumption, investments, government expenditure and net exports.
- However, consumption and investment demand have been subdued for the past few quarters, dragging down overall growth.

How are the demands subdued?

- **Consumption demand** - The Non-Banking Financial Company sector suffered from funding crunches.
- This led to a further squeeze in credit supply, thereby affecting consumption demand.
- Moreover, the industry-wide job/pay-cuts with a growing uncertainty over the future may limit spending to non-discretionary items.
- **Investment demand** - Broad-based utilization levels dropped to 68.6% in Q3FY20.

- This is well below the 75% benchmark for new capacity addition, implying suboptimal levels of fresh investments.
- A higher investments is essential for sustainable economic growth.
- The deteriorating economic scenario and increasing levels of debt with rating downgrades for industries may aggravate the existing problems.
- **Export demand** - India's limited share in global trade along with a battered domestic and global outlook provides little room for exports to contribute towards growth.

Where should the push come from?

- There is limited room for consumption, trade or investments to expand significantly.
- Therefore, the positive push required to aid a demand recovery has to come through the **government**.
- However, with sparse resources that India has, it must deploy funds that yield a higher return.
- One key area that can provide the necessary support is **infrastructure investment**.

How will infrastructure investment help?

- A study by S&P Global estimates 1% of GDP spend on infrastructure can boost real growth by 2% while creating 1.3 million direct jobs.
- Historically, countries have used infrastructure to provide counter-cyclical support to the economy.
- Notably, infrastructure has strong links to growth.
- With both supply and demand-side features, infrastructure helps **generate employment** and **long-term assets**.
- For India, front-loading key projects with greater visibility from the National Infrastructure Pipeline (NIP) could aid in a quicker recovery.

How could India do this?

- India has several institutions for infrastructure development purposes.
- They are India Infrastructure Finance Company Ltd (IIFCL), Indian Railway Finance Corporation (IRFC), National Investment and Infrastructure Fund (NIIF), etc.
- These institutions should be restructured into **one large development institution.**
- This could help reduce inefficiencies and allow for greater advantage.
- Floating **special infrastructure bonds** through this organisation to accelerate the funding of the NIP could aid a speedier recovery.

2. PUBLIC FINANCE

2.1 15th Finance Commission's Interim Report

Why in News?

The interim report of the 15th Finance Commission (FC) has been tabled in Parliament this budget session.

How the devolution to the States is to be carried out?

- The report has largely preserved the devolution mathematics of its predecessor, belying concerns of a sizeable cut in States' share.
- (Devolution - A process in which a central government of a country grants powers to sub-national governments).

- The report has recommended a **one percentage point reduction** in the vertical split of the divisible pool of tax revenues accruing to States to 41%.
- This follows the reorganisation of the erstwhile State of Jammu and Kashmir into the Union Territories of Jammu and Kashmir and Ladakh.
- The former State's notional share based on the parameters for horizontal devolution would have been about 0.85%.
- But, the FC has cited the security and other special needs of the two territories to enhance their aggregate share to 1%, which would be met by the Centre.

Finance Commission

- **Article 280** of the Constitution of India provides for a quasi-judicial body, the Finance Commission.
- It is constituted by the President of India every fifth year or at such earlier time as he considers necessary.
- The recommendations made by the Finance Commission are only advisory in nature and hence, not binding on the government.
- The 15th Finance commission makes recommendations for the period of 2020-2025 (5 years).

How the devolution to the local bodies is to be carried out?

- Urban local bodies, especially municipalities in cities with populations of more than one million, are set to get a larger share of the devolution.
- There has been an increase in the percentage of outcome-tied funds from 10% to 50%
- This could prove vexing to the last mile providers of basic services in India's federal and highly fragmented structure of governance.

What is done to balance the financial needs?

- As part of an effort to balance the principles of fiscal needs, the following have been changed,
    1. Equity and performance,
    2. The need to ensure stability and predictability in transfers,
    3. The criteria for the horizontal sharing of taxes among States.

What is the new added parameter?

- The **demographic performance** is the new crucial parameter that has been added to the mix.
- The mandate to adopt the population data from the 2011 Census is the reason why the FC has incorporated this additional criterion.
- This will ensure that the States which have done well on demographic management are not unfairly disadvantaged.
- The norm has been assigned a 12.5% weight, as it indirectly evaluates performance on the human capital outcomes of education and health.
- This should address the concerns voiced by several States over the switch to the 2011 Census from the 1971 data.

What does the report say about the tax system?

- Among the States, with the exception of Tamil Nadu, all the other four southern States see a reduction in the recommended share of taxes for the year 2020-21.
- Notably, the suggested devolution to Odisha and Uttar Pradesh has also shrunk in percentage terms.
- Crucially, the FC has flagged the issues dogging the GST as indirect taxes constitute almost half the total tax revenues of the Union.
- The **new tax has yet to stabilise** which leaves a majority of the States dependent on compensation from the Centre.

What was the criticism the report made?

- The FC has also been justifiably critical of the Union and State governments' tendency to finance spending through off-budget borrowings and via parastatals.
- It has done well to ask that such extra-budgetary liabilities be clearly earmarked and eliminated in a time-bound manner.

2.2 NRIs to Pay Tax

What is the issue?

- An amendment is proposed to the Income Tax Act in the Finance Bill or the Union Budget 2020.
- It says that all Indians who are working abroad and not paying any income tax in those countries would be liable to pay tax in India.

What is the response?

- Kerala Chief Minister wrote to Prime Minister recording his government's disagreement with the provision.
- He said that the proposal would hurt those who toil and bring foreign exchange to the country.

What is the existing law?

- Two parameters determine whether India levies income tax on an individual.
- **Residency** - In India, residency requires a person to actually live in the country for a specified number of days in a year.
- **The Source of the Income** - It is the country where the income is being generated.
- For a resident Indian citizen, the income tax law applies to that person's worldwide income and such a resident Indian is required to pay tax on all of it.
- But for a non-resident Indian, the income tax law applies only to the income earned from within India.
- This difference between residents being taxed on their global income and non-residents being charged only on their Indian income lies at the heart of the confusion.

What is the amendment proposed by the government?

- The proposed amendment to the IT Act has three parts.
- **Number of Days** - The number of days that an Indian citizen can stay in India without becoming a resident is cut from 182 to 120.
- The Memorandum to the Budget said this provision was being misused.
- **NOR category** - The Memorandum has carved out the "Not Ordinarily Resident (NOR)" category.
- This status ensures that an individual who isn't ordinarily a resident isn't taxed as a resident, just because he spends more than specified number of days in India during a particular year.
- The amendment states that an NOR would be someone who has not been a resident of India for seven of the past 10 years.
- Under the existing law, it is nine out of the past 10 years.
- **The Confusion** - This amendment said that an Indian citizen who isn't liable to tax in any other country or territory shall be deemed to be resident in India.

What is the problem with this?

- The amendment tries to tax non-residents as residents.

- This led to panic because, in the absence of clarifications, all non-residents working in tax-free jurisdictions concluded that all their income in there will now attract the Indian income tax rate.
- Apart from the likely harassment, this undermined the whole point of people leaving their homes in India to work in tax-free jurisdictions.

Why did the government propose this?

- The government has clarified that its intention isn't to target bona fide workers.
- It says it wants to catch tax evaders who game the residency provisions to evade all taxes.
- It says that the tax laws should not encourage a situation where a person is not liable to tax in any country.

2.3 State of Voluntary Tax Compliance

Why in news?

PM recently commented on the state of voluntary tax compliance in India.

What was his comment?

- Only 1.5 crore out of the 130-crore people pay income tax in India.
- Those persons declaring an annual income of Rs 50 lakh are just 3 lakhs.
- Only 2,200 professionals declare their annual income of over Rs 1 crore.
- The PM remarked that when lots of people find ways not to pay tax, the burden comes on those who pay their taxes honestly.
- He appealed to all citizens to take a pledge to pay their taxes honestly, saying there was a long way to go in terms of tax compliance in India.

What does data on I-T Return reveal?

- The Income Tax Return Statistics for various assessment years (AYs) reveal that **salary income is the highest source of income** reported by individuals between FY15 and FY18.
- Salary income reported across all income ranges is significantly higher than business income.
- Tax returns filed by individuals over this period indicate that salary income is higher than business income in the slabs above Rs 50 lakh.

What is the situation of the salaried class?

- The gap between salary and business income is increasing year on year.
- The salaried class is subject to **tax deduction at source** on their entire income, even before they get their salary which results in accurate reporting of income.
- No other class of taxpayers is subject to this type of tax withholding, resulting in rampant under-reporting and non-reporting of income.
- For AY17, the income-tax paid by a salaried taxpayer was about three times higher than that of business taxpayer - not a feat to be proud of.
- This is so as the individual business taxpayer doesn't report their income and they get away with impunity.
- **Under-reporting** of income has been the bane of India's tax system.

Why the salaried class are penalised with higher taxes?

- This is due to the government's **inability to increase the taxpayer base**, and collect income tax from the non-salaried class.
- Taxes on honest salaried taxpayers have increased over last four years.

- This has resulted in a minuscule 0.1% of individuals contributing about 20% of the tax payable by all individuals between FY15 and FY19.
- In FY21 budget, the **dividend distribution tax has been abolished**, and shareholders are required to pay income tax on the dividend income.
- Individuals earning a gross total income (GTI) above Rs.5 crore have an additional tax impact of 7.94%on dividend received in FY21 and beyond.
- So, the salaried taxpayers are penalised with more tax for being honest.

How do salaried class feel?

- There is **strong resentment** and anger among the salaried class for being penalised for their honesty.
- Many high-income earning, honest, taxpaying citizens are **relocating out of India** due to the growing disparity due to tax evasion.
- There is **very low tax morale** among the salaried class.

How tax evasion is driven?

- Tax evasion is driven significantly by **tax morale**, viz., the intrinsic motivation of taxpayers in a country to pay taxes.
- Tax morale itself is driven primarily by two perceptive factors:
    a) **Vertical fairness**, i.e., what one pay in taxes is commensurate to the benefits one receives as services from the government; and
    b) **Horizontal fairness**, i.e., differences in the taxes paid by various sections of society.

2.4 Making GST a Success

What is the issue?

- The reality of Goods and Services Tax (GST) in the field is worrisome as there is tax evasion and administrative hurdles.
- There is a need to make some fundamental changes to make GST a success.

What are the challenges?

- The tax administration is unable to fulfil the objective of providing a tight infrastructure to weed out evasion.
- The administration and the taxpayer have to contend with continuing changes in GST rates made by policymakers.
- New laws in other sectors have conflicted with GST implementation.
- Large businesses are as much prone to tax evasion as small, lending a touch of implausibility to the tax.
- Examination of systemic deficiencies and correcting them promptly are missing.
- The frequent dropping and jamming of the GST website have to be mitigated successfully if good taxpayers are expected to comply on time.

What is leading to tax evasion?

- The biggest challenge for the system has been its **inability to auto-populate linked information** from one tax form to another.
- The taxpayer has to report his sales, purchases and the GST return in three different forms separately.
- These forms are supposed to be linked electronically but are not.
- The introduction of GST without this basic linked-framework is now rearing its head in tax evasion.

- GST without the innovation of linkages is not fundamentally different from India's earlier indirect tax structures.
- Similar modes of evasion continue under GST.

What are these modes of evasion?

- One method of evasion is **claiming huge amounts** of tax payment **through accumulated credit** (AC).
- Without field investigation there is no way to find if the AC used to pay tax reflects the true picture.
- Another method is to show **large and false turnover** and, together with it, large input costs.

What would be the impact?

- False AC limits GST revenue collection, in turn constraining government expenditure disbursements.
- This will increase the pressure on tax collectors to increase collection haphazardly which will in turn limit legitimate input tax credit claimed by honest taxpayers.
- Fake invoices are used by brokers who are being used by company executives in particular sectors.
- Such brokers are the ones who make illicit profit through exploiting such businesses that they are supposed to serve.
- The Bankruptcy Code has not helped. It allows taxpayers to hide behind Section 13 on non-performing assets (NPAs).

How GST could be made a success?

- Terminating GST registration when a supplier goes out of operation should be considered automatic rather than pending the process.
- Ultimately, how GST fares will depend on the Indian taxpayer's attitude towards paying tax.
- Complementary policy and administrative actions are imperative.
- Policymakers should produce a consistent and stable tax rate structure.
- The model for auto-populating forms should be achieved without delay.
- Facilitation by the administration in refunds, de-registration and other functions should not be thwarted by the administration to meet revenue objectives.

2.5 Abolition of Dividend Distribution Tax

What is the issue?

- The abolition of the Dividend Distribution Tax (DDT) in Budget 2020 is hailed as a big relief for corporates and non-resident shareholders.
- There will be no disputes regarding disallowance of expenses in terms of Section 14A of Income Tax (I-T) Act read with Rule 8D of I-T Rules.

What is dividend and DDT?

- **Dividend** is a return given by a company to its shareholders out of the profits earned by the company in a particular year.
- Dividend constitutes income in the hands of the shareholders which ideally should be subject to income tax.
- However, the Indian income tax laws provide for an exemption of the dividend income received from Indian companies by the investors.
- **DDT** is levied on any domestic company which is declaring/distributing dividend and is paid at the rate on the gross amount of dividend.

What are the current regulations?

- **Section 14A** provides that any expense concerning income not forming part of total income would not be allowed as deduction.
- Presently, the dividend income is not taxable in the hands of shareholder and does not form part of total income.
- **Section 56** charges income tax on the dividend.
- **Section 57** allows certain deductions while computing income from other sources.
- All expenses incurred wholly and exclusively to earn income taxable under Section 56 are allowed as deduction.

What does the Budget 2020 propose?

- It proposes a proviso to Section 57 that states that no deduction shall be allowed against dividend income other than interest expenses.
- The deduction on account of interest will be restricted to 20% of the dividend income.
- The cap of 20% is based on the amount of income earned and offered to tax in the previous year.
- Hence, in case, no dividend income is earned in a year even though the assessee incurs interest expenditure or fee on investment managers, she cannot claim any deduction.

What are the other proposals?

- Besides restricting the quantum of deduction in respect of interest, the amendments change the regime of taxation from being net to gross.
- The intention cannot be to discourage investors from borrowing heavily to invest in shares or paint all dividend earned as a windfall, nor can there be a fear of an excessive claim of expenses.
- Presently, expenses are allowed to be deducted as per Section 57, and it is nobody's case that it has resulted in a massive leakage of revenue.

How income is taxed now?

- Income may be interpreted in a wide manner to include receipts, windfalls and gifts.
- When the income like **profit** is taxed, the mechanism provided to tax it would allow for a deduction of expenses.
- Certain incomes like **royalty, fee** for technical service, etc, are subject to taxation on a gross basis.
- In case of **income from house property**, there is a cap on deduction towards interest paid on borrowed capital.
- The rationale is that the annual lettable value of a self-occupied property is deemed as nil.
- Where the assessee claims that dividend is **business income**, it may be possible to claim all expenses regarding it.
- However, the debate of whether dividend can ever constitute business income is already before the courts.

What would be the impact?

- The abolition of DDT and reintroduction of tax on dividends in the hands of the shareholder has brought relief to non-resident investors.
- However, this change is likely to increase the pain of resident shareholders, especially those falling in higher tax brackets.

2.6 Taxing E-Businesses - ESS EQL

What is the issue?

- With models of e-businesses evolving at a rapid pace, taxation around the same has become a huge debate between countries.
- In this context, here is an overview on the models of taxations globally and in India, and the concerns for Financial Services (FS) industry in this regard.

What is the G20 response?

- The G20 recognised this as a major issue requiring guidance around how countries should tax such e-businesses.
- The OECD, nominated by the G20, has put in a lot of efforts to develop a globally-acceptable tax model.
- The same is being debated across member nations.

What is the EQL that India introduced?

- In 2016, India introduced equalisation levy (EQL).
- This was to tax India-sourced income earned by a non-resident (NR) from online advertisements through digital means.
- This covers entities earning advertisement revenue from India through digital means, but not being subject to tax in India.
- Since its introduction, the government of India has seen EQL's contribution to the Indian exchequer increasing.

What is the recent change?

- In the course of the enactment of the India Budget 2020, the government expanded the scope of EQL with effect from April 1, 2020.
- It now covers within its ambit the e-commerce supply or services (ESS) provided by an e-commerce operator (EOP).
- It was a unilateral move by the government; while the OECD is yet to conclude its discussions.

What does this mean in practice?

- E-commerce operator (EOP) is defined as any NR who owns, operates or manages digital or e-commerce facility/platform for the online sale of goods or online provision of services.
- [NR - as per Indian tax laws (ITL)]
- The ESS EQL shall apply to ESS made or provided or facilitated by EOP to a person, among other things -
    i. resident in India (or)
    ii. using internet protocol address located in India
- Also, it applies where the sales, turnover or gross receipts in a year exceeds Rs 2 crore.
- The consideration received shall be taxable at 2%.

What is the case with financial services industry?

- The ESS EQL shall apply to instances of e-commerce platforms situated outside India or online sale of software and the like.
- Notably, the financial services (FS) industry should be outside the purview of ESS EQL, as they are not EOP.
- However, given the language of the regulation and in the absence of any specific exclusion for the FS industry, it is not free from regulation.

- This can be illustrated below:
    i. an Indian company (ICo) has sold goods to a customer in the US through an e-commerce platform in the US
    ii. ICo has tied up with a money exchanger in the US to collect and remit the funds to ICo for a commission/fee
    iii. ICo makes payment to the merchant through a payment gateway (a NR entity), which charges network fees for the payments transmitted
- Prior to April 1, 2020, the afore-mentioned commission/fee was not subject to tax in India.
- This was because the NR did not have any presence in India.
- However, with ESS EQL in place, the consideration received by NR may now be subject to tax at 2%.
- The NR is required to obtain a tax ID in India and adhere to compliances.
- The failure of this would result in levy of interest and penalty.

What are the challenges involved?

- EQL is not administered under ITL, but it is governed by a separate legislation.
- Accordingly, the availability of treaty protection and foreign tax credit in the home jurisdiction for NR is likely to be a challenge.
- The objective of the government in expanding the scope of EQL was to cover supply of goods or services provided by NR.
- However, the financial services industry, too, has been covered within the ambit of ESS EQL.
- Now, ESS EQL may require the financial services players to relook at their commercial arrangements.
- This may, among other things, involve passing on transaction costs to customers in India.
- Countries like the UK, France and Spain have amended their digital tax laws to exclude the financial services industry.
- A clarification on similar lines from the Indian government will be welcomed by the financial services industry in India.

2.7 GST Arrears

Why in news?

The Goods and Services Tax (GST) Council has deepened the Centre-States rift over the issue of GST compensation arrears due to them.

What did the Centre propose?

- An estimated figure of Rs.3 lakh crore was due as compensation to States for falling short of the 14% annual target under the GST Act.
- The Centre has now proposed that it give only Rs.1.62 lakh crore.

How did the Centre jeopardise the GST system's future?

- There is no argument against the principle that a 14% annual increase was never really on the cards this year, after the Covid-19 outbreak.
- But, this 14% increase was added as compensation to the States for transiting into the new system and forgoing their revenue gathering powers.
- The Centre did not negotiate with the States regarding the transition to a new compensation arrangement.

- By doing so, the Centre has jeopardised the future of the GST system.

What is the Centre's proposal regarding the assistance to States?

- The Centre said that it will assist the States in getting loans at G-Sec rates.
- This will give them two 'options' on the extent of loan that they can take.
- This proposal does not seem to have gone down well with some States.

How did the States react?

- With the Centre being perceived as high-handed, the Chief Minister of Maharashtra has said that it is perhaps time to exit the GST.
- Punjab, Chhattisgarh and Puducherry have voiced their displeasure.
- But, the GST came into being as a showpiece of cooperative federalism.
- It took a Constitutional Amendment to create the GST Council and a new indirect tax architecture.
- All these efforts were taken to usher simplicity and uniformity in indirect taxes across regions. These efforts should not go in vain.

What could the Centre do?

- The Centre can prolong the compensation period beyond July 2022.
- It can offer a greater share of the revenues (the SGST part) to the States.
- It is important to bear in mind that the States' finances are under stress due to Covid-related welfare commitments.
- While States have to bear some of the burden, the Centre cannot absolve itself of its constitutional commitment.
- The Centre needs to invest time and energy in 'statecraft' - in reaching across to States and bridging an alarming trust deficit.
- It should reconsider 'conditionalities' for the States to exceed the FRBM limit by more than 0.5% of the SGDP.
- The GST Council should arrest the imminent slide into chaos in these unprecedented times.

2.8 Assessing NYAY Scheme

What is the issue?

- The economic package announced to deal with the COVID-19-led crisis is likely to take a long time to fix the situation.
- In this context, here is an assessment of the efficacy of the NYAY scheme proposed by former Congress President Rahul Gandhi during the Lok Sabha elections.

What is the shortfall in the economic package?

- The Centre has announced an economic package of Rs 20 lakh crore for the entire country.
- Of this, half has been used even before it was announced.
- Much of the rest will be provided to entrepreneurs in the form of debt.
- However, amid the current lockdown situation, how demand would be generated is highly uncertain.
- And if demand does not rise, how would these new loans boost the economy is a big question.

What is the Nyay scheme all about?

- The essential goal of Nyay scheme is "transfer cash not loans".

- It proposes direct cash transfers to be the best solution, be it for saving lives or the economy.

What example does Chhattisgarh offer?

- The Nyay Yojana is in place in Chhattisgarh since the start of 2019.
- The support price for the largest crop in the state, paddy, was raised from Rs 1,800 to Rs 2,500.
- Due to this liberal policy, 80.37 lakh metric tonnes of paddy was collected from farmers at the rate of Rs 2,500 per quintal.
- This injected Rs 20,000 crore directly into farmers' pockets.
- This was an increase of about Rs 8,000 crore from the support price that prevailed before.
- Not just the purchase of paddy, but a grant-in-aid is being provided for a total of 14 items, including maize and sugarcane.
- The State government waived loans worth Rs 9,000 crore for farmers, and Rs 244 crore worth of irrigation tax was forgiven.
- The same was done for the tendu patta collectors, whose wage rate was increased from Rs 2,500 to Rs 4,000 per standard bag.
- Also, the state government from 2019 buys 25 items of forest produce at the minimum support price, unlike the earlier 7 items.
- This increased the purchasing power of common villagers, farmers, and tribals residing in the forests. This went a long way in reducing the effects of the economic slowdown in the state within one-and-a-half years.
- In Chhattisgarh, 80% of the state's population is engaged in farming, and 44% of its area is covered with forests.
- So the system worked with an understanding that the real entrepreneurs were farmers and tribal forest produce collectors.

What does the COVID-19 situation call for?

- As learnt from the GDP growth rates, even before COVID-19 and lockdown, socio-economic life was in great distress.
- So, the need for a basic minimum monthly income was a long-felt one.
- Now, across India, migrant workers are returning back home due to prolonged stagnation of economic activity.
- Given this, direct cash transfers should be made into the bank accounts of farmers, labourers, villagers, tribals, women and the deprived sections of society.
- A minimum monthly income will help in times of illness and save families from starvation.
- More importantly, it will bring money to the market and strengthen the economy indirectly from the ground up.
- Most of the nations of the world affected by COVID-19 are following this path of recovery.

3. INFLATION

3.1 Benchmark Interest Rate

What is the issue?

- To meet with the economic slowdown due to the spread of COVID-19, the RBI has cut interest rates to boost the economy.
- However, unlike in the past, it is the reverse repo rate that is effectively setting the benchmark. Here is why.

What is the current economic scenario?

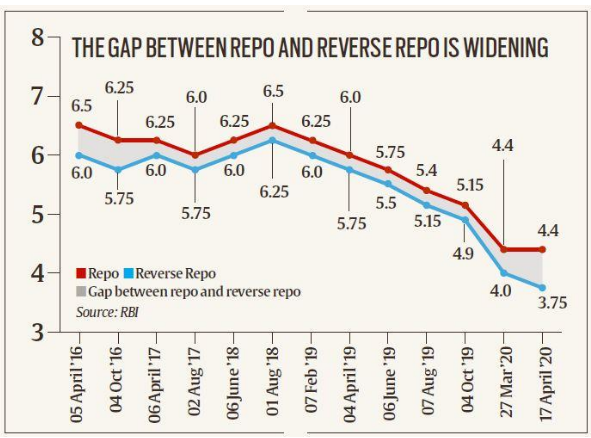
- Over the last couple of years, India's economic growth has decelerated sharply.
- This has happened for a variety of reasons and apparently, the consumer demand is lower.
- In response, businesses are cautious in making fresh investments and so, do not ask for as many new loans.
- The pre-existing incidence of high non-performing assets (NPAs) within the banking system is another factor as banks are too risk-averse to lend.
- In all, the banks' demand for fresh funds from the RBI has diminished.
- This whole cycle has acutely intensified with the ongoing lockdown due to the Coronavirus.
- In effect, the banking system is now flush with liquidity for two broad reasons:
    1. the RBI is cutting interest rates and other policy variables like the CRR to release additional and cheaper funds into the banking system
    2. banks are not lending to businesses

What is the normal benchmark rate?

- The <u>repo rate</u> is the rate at which the RBI lends money to the banking system (or banks) for short durations.
- The <u>reverse repo</u> rate is the rate at which banks can park their money with the RBI.
- Under normal circumstances, the repo rate is the benchmark interest rate in the economy.
- Because, it is the lowest rate of interest at which funds can be borrowed.
- So, it also forms the floor rate for all other interest rates in the economy.
- So the RBI usually uses the repo rate as the main instrument to tweak the interest rates.

Why is reverse repo becoming significant now?

- The sources of lending to businesses for commercial banks are primarily two.
- One is the money that banks receive from common people who maintain savings deposits with the banks, and the other is the Repo option.
- As mentioned earlier, there is now excess liquidity in the banking system.
- This has meant that during March and the first half of April 2020, banks have been using only the reverse repo (park funds with the RBI) instead of the repo (borrow).
- As of April 15, 2020 RBI had close to Rs 7 lakh crore of banks' money parked with it.
- In other words, the reverse repo rate has become the



most influential rate in the economy.

- Recognising this and the current economic scenario, the central bank has cut the reverse repo rate more than the repo.

What is the RBI's rationale?

- Banks doing nothing with their funds hurts the economy and starves the businesses that genuinely need funds.
- The idea is thus to make it less attractive for banks to just park their funds and not lend.

Will the move help revive the economy?

- More than the availability of funds with banks, it all now depends on the revival of consumer demand in the country.
- If the lockdown and disruptions due to the novel coronavirus continue for a long time, the above is less likely to happen.
- Consumer demand, which was already quite weak, is likely to stay muted and businesses might not borrow heavily to make fresh investments.
- On the other hand, it is important for the banks to be confident about new loans not turning into NPAs.
- So for cuts in reverse repo rates to fructify, reviving consumer demand as well as banks being confident about economic prospects is crucial.

What could be done?

- Banks could be offered credit guarantee, say 10%, for fresh loans given to micro, small and medium (MSME) enterprises.
- The government has done a similar thing to encourage banks to lend to the stressed non-banking financial companies.
- It can do that for the MSME segment, affected the most by Covid-19 and most critical for bringing the economy back on the growth path.

3.2 Core Sector Output Contraction

Why in news?

Data released recently by the commerce department showed that India's core sector output contracted by 6.5% in March 2020.

How is the growth scenario?

- The Index of Eight Core Industries captures the output of coal, crude oil, natural gas, steel, cement, fertilisers, electricity, and refinery products.
- Crude oil production contracted 5.5%, natural gas 15.2%, refinery products 0.5%, fertilisers 11.9%, steel 13%, cement 24.7% and electricity 7.2% during the month.
- Coal was the only sector that grew 4%.
- The nationwide lockdown to combat the spread of Covid-19 has nearly stalled the economy. The core sector contraction is a sharp reversal from 7.2% growth in February 2020, which was an 11-month high.
- This is the sharpest contraction in the index since the new series began in April 2012.
- For the full year, infrastructure industries grew 0.6% against 4.4% last year.

What does the sector-wise trend reveal?

- The output has contracted by as much as 6.5% in a month.
- But the most economic activities came to a halt only in the last 7 days of the month.

- The drop in electricity and steel production sectors reflects the underlying stress in the economy, most crucially on the demand side.
- Demand for electricity declined by more than 9% in March 2020.
- The power sector has been exempted from the lockdown because of its essential nature.
- But the slump in demand from commercial customers is bound to have a significant sector-wide cascading impact.
- The existing cash flow problem at the already stressed power distribution companies is set to worsen the impact.
- Coal is the only sector to post a positive figure in March as output expanded 4%. But even this presents a far from reassuring picture as growth slowed sharply from February's 11.2%.
- It is also less than half the 9.1% pace seen in March 2019.
- The demand for coal from user sectors like thermal generators and the key process industries of steel and cement is unlikely to revive any time soon. So the production of coal is very likely to shrink in April 2020.
- The construction sector is hit hard and is likely to face serious labour supply issues even after the economy gradually reopens.
- So, cement production may shrink in April by an even greater extent than the 25% drop seen in March 2020.
- The uncertainty in the oil market with global crude prices falling is also certain to undermine the industries in the energy sector.

What are the wider implications?

- The latest data on core sector output is signalling that considerable economic pain lies ahead in the wake of the COVID-19 pandemic.
- Undoubtedly, April 2020's overall core output appears headed for an even sharper contraction given the extension of lockdown.
- The eight major industries (core sector) has 40.27% weight in the Index of Industrial Production (IIP).
- Thus, core sector contraction is certain to drag industrial output as a whole into negative territory for March 2020.
- The Centre may be left with little option but to massively lift public spending on infrastructure once the lockdown eases to revive the economy.

4. BANKING

4.1 Yes Bank Crisis

Why in news?

The Reserve Bank of India (RBI) has placed the financially troubled Yes Bank under a moratorium (temporary suspension).

What happened after this?

- After placing this bank under a moratorium, the RBI announced a **draft 'Scheme of Reconstruction'**.
- This scheme entails the State Bank of India (SBI) investing capital to acquire a 49% stake in the restructured private lender.
- Yes Bank's stock tumbled that eroded shareholders' holdings and dragging the 10-bank S&P BSE Bankex down with it.

- This is an indicator of the contagion risk that a sudden bank resolution can pose to the financial system.
- So, the enthusiasm with which the bailout has been proposed is praiseworthy.

Why the lender was hit hard?

- Yes Bank's problems with mounting bad and illegal loans reflect the underlying woes in the borrower industries.
- The continued inability of many corporate to repay their loans has resulted in many landing up in **insolvency proceedings**.
- This has meant that lenders have been the hardest hit.
- It has suffered a **doubling in gross non-performing assets** over the April-September period, even as it scrambled to raise capital to shore up its balance sheet.
- With the economy in the throes of a persistent slowdown, the prospects of banks' burden of bad loans easing soon are limited.
- The lender has been ended up at the resolution stage, without being placed under the Prompt Corrective Action (PCA) framework of the RBI.
- This raises a question over how and why the bank escaped the PCA that was a tailor-made solution to address weakness at banks.

How did the lender escape the PCA framework?

- The lender's stated operational metrics had not breached the pre-set thresholds for triggering the PCA action.
- But, the central bank had flagged several concerns in recent years.
- This also includes the concern of the distinct divergence between the reported and RBI's own findings on the financials of the bank.
- This could be a good opportunity for the RBI to **review its PCA** guideposts and revise them to ensure that such a slipping under the radar does not recur.

Why SBI has been chosen as an investor?

- The choice of SBI as the investor to effect the bailout reflects the scarcity of options with the government.
- Several other public sector banks are also currently engaged in merging with weaker peers as part of the Centre's plan.

4.2 RBI and Payment Aggregators

Why in news?

RBI has issued final guidelines for bringing payment aggregators (PAs) under its direct supervision.

What is the significance of the move?

- Extending RBI's regulatory oversight is a welcome move.
- PAs (like Bill Desk, CCAvenue, etc.) facilitate online payments and they play a crucial role in the digital payments ecosystem.
- So, the RBI guidelines will be instrumental in ensuring that only serious players with robust governance framework remain in the market.

What was the distinction made?

- The 2019 RBI discussion paper proposed common regulatory framework for PAs and PGs without making any distinction in their roles.

- Contrary to these, the final guidelines distinguished a PG from PA as,
    1. Payment Gateways (PGs) - Merely provides technological infrastructure without any access to consumer funds.
    2. Payment Aggregators (PA) - Actually handles consumer funds.
- Accordingly, only PAs are mandated to comply with the regulatory requirements outlined in the guidelines.
- However, as a measure of good practice, PGs are recommended to adopt the baseline technology measures in the guidelines.

What is the mandate regarding net-worth?

- The discussion paper recommended a net-worth requirement of Rs 100 crore for PAs and PGs, which was heavily criticised by the industry.
- But, the final guidelines mandate PAs to have a net-worth of Rs 15 crore initially, and then Rs 25 crore by 2023.

What consumer difficulty was addressed?

- The guidelines require refunds to be made to the original method of payment, unless an alternate mode has been agreed to by the consumer.
- This may prohibit the practice of many e-commerce platforms to credit refunds automatically to a consumer's e-wallet created on the platform.
- This was a difficult practice for a consumer, as the amount in these wallets can only be used for transactions on that particular platform.
- Now, the e-commerce platforms have to credit the refunds to the account from where the amount was originally debited.

What are the issues that require further clarity?

- **Account with only one SCB** - The guidelines require PGs to maintain an escrow account with only one State Cooperative Bank (SCB).
- It may be worthwhile to reconsider this provision and enable more than one account, in light of Yes Bank debacle.
- Due to restrictions imposed by the RBI on Yes Bank, the nodal accounts maintained by payment intermediaries with it could not be operated.
- This resulted in disruption of services by fintech companies, especially related to paying out merchants.
- **Background check** - In addition to undertaking KYC for on-boarding merchants, PAs have been mandated to undertake background and antecedent check of the merchants.
- This is to ensure that such merchants do not have any mala fide intention of duping consumers or selling counterfeit products.
- Mandating PAs to address the regulator's concern regarding the quality of the merchant and its goods appears to be an onerous burden for a PA.
- **Grievance redressal** - The PA is mandated to maintain customer grievance redressal mechanisms in line with RBI's prescriptions on turnaround time for resolution of failed transactions.
- Unlike the regulatory prescriptions for prepaid payment instrument issuers, there is no requirement for PAs to report about the receipt of complaints and action taken status thereon to the RBI.
- **Preparation of plans** - The impact of the Yes Bank moratorium on the fintech sector clearly indicates the relevance of business continuity plans.
- Accordingly, it may have been useful for guidelines to refer to preparation of plans by PAs.

4.3 Ways and Means Advances

Why in News?

The Reserve Bank of India (RBI) increased the Ways and Means Advances (WMA) limit of state governments.

Why the WMA limit was increased?

- On 17th April 2020, the RBI announced a 60% increase in the WMA limit of the state governments.
- This increase is over the level as on March 31, 2020.
- It would enable the state governments to undertake effective COVID-19 containment and mitigation efforts.
- It would also enable them to better plan their market borrowings.

What is WMA?

- Section 17(5) of the RBI Act, 1934 authorises the RBI to lend to the Centre and state governments as WMA.
- It can lend them only if they can repay it within 3 months from the date of making the advance.
- These borrowings may help the governments to **tide over temporary mismatches** in cash flows of their receipts and expenditures.

How much does the RBI charge on these advances?

- The interest rate on WMA is the RBI's repo rate, which is currently 4.4%
- [Repo rate is a rate at which the RBI lends short-term money to banks.]
- But the governments can draw amounts in excess of their WMA limits.
- The interest on such overdraft is 2 percentage points above the repo rate, which now works out to 6.4%.
- Further, no state can run an overdraft with the RBI for more than a certain period.

What are the existing WMA limits and overdraft conditions?

- **For the Centre** - The WMA limit for the period of April-September, 2020-21 has been fixed at Rs 120,000 crore.
- This is 60% higher than the limit for the same period of 2019-20.
- **For the states** - After a 60% increase, the aggregate WMA limit is at Rs 51,560 crore.
- The higher limit will be valid until September 30.

Why all these relaxations been made?

- Due to lockdown, the revenues are collapsing and uncertain.
- The expenditures for combating the novel coronavirus are mounting.
- Therefore, the states are facing an unprecedented cash crunch.
- Most of the states are slashing expenditures of other departments in order to meet COVID-19 exigencies.
- However, these measures have not addressed the underlying problem of liquidity and cash flow mismatches.

So, will the increase in the WMA limits help?

- There is a likelihood of the total government borrowings crossing Rs 20 lakh crore.
- So,a WMA limit of Rs 120,000 crore for the Centre and Rs 51,560 crore for states may prove grossly insufficient.

What could be done further?

- **Centre -** The Centre may invoke Section 5(3) of its Fiscal Responsibility & Budget Management Act, 2003.

- This would allow the RBI to subscribe to the primary issues of Central Government securities under very specified grounds.
- Those cover, among other things, “act of war” and “national calamity”.
- **RBI** - It may undertake increased secondary market purchases and sales of central and state government securities.

4.4 Deficit Monetisation by the RBI

What is the issue?

- The Union Finance Minister recently remarked that she was keeping her options open on monetisation of the deficit by the RBI.
- How the government and the RBI decide on this will have significant implications for India’s economic prospects, and here is an overview on that.

What is the present deficit scenario?

- Indian economy is passing through an unprecedented phase, and so is the fiscal health of the country.
- Apparently, the government will not be able to achieve its FY21 fiscal deficit target of 3.5% of GDP.
- The exchequer is facing a revenue crunch due to falling tax revenue post the lockdown.
- There is also difficulty in realising the disinvestment target in an uncertain market.
- Adding to it, the RBI has projected a negative GDP growth rate for the Indian economy in FY21.
- The Government has even raised its gross market borrowing for FY21 by 54% (Rs 7.8 - 12 lakh crore).
- Given these, the fiscal deficit as a percentage of GDP may even cross the double-digit mark.
- The government stimulus package of Rs 20 lakh crore also seems to be inadequate to revive the economy.
- As is seen, a large part of it accounts for liquidity-boosting measures by the RBI.
- Because, the weak fiscal position has forced the government to restrict the stimulus.
- It is in this scenario, that the need for monetisation of deficit has been widely felt.

What is monetisation of deficit?

- In simple terms, monetising the deficit is equal to the central bank creating money to help the government meet its expenditure.
- In layman’s language, this means printing more money ('monetisation'), which is direct monetisation.
- In other way, deficit monetisation happens when the RBI buys government securities directly from the primary market to fund government’s expenses.
- This is a kind of implicit monetisation.

How have the modes evolved?

- Monetisation of deficit was in practice in India till 1997.
- Back then, the central bank automatically monetised government deficit.
- It does it through the issuance of ad-hoc treasury bills.
- However, two agreements were signed between the government and RBI in 1994 and 1997.
- This was to completely phase-out funding through ad-hoc treasury bills.
- Later on, with the enactment of FRBM Act, 2003, RBI was completely barred from subscribing to the primary issuances of the government from April 1, 2006.

- It was agreed that henceforth, the RBI would operate only in the secondary market through the OMO (open market operations) route.
- [OMOs involve the sale and purchase of government securities to and from the market by the RBI to adjust the rupee liquidity conditions.]
- The implied understanding was that the RBI would use the OMO route not so much to support government borrowing.
- Instead, it would be used as a liquidity instrument.
- This was to manage the balance between the policy objectives of supporting growth, checking inflation and preserving financial stability.

How does it work?

- Direct monetisation (or simply 'monetisation') of the deficit does not mean the government is getting free money from the RBI.
- It has to be worked out through the combined balance sheet of the government and the RBI.
- In that case, it will turn out that the government gets it not free, but in heavily subsidised manner.
- That subsidy is forced out of the banks.
- And, as in the case of all invisible subsidies, banks do not even visibly know.
- In the other way, now, the RBI is monetising the deficit indirectly by buying government bonds through open market operations (OMOs).
- Notably, both monetisation and OMOs involve printing of money by the RBI.
- But there are important differences between the two options that make shifting over to monetisation a risky decision.

How is OMO better to direct monetisation?

- Both monetisation and OMOs involve expansion of money supply that can potentially result in inflation.
- However, the inflation risk that both carry is different.
- OMOs are a monetary policy tool with the RBI deciding on the amount of liquidity to be injected in and when to.
- In contrast, in monetisation, the quantum and timing of money supply is determined by the government's borrowing rather than the RBI's monetary policy, to fund the fiscal deficit.
- If RBI is seen as losing control over monetary policy, it will raise concerns about inflation.
- That can be a more serious problem than it seems.
- More importantly, India is inflation prone unlike many other economies.
- Notably, after the global financial crisis when inflation "died" everywhere, India was hit with a high and stubborn inflation period.
- As is said by some, the RBI back then failed to tighten policy at the right time.
- But since then, India has embraced a monetary policy framework.
- The RBI has indeed earned credibility for delivering on inflation within the target in this period.
- Now, forsaking that credibility can be costly, with wider implications for the economy both in the short- and long-terms.
- If, despite these, the government decides to go ahead, markets will fear that the constraints on fiscal policy are being abandoned.

- They may see the government as planning to solve its fiscal problems by inflating away its debt.
- If that occurs, yields on government bonds will shoot up, which is the opposite of what is sought to be achieved.
- If in fact bond yields shoot up in real terms, there might be a case for monetisation, strictly as a one-time measure. India has not reached that point yet.
- In sum, monetisation has few advantages but it carries a large cost in credibility.

4.5 Discontinuing 7.75% RBI Bonds

Why in news?

The Government of India discontinued 7.75% savings (taxable) bonds, 2018 for subscription with effect from the close of banking business on 28 May 2020.

What are 7.75% RBI bonds?

- The 7.75 bonds 2018 were issued with effect from January 10, 2018.
- These bonds are guaranteed for repayment by the RBI.
- These were available for subscription to resident citizens/HUF to invest in a taxable bond.
- While one bond was of Rs 1,000 each, the bonds had no maximum limit for investment.
- The bonds had a 7-year lock-in period from the date of issue.
- However, it permitted premature encasement to individuals who were 60 years and above.
- Interest on these bonds will be taxable under the Income-tax Act, 1961.
- Effectively, after tax, the bond will yield 4.4%.

What has happened now?

- The government has withdrawn these bonds with effect from 28 May 2020.
- Therefore, it will not be available for investors to invest.
- This means it is only ceasing fresh issuance, and not redeeming those already invested.
- Those whose cheques got submitted and cleared till 28 May 2020 will get 7.75%.

Why is the decision now?

- The global growth rate projections have been brought down following the spread of coronavirus Pandemic.
- And since then, the interest rates have been on a decline.
- The bonds move now comes in line with -
  - i. the cut in repo rate by the RBI
  - ii. cut in deposit rates by banks
  - iii. cut in small savings rate by the government
- The RBI's move to cut repo rate has been to push credit growth and demand to give a boost to the economy.

What will the impact be?

- Every government is bound to provide at least one safe, risk-free investment option to its citizens. It was the RBI bond since 2003.
- The 7.75% Savings (Taxable) Bonds, 2018 was mostly used by HNIs (High Net Worth Individuals) to invest.
- It has been a favourite investment option for savers and pensioners.

- They had considered these bonds as safe and generating adequate returns.
- The demand for RBI bonds went up significantly over the last couple of months as investors turned risk averse.
- At this time, investors are not looking much for returns on investment, but for the safety of their capital.
- So, investors rushed for the 7.75% bonds as they saw it as the safest investment instrument available.
- Given this demand, the present move will deprive investors of another saving instrument that yielded relatively higher post-tax returns.
- It has come as a big blow to savers and pensioners at a time when their returns from bank deposits have fallen steeply.

4.6 RBI's Lockdown Stimulus

Why in news?

The RBI has announced a second set of financial measures to combat the lockdown impact on the economy.

What are the measures?

- The RBI has increased the Ways and Means Advances (WMA) limit of the state governments by 60% over the level as on March 31, 2020.
- It has extended a special refinance facility of ₹ 50,000 crore to NABARD, SIDBI and NHB.
- There will be an asset classification standstill during the moratorium period for accounts that were not NPAs as of March 1.
- Most of these RBI measures are liquidity maintenance measures.

What do these measures mean?

- State finances have got some breathing space through the 60% increase of WMA limit.
- The special refinance facility extended to NABARD, SIDBI and NHB will help them to prop up their respective constituents.
- With asset classification standstill, the RBI has relieved the borrowers who were worried about the moratorium turning them into NPAs.

Why banks are not lending currently?

- The RBI has reduced the reverse repo rate by 25 basis points to 3.75%
- [**Reverse repo rate** is the rate at which the RBI borrows money from commercial banks within India.]
- By reducing this rate, the banks have parked as much as ₹ 6.9-lakh crore with the RBI as on April 15.
- This is the time, when banks will have to be extending help for working capital loans and overdrafts to their borrowers, including MSMEs.
- The government could help here by extending a credit assurance scheme.
- This will encourage banks to be more liberal in their risk outlook.

What could be done?

- The objective now should be to keep the economy afloat by deploying all the instruments at the RBI's command.
- The RBI has done what it can.
- It is now over to the government for the fiscal support package.

4.7 Interest-Free Moratorium - RBI's Stance

Why in news?

SC has asked the finance ministry for its opinion on an interest-free moratorium.

What is the case about?

- The RBI has allowed lenders to extend a moratorium on term loans till August 2020-end, following the extension of lockdown.
- However, the levy of interest during the moratorium period has been challenged.
- It is said to create hardships to the borrowers and create hindrance and obstruction in 'right to life' guaranteed by the Constitution of India.
- In this light, the Court asked for the government's opinion on waiver of interest on loans during the ongoing moratorium period.
- The Court also observed that it could not prioritise economics over health issues.

What is the RBI's stance?

- The RBI has filed an affidavit in this regard.
- It has argued that a forced waiver of interest would affect banks badly.
- It would also endanger the interests of depositors.

How valid is RBI's argument?

- Covid-19 and the lockdown have resulted in significant hardships for most economic agents.
- However, the basic rules of economic and financial governance cannot be discarded.
- A waiver would result in about a Rs 2-trillion hit for the banking system.
- Lenders are expecting bad loans to rise because of the pandemic.
- But, a waiver could affect confidence in the banking system.
- The government has suspended the Insolvency and Bankruptcy Code for 6 months.
- This is again likely to increase problems for lenders.
- The Indian banking system was anyway not in good form even before the Covid-19 crisis.
- So, in all, it is difficult to find fault with the RBI's argument.

How important are the depositors?

- If the borrowers are given an interest waiver, the banks' role to service the depositors would be at stake.
- Banks have an obligation to serve their depositors too and not just borrowers.
- There is no concrete reason why the system should serve only the interests of the borrowers at the cost of the depositors and investors.
- Their right to life is no less important than that of the borrowers.
- Thus, it is important to strike a balance.

What other measures has the RBI taken?

- To be fair, the RBI on its part has taken several steps to support borrowers.
- Apart from the moratorium, the central bank has lowered interest rates.
- This has infused significant amounts of liquidity.

- Besides, it is widely expected that the RBI would allow a one-time restructuring of debt.

4.8 Banking Regulation Ordinance, 2020

Why in news?

- The Centre recently passed the Banking Regulation (Amendment) Ordinance, 2020.
- It gives the RBI more regulatory powers over urban co-operative banks (UCBs) and multi-State co-operative societies.

What does the amendment mean in practice?

- The Ordinance amends the Banking Regulation Act, 1949 as applicable to cooperative banks.
- With respect to UCBs and multi-State co-operative societies, the RBI will now have powers to -
    i. supersede boards
    ii. restructure managements
    iii. formulate resolution plans
- The change will subject 1,544 co-operative banks to greater RBI supervision.
- It will also partly address the problem of dual regulation by registrars of co-operative societies.
- Notably, the dual regulation is often cited as the reason for the string of co-operative bank failures.
- The Centre has expressed hope that this decision would reassure the 8.6 crore depositors in these banks about the safety of their money.

What are the concerns though?

- **RBI** - The RBI already has enough responsibilities in monitoring regulatory compliance by the following under its watch:
    i. 86 scheduled commercial banks
    ii. 10 small finance banks
    iii. 53 regional rural banks
    iv. thousands of NBFCs
    v. housing finance companies (recently been added)
- So, the addition of over 1,500 new constituents is unlikely to make its task easier.
- **Role of UCBs** - The UCBs were originally conceptualised to further financial inclusion.
- But it is questionable if the UCBs are faithfully fulfilling this mandate.
- A 2014 study in this regard shed some light.
- It finds that smaller, unscheduled UCBs were indeed focussed on sub-Rs.10-lakh loans
- The larger scheduled UCBs actually make up for the bulk of the deposit and asset base of the co-operative banking sector.
- But these have stayed quite far from their original mandates.
- These were actively vying with commercial banks in extending non-priority sector loans to commercial borrowers.
- In the process, they have availed themselves of numerous regulatory concessions.
- UCBs do cater to smaller depositors ignored by commercial banks.

- But the failure of players such as PMC Bank shows that their lax lending practices can put depositors' money at risk.
- **Approach** - Banking correspondents, Mudra loans and Jan Dhan accounts, apart from microfinance NBFCs and small finance banks are active in the banking landscape.
- Given this, the UCBs seem less relevant.
- There are better alternatives to balance macro financial inclusion objectives with depositor interests.
- It is perhaps for this reason that the RBI has refrained from granting new UCB licences in recent years.

How has RBI dealt with it?

- RBI has tried to implement the recommendations that UCBs be actively encouraged to convert into small finance banks.
- By doing so, the regulatory arbitrage can be bridged.
- Since the PMC Bank failure, the RBI has ushered in several new rules to tighten governance structures at UCBs.
- It has sought more disclosures of loan books and constituted new boards of management.
- However, given the deep-rooted issues at many UCBs, it is doubtful if they will be able to manage the transition.

4.9 New Loan-Restructuring Scheme

Why in news?

The Reserve Bank of India gave the green signal to a loan-restructuring scheme for stressed borrowers.

What is the scheme?

- This scheme is a special window that provides one-time loan restructuring to companies and individuals.
- It will provide relief specifically to those impacted by the pandemic.

Who will benefit from the scheme?

- Only those companies and individuals whose loans accounts are in default for not more than 30 days as on March 1, 2020, are eligible.
- For corporate borrowers, banks can invoke a resolution plan till December 31, 2020 and implement it till June 30, 2021.
- Such loan accounts should continue to be standard until the date of invocation.
- The one-time restructuring window is available across sectors.
- The companies that were already in default for more than 30 days as on March 1 cannot avail this facility.
- This could affect revival plans of companies that were about to regain profitability but were hit when the lockdown was imposed.
- For personal loans, the resolution plan can be invoked until December 31, 2020 and will be implemented within 90 days thereafter.

How will it be implemented?

- The RBI has set up a five-member expert committee headed by K V Kamath.
- This committee will make recommendations on the financial parameters required.
- It will recommend the sector-specific benchmark ranges for such parameters to be factored into each resolution plan for borrowers with an exposure of Rs 1,500 crore or above at the time of invocation.

- It will also undertake a process validation of resolution plans for accounts above a specified threshold.
- The RBI will notify this along with modifications in 30 days.
- This means the RBI will have the last word on who will be eligible and the parameters.
- As per the RBI, the most adversely affected sectors by the pandemic are tourism and hospitality, construction and real estate, and aviation.

How will the scheme impact banks?

- The biggest impact will be that banks will be able to check the rise in non-performing assets (NPAs) to a great extent.
- However, it will not bring down the NPAs from the present levels.
- Banks will not face much of a problem in working out individual resolutions plans.
- But they will have to tackle borrowers who were in stress after the pandemic hit.
- Were earlier such schemes not misused by banks and corporates?
- Strategic Debt Restructuring (SDR) scheme - Banks were given an opportunity to convert the loan amount into 51% of equity.
- This equity was to be sold to the highest bidder, once the firm became viable.
- This was unable to help banks resolve their bad loan problem as only two sales have taken place through this measure due to viability issues.
- Sustainable Structuring of Stressed Assets scheme - Banks were unwilling to grant write-downs as there were no incentives to do so.
- Write-downs of large debtors could exhaust banks' capital cushions.
- Asset reconstruction scheme - The major problem was that asset reconstruction companies were finding it difficult to resolve assets they had bought from banks.
- Therefore, they wanted to purchase the loans only on low prices.
- Consequently, banks were reluctant to sell them loans on a large scale.
- IBC: The Insolvency and Bankruptcy Code kicked off.
- The RBI announced a stringent loan resolution process through its circular.

Does the new scheme have safeguards against misuse?

- Yes, the RBI has built in safeguards in the resolution framework to ensure it does not lead to ever greening of bad loans.
- Restructuring of large exposures will need independent credit evaluation done by rating agencies and a process validation by the expert committee.
- For personal loans there will be no requirement for third party validation by the expert committee, or by credit rating agencies, or need for ICA.
- The RBI has said that the term of loans under resolution cannot be extended by more than two years.
- In the case of multiple lenders to a single borrower, banks need to sign an Inter-Creditor Agreement (ICA).
- To mitigate the impact of expected loan losses, banks need to make a 10% provision against such accounts under resolution.
- For banks not willing to be part of the ICA, a penal provision of 20% has been specified.

What are the major differences with previous recast schemes?

- The earlier restructuring schemes did not have any entry barrier.
- The current scheme is available only for companies facing Covid-related stress, as identified by the cut-off date of March 1.
- Strict timelines for invocation of resolution plan and its implementation have been defined in the scheme.
- In the past, this was largely open-ended.
- Independent external evaluation, process validation and specific post-resolution monitoring are further safeguards.

4.10 RBI's Annual Report

Why in news?

The Reserve Bank of India (RBI) has released its annual report.

What are RBI's assessments?

- The RBI's assessment of the economic landscape and its prognosis for near-term prospects posit a stark picture of:
    1. Demand hollowed out by the severe shock to private consumption,
    2. Public finances strained by the imperative of funding mitigation measures,
    3. Anaemic appetite for investment among corporates and
    4. Credit-flow-impeding risk aversion among bankers.
- The RBI said that the Covid-19-induced economic contraction is almost certain to extend through the July-September period.
- Reimposition of lockdowns in the country in July and August damped the tentative revival in momentum seen in the preceding two months.
- The RBI said that several recent high-frequency indicators pointed to an unprecedented retrenchment in activity.
- It noted that the consumption which survived the shock was now manifesting.
- It said so as essential spending with services including transport and hospitality are almost completely eviscerated.

What would the governments do?

- The Central government has attempted 'pandemic proofing' demand by increasing its net revenue expenditure by a third in the first quarter.
- However, it is likely to find itself strapped for resources in the coming months.
- So, it would have little leeway to continue to undergird momentum.
- States are expected to find their finances so tightly squeezed as to have to cut capital spending.

What does the RBI suggest?

- The RBI suggests that the government should help crowd in private investment through targeted public investment.
- This public investment could be funded by monetising assets in steel, coal, power, land and railways.
- But the private companies are too highly in debt and keen to use gains from the government's corporate tax rate cut to repay loans.

- So, it is hard to see the government raising much out of its privatisation efforts.

What could be done?

- The Centre may opt to marshal its meagre resources more prudently.
- It should wait for the curve of infections to start flattening before committing to any further stimulus spending.
- A revival will ensue only once consumers regain confidence to go out and spend.

5. MONEY MARKET

5.1 SC Quashed Ban on Virtual Currency

Why in News?

The Supreme Court (SC) has set aside a ban by the Reserve Bank of India (RBI) on virtual currency.

What was the ban?

- In a 2018 circular, the RBI had banned banks from dealing with virtual currency exchanges and individual holders.
- This ban was based on the grounds that these currencies had **no underlying fiat**.
- The RBI said that this ban was necessary in the **larger public interest** to stop banks from providing any services related to these.

Why this ban was set aside by the SC?

- The court held that the ban didn't pass the "proportionality" test.
- The test of proportionality of any action by the government, the court held, must pass the test of Article 19 (1) (g).
- [Article 19(1)(g) - All citizens of the country will have the right to practise any profession, or carry on any occupation or trade and business.]

Five-prong Test to check Proportionality

- Direct and immediate impact upon fundamental rights.
- The larger public interest sought to be ensured.
- Necessity to restrict citizens' freedom.
- Inherent pernicious nature of the act prohibited or its capacity or tendency to be harmful to the general public.
- The possibility of achieving the same object by imposing a less drastic restraint.

What are virtual currencies?

- As there is no globally accepted definition, virtual currency may be regarded as a method of exchange of value; or as a commodity.
- It may be defined as a **new electronic cash system** that's fully peer-to-peer, with no trusted third party.
- There would be **no central regulator** for virtual currencies as they would be placed in a globally visible ledger, accessible to all its users.
- All users of such virtual currencies would be able to see and keep track of the transactions taking place.
- Virtual currency is the larger umbrella term for all forms of non-fiat currency being traded online.
- They are mostly created, distributed and accepted in local virtual networks.

Why did the RBI ban virtual currencies?

- The RBI flagged its concerns on trade and use of the currency due to,
    1. Lack of any underlying fiat,

2. The episodes of excessive volatility in their value,
3. Their anonymous nature which goes against global money-laundering rules,
4. Risks and concerns about data security and consumer protection,
5. Its potential impact on the effectiveness of monetary policy.

- The RBI argued in the SC that these currencies weren't safe for use due to a significant shoot in the valuation of many virtual currencies and rapid growth in initial coin offerings.

What did the petitioners say?

- The petitioners included virtual currency exchanges operational in the country.
- They told the SC that the **RBI action was outside its purview** as the non-fiat currency was not a currency as such.
- Arguing that the ban was solely on "moral grounds", the petitioners said the RBI should have adopted a **wait-and-watch approach**.

What did the SC rule?

- In its judgment, the SC held that the RBI directive came up short on the five-prong test to check proportionality.
- The court did not agree, however, with any other submission made by the petitioners.
- The court said that the RBI could not be faulted for not adopting a "light-touch" approach as adopted by the developed economies.
- Therefore, the court said that it won't test the correctness of the measure taken by RBI on the basis of the approach adopted by other countries.
- The verdict removes the arbitrariness of regulatory actions without disregarding the power of RBI to regulate.

What happens now?

- The SC's judgment could lead to the RBI rethinking its policies surrounding virtual currencies.
- If rethought, the RBI may come up with a new framework that deals with the reality of these technological advancements.
- The decision will help those investors who had used this money through banking channels.

5.2 Companies Order, 2020

Why in news?

The Union Ministry of Corporate Affairs (MCA) has announced the notification of the Companies (Auditor's Report) Order, 2020 (CARO 2020).

What changes did the Order introduce?

- It has introduced several **changes to the rules governing audit reports of companies**, with a view to increase transparency.
- These changes may enhance the role of auditors and bring their incentives into more clear alignment.
- It proposed that **non-audit services** not be provided to audit clients.
- It said so to prevent revenue from such services impinging upon the decisions taken by the auditor when writing its report.
- The auditors should provide reports that are as **factual** and **complete** as the information they are provided by the company in question.

What are the transferred responsibilities?

- The 2020 CARO has now sought to transfer greater responsibility for **providing complete information to its auditors**.
- Auditors have essentially been forced to demand more information, in what will be a net positive for shareholders and other stakeholders.
- It is true that the **paperwork burden** will significantly increase.
- The 2020 CARO requires auditors to comment on 50 matters, including sub-clauses, where 2016 CARO required comment on only 21 matters.
- This is a significant expansion in scope and it remains to be seen how much it adds to transaction cost and delays in practice.

How the auditor's report should?

- The auditors are now required to **report on how the company is using its connections** with subsidiaries and joint ventures i.e.,
    1. Are loans being raised to finance them? or
    2. Are loans being taken out against them?
- The auditor will also have to **examine what the auditors of the subsidiary** have said in their annual reports.
- They should also report these auditor's reports in the holding company's report if they find "adverse" remarks.
- Several requirements seem designed to ease the load on banks, such as
    1. The requirement to specify the amount of loans that don't have terms for repayment, and
    2. The requirement to specify whether the company has itself loaned money to related parties.
- The provision, the auditor has been directed to provide an opinion on the main financial ratios of the firm, may simply go too far.

What is the significance of CARO?

- The CARO 2020 restricts itself to enhancing the information available to both investors and financial institutions.
- It should be considered to be a major step forward for transparency in accounts.
- It is important that **audit companies implement the rules** in both letter and spirit.

Why regular audit matters?

- There have been some recent high-profile examples of companies that have knowingly deceived their auditors.
- Yet a regular audit is not a forensic exercise, and instead relies on the companies to turn over information in a timely and accurate fashion.
- If they do not do so, the entire process is naturally called into question.

5.3 Franklin Templeton Mutual Fund

Why in news?

Franklin Templeton Mutual Fund (MF) in India recently made a decision to wind up six yield-oriented managed credit funds.

How does a mutual fund work?

- Mutual Fund (MF) is an investment vehicle made up of a pool of moneys collected from public investors.

- The pooled money is used to buy other securities by professional money managers (fund house).
- It gives small or individual investors access to professionally managed portfolios of equities, bonds and other securities.

What does winding up of the schemes mean?

- Winding up of the schemes essentially means that the MF will first liquidate the assets in the schemes.
- It will then return the money to investors.
- The six schemes have combined assets under management of around Rs 28,000 crore.
- This is nearly 25% of the total assets under management of Franklin Templeton MF in India.

Why was the decision now?

- The fund house said the decision was to protect value for investors via a managed sale of the portfolio.
- This comes amid the severe market dislocation and illiquidity caused by the COVID-19 pandemic.
- Reportedly, the ongoing liquidity crisis in the market has impacted higher yielding, lower-rated credit securities in India.
- Since these six schemes had direct exposure to them, they have been impacted.
- [**Higher-rated bonds** of companies are more secure and offer lower interest rates.
- On the other hand, credit risk funds generally invest in **lower-rated bonds** that offer higher return but also carry a higher risk.]

What led to this condition?

- Credit risk funds are debt funds that play on the principle of high-risk-high-reward.
- The managers of most credit risk funds have been seen chasing high yields and ignoring the associated higher risk.
- This worked well when the external environment was good, with high economic growth rate and no undue pressures on the liquidity front.
- However, when there is stress in the economy, even strong companies find it tough to raise funds.
- So naturally, companies with a weaker balance sheet and higher leverage are most vulnerable to chances of default.
- At such a time, banks, mutual funds and financial institutions that have lending exposure to such companies will see stress building.
- Also, borrowers will not be able to service the interest and principal payment.
- The COVID-19 pandemic and the lockdown resulted in a combination of these factors.

What are the implications?

- With the market situation tough for now, investors may not get an immediate exit.
- The fund house may find it difficult to get a buyer for the low-rated assets in the portfolio.
- In effect, the investors may have to wait.
- If at all the fund house pushes hard to get new buyers for those assets, it will go at a substantial haircut.
- This would mean a big loss for investors on their capital investment.
- In essence, investors will have to pay a heavy price for the incompetence of the fund house.

What caution should investors take now?

- The fund house has said that all other funds it manages - equity, debt and hybrid - are unaffected by the decision.
- So, the winding up of the six schemes will have a limited impact on investors of other schemes.
- However, as the economy is facing a serious challenge, investors should look at the quality of the companies where their investments lie.
- If their investments have exposure to lower-rated companies that are highly leveraged, they must consider reallocating them.
- The Association of Mutual Funds in India has assured investors of the healthy credit and liquidity profiles of investments.
- Despite all, shutting down six schemes is unprecedented and can break investor confidence in mutual funds.

How important is the role of the fund manager?

- Franklin Templeton Mutual Fund is the 9th largest in the country.
- Investors are now questioning why only Franklin Templeton was unable to anticipate the unfavourable developments.
- Generally, all credit risk funds invest up to 65% in bonds rated AA or below.
- However, market experts say that fund managers can lower their risk by following a higher diversification strategy.
- On significant diversification on the asset side (not given large exposure to a few companies), the entire portfolio will not be affected even if there is a default by one or two companies.
- Similarly, on significant diversification on the liability side (not having just a few large investors), fund houses may not have to sell even if one or two investors seek redemption.

What should the policy support be?

- The results of the latest round of the RBI's targeted long-term repo operations suggest that banks are unwilling to take on credit risk.
- So, the RBI should fill this vacuum in taking credit risk.
- It should consider providing direct liquidity to intermediaries, similar to what was done during the financial crisis of 2008-09.
- The costs of intervening early are less than the price of delayed action.

5.4 RBI's Liquidity Offer for Mutual Funds

Why in news?

The RBI recently announced a special liquidity window of Rs 50, 000 crore to bail out mutual funds hit by the crisis in the debt fund segment.

How does the liquidity window work?

- Under the special liquidity facility for mutual funds (SLF-MF), the RBI will conduct repo operations of 90 days tenor at the fixed repo rate.
- The SLF-MF is on-tap (on demand, anytime) and open-ended.
- Banks can submit their bids to avail the funding till May 11, 2020 or up to utilization of the allocated amount, whichever is earlier.

- Funds availed under the SLF-MF will be used by banks exclusively for meeting the liquidity requirements of MFs.

What are the features of the offer?

- The RBI says exposures under this facility will not be reckoned under the *Large Exposure Framework* (LEF).
- It thus gives greater comfort for banks to borrow under this window.
- The face value of securities acquired under the SLF-MF and kept in the *HTM category* will not be counted for *adjusted non-food bank credit* (ANBC) for determining priority sector targets or sub-targets.
- The support extended to MFs under the SLF-MF will be exempted from banks' capital market exposure limits.

What will banks do with this money?

- Banks can extend loans to mutual funds.
- They can undertake the outright purchase of and/or repos.
- This can be offered against the collateral of investment grade corporate bonds, commercial papers (CPs), debentures and certificates of Deposit (CDs) held by MFs.

Why is the offer now?

- There is heightened volatility in capital markets in reaction to Covid-19 pandemic.
- This has imposed liquidity strains on mutual funds.
- The stress is however confined to the high-risk debt funds segment.
- The debt segment has witnessed outflows of Rs 1.94 lakh crore in the month of March 2020.
- The credit risk fund category, notably, has assets of over Rs 55,000 crore.
- The condition has intensified more in the wake of redemption pressures related to closure of six debt schemes of Franklin Templeton.
- The RBI's liquidity offer is thus expected to bring some degree of comfort in the debt market, given such huge redemption pressure.

Large Exposure Framework (LEF)

- The large exposures framework sets prudent limits to large exposures.
- A large exposure is defined as the sum of all exposures of a bank to a single counterparty that is equal to or above 10% of its Tier 1 capital.

HTM category

- The investment portfolio of banks is classified under three categories:
    1. Held to Maturity (HTM)
    2. Available for Sale (AFS)
    3. Held for Trading (HFT)
- Banks normally hold securities acquired by them with the intention to hold them up to maturity under HTM category.
- Only debt securities are permitted to be held under HTM with a few exceptions, e.g., equity held in subsidiaries.
- Holding securities under HTM provides cushion for banks from valuation changes.
- However, holding in HTM book is subjected to a ceiling.

Adjusted non-food bank credit

- This includes non-food bank credit and total non-statutory liquidity ratio (SLR) investments of banks in commercial papers, shares and bonds/debentures.

5.5 Consol Bond

What is the issue?

- With rising COVID-19 cases, urgent attention needs to be paid to the economy that is on a weakening trend.
- In this context, a Consol Bond issue is a more convincing solution for the government, to go beyond current revenue receipts to fund the complete stimulus.

What is the deficit scenario?

- In the Budget (2020) before the pandemic, India projected a deficit of Rs.7.96-lakh crore.
- However, even then there were concerns around -
  i. off balance sheet borrowings of 1% of GDP
  ii. an overly excessive target of Rs. 2.1 lakh crore through disinvestments
- The financial deficit number is set to grow by a wide margin due to revenue shrinkage from the coming depression.
- This will most certainly be accompanied by a lack of appetite for disinvestment.

Is the stimulus announced so far sufficient?

- In addition to the expenditure that was planned, the government has to spend Rs. 5-6 lakh crore as stimulus.
- The Finance Ministry is optimistic at this front and has suggested that the government will not exceed the borrowing limits indicated in the Budget.
- However, the stimulus provided so far and recent announcements by the RBI leave much to be desired given the ground reality.
- All the RBI's schemes are dependent on the availability of risk capital, the market for which has completely collapsed.
- RBI has been encouraging banks to lend to below investment grade micro, small and medium enterprises, but the results are not welcoming.
- The 60% increase in ways and means limits for States is a welcome move.
- But many States have already asked for double the limits due to the shortages in indirect taxation collections from GST, fuel and liquor.
- The government and the RBI need to understand that half measures will do more harm than good, giving a false sense of security.

What is the Consol Bond?

- The COVID-19-led condition is termed as a war-like condition.
- Given this, it is fitting to look at war-time methods of raising finance.
- One such method that has been used as early as the First World War is the Consol Bond.
- Consol bond is a form of British government bond that has no maturity and that pays a fixed coupon.
- The value of a console bond was equivalent to its face value.
- The bonds, which paid out an interest of 5%, were issued in 1917 to raise more money to finance the ongoing cost of the First World War.
- The British government, in 2014, a century after the start of the First World War, paid out just 10% of the total outstanding Consol bond debt.

How will such a bond help India?

- For India, such bonds now would be a better option than the donations to PM-CARES Fund.
- Unlike PM-CARES, the proceeds of the bonds could be used for everything from PPE for doctors to a stimulus for small and medium-sized enterprises.
- Furthermore, with the fall of real estate and the lack of safe havens outside of gold, the bond would offer a dual benefit.
- It would be a risk-free investment for retail investors.

- Notably, most of the Consol bonds in the UK are owned by small investors, with over 70% holding less than £1,000.
- When instrumented, it would be issued by the central government on a perpetual basis with a right to call it back when it seems fit.
- An attractive coupon rate for the bond or tax rebates could also be an incentive for investors.
- The government can consider a phased redemption of these bonds after the economy is put back on a path of high growth.

5.6 NCLAT on Liquidation holds Precedence

Why in news?

The National Company Law Appellate Tribunal (NCLAT) has ruled that liquidation process of a company under the Insolvency and Bankruptcy Code (IBC) holds precedence over outcome of an arbitration proceeding.

What is the case about?

- Tamil Nadu-based Surana Power was admitted into insolvency under the Insolvency and Bankruptcy Code (IBC) in January 2019,
- It did not receive any valid resolution plans.
- So, it was ordered to be liquidated by the Chennai Bench of National Company Law Tribunal (NCLT).
- During the liquidation proceedings, state-run BHEL (Bharat Heavy Electricals Limited) won an ex-parte arbitration award against Surana Power.
- This gave BHEL complete and undisputed rights over all the assets, equipment, goods lying at the site of the Surana power plant.
- It also gave BHEL title rights over the finished and unfinished buildings.
- BHEL is also one of the secured creditors to Surana Power.
- On liquidation, BHEL would have got the money over other unsecured creditors.
- But its share would have come down by a lot going by IBC's waterfall mechanism *(discussed below)*.
- So, following the award, BHEL, as a creditor, refused to give its consent for liquidation.
- BHEL's refusal was challenged by the liquidator at the Chennai bench of NCLT.
- The NCLT ruled in favour of BHEL.
- It said that BHEL had full rights to realise the security interests it had won as part of the arbitration.

What is the NCLAT ruling now?

- The NCLAT set aside the Chennai NCLT's ruling.
- NCLAT held that the liquidation process of a company under the IBC holds precedence over outcome of an arbitration proceeding.
- So just because BHEL won the arbitration award, the liquidation process would not be stopped to favour it.
- BHEL had claimed that it had the first right over the assets and properties of Surana Power.
- But the NCLAT held this claim as invalid.
- BHEL did not have the minimum 60% value in secured interest; it had 26.24% share.
- So, BHEL could not be allowed to stall the IBC proceedings.
- Moreover, all other creditors had given the assent to liquidate Surana Power ('corporate debtor').

- It would be prejudicial to stall the liquidation process at the instance of a single creditor having 26.24% share (in value), in the secured assets.
- NCLAT ruled that BHEL's charge over Surana Power assets were equal to the other 10 financial creditors.
- So, BHEL could not be given precedence.

What does the NCLAT order mean?

- Essentially, if a corporate debtor is being liquidated, a creditor cannot claim superiority over other secured creditors in the same band.
- Also, everyone must receive a fair share by following the waterfall mechanism of liquidation.

What is the waterfall mechanism for liquidation?

- Section 53 of the IBC deals with the waterfall mechanism for liquidation.
- The waterfall mechanism gives priority to secured financial creditors over unsecured financial creditors.
- Under this, if a company is being liquidated, the secured financial creditors must be first paid the full extent of their admitted claim.
- This should be done before any sale proceedings are distributed to any other unsecured creditor.
- The top most priority, however, is given to costs related to the liquidation process and dues of workmen of the corporate debtor.
- The dues of the workmen include all their salaries, provident, pension, retirement and gratuity funds.
- It also includes any other funds maintained for the welfare of the workmen.

5.7 SEBI on Takeovers and Equity

Why in news?

The Securities and Exchange Board of India (SEBI) released an amended set of guidelines on takeovers and equity.

What is the relaxation regarding fresh equity?

- They sought to make it easier for entrepreneurs and promoters to raise fresh equity during 2020-21.
- Promoters may acquire up to 10% of shareholding via the creeping acquisition route without triggering mandatory open offers under the Takeover Code.
- [The previous threshold for this route was up to 5% of equity annually.
- Beyond this, the process of a mandatory open offer was triggered.]
- However, the new 10% limit doesn't apply to secondary market operations.
- The acquisition must occur through a preferential offer where the promoter group issues new shares to itself.
- This relaxation will be in force only until March 31, 2021.

What is the relaxation regarding voluntary open offers?

- SEBI has also relaxed the provisions for voluntary open offers.
- Earlier, a shareholder having 25% or more of shares, or voting rights, was permitted to make a voluntary open offer.
- But this was pemitted only if he had not acquired any shares via the creeping acquisition route in the preceding 52 weeks.
- That condition has now been relaxed till March 31, 2021.

- This would enable promoters to use the creeping acquisition route and also make an open offer if they so choose.
- However, the overall limit of 75% shareholding for a listed company remains.

What is the relaxation regarding QIP funding?

- Another relaxation pertains to the interval between accessing qualified institutional placement (QIP) funding for a listed company.
- Compared with an initial public offer, raising money from QIPs is a relatively easy process in terms of compliance.
- However, prior to this, follow-on public offers (FPOs) made to institutional investors had to be staggered at an interval of at least 6 months.
- That period has now been reduced to 2 weeks, again only with respect to the 2020-21 fiscal year.

5.8 SEBI's Norms for Preferential Issues

Why in news?

The Securities and Exchange Board of India has relaxed its norms for preferential issues.

What is SEBI?

- The Securities and Exchange Board of India (SEBI) is a regulatory body established under the SEBI Act, 1992.
- It monitors and regulates the Indian capital and securities market.
- It will protect the interests of the investors formulating regulations and guidelines to be adhered to.

What are the relaxed norms?

- The SEBI has announced a pricing methodology that will make it easier for companies to raise funds.
- Now, the companies have the option of pricing the preferential offer at the weekly average price over the preceding **12 weeks or 2 weeks**.
- This pricing rule will be applicable only for preferential issues made from July to December 2020.

What are the existing rules?

- The existing rules required the pricing to take into account the average price over the preceding **26 weeks**.
- This would have resulted in the offers being priced very high, thus deterring potential investors.

What is the significance of this move?

- The SEBI's tweak to the pricing rules for preferential issue is among the preferred channel of fund raising due to its relatively easier process.
- It had also allowed distressed firms to raise funds through preferential issue considering the share price of only the preceding 2 weeks.
- Investors in distressed firms were also exempted from the need to make an open offer.

What are the other changes that SEBI has made?

- If an open offer is delayed due to omissions by the acquirer, 10% penal interest is to be paid to all shareholders who have tendered shares in it.
- This move is necessary to check bogus open offers announced with the mal-intent of manipulating the stock price.
- The Prohibition of Insider Trading Regulations has also been amended.

- This makes all companies to maintain a database of unpublished price-sensitive information and the names of persons who have shared it.

5.9 Investing in Gold Bonds

Why in news?

Fourth tranche of sovereign gold bonds 2020-21 are opened for subscription.

What are gold bonds?

- The government introduced the gold bonds scheme in 2015.
- The scheme was introduced to wean away investors from the physical gold market.
- These bonds have a maturity period of eight years.
- But, the investors have the option to exit after the fifth year.
- Funds raised through such issuances form part of the government's overall borrowings in a year.

What are the benefits of buying gold bonds?

- Gold bonds offer investors twin benefits of price appreciation along with a fixed 2.5% coupon per year.
- Interest earned on these gold bonds is added to the holders' income.
- Interest earned on these bonds is taxed according to their slab rate.
- Any capital gains on these bonds at maturity are tax free.
- This makes them far more attractive than owning physical gold.
- To offer greater liquidity, the bonds are listed on stock exchanges within a fortnight of issuance, and can be traded.
- Gold bonds appear attractive when gold prices spike.
- This leads to greater investor interest in this asset class.

Why are gold prices rising globally?

- Much before Covid-19's impact led to a crash in global stock markets, gold prices had started their upward glide.
- The global **spread of Covid-19** has raised concerns on global growth over the last three or four months.
- **Negative growth rates** and **fears of a global recession** have pushed central banks and big investors to take shelter in gold.
- There is nearly 40% crash in benchmark equity indices in the US between February and March 2020.
- This has forced the US Federal Reserve to announce a record liquidity injection and bond-buying programme of more than $3 trillion.

Why prices are rising in India?

- Since **India mostly imports gold**, the depreciation of rupee with regard to dollar makes gold costlier in India.
- **Domestic factors** such as concerns over the country's fiscal health and a higher demand for gold also pushes up prices.
- In India, the RBI has cut policy rates by 115 basis points over the last three months, and brought down the repo rate to 4%.
- [Repo rate - The rate at which the RBI lends to commercial banks]

- The RBI has also announced liquidity injection in the economy.
- Any expansion in the paper currency tends to push up gold prices.

Will gold prices continue to rise?

- Gold is an efficient tool to hedge against inflation and economic uncertainties.
- It is also more liquid when compared with real estate and many debt instruments.
- Generally, after any major economic crash and recession, gold prices continue their upward run.
- Market analysts feel that gold could overtake its previous peak of around $1,900 per ounce in the global market.

Can one invest in gold at the current price point?

- In India, there is a sharp decline in interest rates over the last year alongside high volatility in the equity markets.
- This has brought investors' focus towards gold.
- A cut in interest rates by the RBI has led to a decline in interest rates on small savings and term deposit rates of banks.
- SBI is currently offering an interest of 2.7% on savings bank deposits, and 5.4% on 5-10 year term deposits.
- Experts say that it makes good sense for investors to invest in gold.

Can the price of gold crash?

- Given the economic uncertainty, gold would touch a new all-time high.
- In India, prices will be supported by any further weakness in rupee.
- Key events that could stall the rise of gold are,
    1. Sudden sale of gold holdings by central banks to tide over the economic crisis,
    2. Crisis in other risk assets prompting investors to compensate their losses through sale of gold ETFs (Exchange Traded funds).

5.10 Social Stock Exchange

Why in news?

Social Stock Exchange (SSE) would be established by the SEBI as a structure within the existing stock market ecosystem.

What would be the purpose?

- SSE would enable the social enterprises and voluntary organisations to raise funds.
- India's rank is 129 among the 189 countries on the Human Development Index (HDI).
- [HDI tracks the progress made in education, health and income]
- So, there is indeed a pressing need to do more for the social sector.

What is the problem?

- Successive governments are under-investing in the social sectors.
- So, the onus has mostly fallen on private entities, that are constantly starved for funds.

How would SSE help to overcome this problem?

- Funds from individual philanthropists have been quite strong in India, amounting to ₹ 70,000 crore in 2018.

- There is an opportunity to help these entities tap other sources of funding such as international philanthropy, domestic CSR, and so on.
- The SSE can play a role here as a platform that brings these funds and causes together.

How do global social exchanges operate?

- The SEBI is complicating matters by allowing both the non-profit organisations and for-profit entities on the SSE.
- Many of the global social exchanges cater only to NPOs.
- They act as an intermediary that screens and certifies them and helps them find eligible donors.
- SEBI can follow this model for SSE, in order to keep things simple.
- According to government estimates, there were 31 lakh NPOs in India and these entities are in more urgent need for funds.

What is a provision that would be misused?

- A self-declaration by FPEs is needed about being a social enterprise.
- This is likely to be misused, in the absence of agencies that can do independent verification of the declarations made by these FPEs.
- The regulator should first establish the mechanism for verifying these claims.

What are the other provisions?

- **Eco-system** - A welcomed suggestion is to build an eco-system, which includes,
    1. Establishing a self-regulatory organisation,
    2. Bringing together the information repositories on NPOs,
    3. Standardising the reporting standards for social impact, governance, etc.,
- With regard to fund-raising, the SEBI recommends that NPOs can raise zero coupon zero capital bonds on the SSE that will be akin to donation.
- **Instruments** - The SEBI suggests listing of equity and debt of NPOs.
- It suggests raising social and development impact bonds.
- It also suggests using social venture funds and mutual funds to channel money into charitable causes.
- These instruments can help worthy causes.
- But liquidity in these instruments is likely to be scant, even if market makers are established in every counter.
- The investors participating on this platform have to be mature enough to understand that they are not playing for returns.

5.11 NFRA's Action against Deloitte

Why in news?

The National Financial Reporting Authority (NFRA) has taken action against an auditor who led the audit of IFIN in 2017-18.s

What is NFRA?

- The NFRA is a national regulator for auditors.
- It was set up in 2018 under the Companies Act, 2013.

- It was set up specifically to investigate the **role of auditors in frauds** in listed and large public interest entities.
- Previously, only the Institute of Chartered Accountants of India can bar chartered accountants from being appointed as auditors for a company.
- Also, the Securities and Exchange Board of India (SEBI) was permitted to bar CAs from auditing listed companies.

What is IFIN?

- IL&FS Financial Services (IFIN) is a subsidiary of IL&FS.
- It ran into deep financial trouble after running out of cash in 2018.

What action has been taken in this case?

- The NFRA has fined Udayan Sen, the former CEO of Deloitte Haskins and Sells, Rs 25 lakh for lapses in the audit.
- It also barred the auditor from auditing activities for seven years.
- The NFRA noted that Deloitte was providing such non permitted services to companies related to IFIN, including the IL&FS.
- This is the first order of its kind by NFRA.

What are the roles of auditors?

- The role of an auditor is to report on whether a company's financial statements have been reported in line with accounting standards.
- An auditor has to raise red flags in case the auditor notes any concerns regarding the statement of accounts or in any financial transactions entered into by the company.
- Auditors are also required to ensure that there is no conflict of interest in their own appointment.

On what grounds can auditors be barred?

- Auditors can be barred for **professional misconduct** including not exercising due diligence, or for **gross negligence** in their duties.
- The Companies Act prohibits audit firms from providing certain **non-audit services to clients** that they are auditing.

What kind of action has been taken against auditors earlier?

- In 2018, SEBI barred an audit firm from auditing listed companies for two years.
- It barred two auditors from auditing listed companies for three years.
- They were barred for professional misconduct in the Satyam Computers scam, which came to light in 2009.
- But, the Securities Appellate Tribunal (SAT) quashed the order in 2019.
- SEBI has appealed against the order by the SAT in the Supreme Court.

5.12 SIP Mutual Funds 2020

What is the issue?

- The Covid-19 pandemic have raised anxiety among individuals who want to keep liquidity at hand to meet any future contingency.
- For many, the big dilemma is whether to continue with their monthly mutual fund investments.

Should one invest in the markets?

- The fall in markets has opened a window of opportunity for investors to invest directly in shares.
- However, one must be very careful about which stock to pick.
- This makes mutual funds the preferred mode when it comes to taking equity exposure.
- Should one invest in equities at all in these times?
- Those who have certainty of income can continue with their existing investments and also look to increase them.
- For others, the situation is tricky.
- With uncertainty all around, the risks associated with equities have only gone up.
- Equity investments are meant for at least 3 to 5 years.
- This means that investors should park only that component of their income into equities, which they may not require for the next five years.
- An investor who is unsure about the sustainability of his job and salary should look towards building liquidity for current times.
- Equity assets do not fit the bill.

Should one continue with their SIPs?

- There is a fall in equity markets on account of any adverse global or domestic event, amidst the ongoing pandemic.
- This fall may just make it unfeasible for an investor to withdraw from her equity portfolio.
- Since these are times to build liquid reserves, investors can move their systematic investment plans (SIPs) from the equity to the debt category.
- As the idea is to build contingency provisions, the best suited would be ultra short-term funds and low duration funds.
- Within that, investors should go for schemes that have the highest exposure to AAA rated papers, and have a lower expense ratio.
- Other than stopping their incremental SIP inflows, investors can:
- Go for a three-month pause option with their mutual funds, where the money won't be debited from their account for 3 months or,
- Go for the option of reducing the ticket size of the SIP.

What should the less impacted ones do?

- Individuals who are not too constrained on the income front may continue with their existing equity SIPs.
- They may even direct their additional savings into equities.
- An investment in current times may mean a higher accumulation of units on account of the drop in net asset value of MF units.
- But, the priority should be to build at least six months' contingency funds that are sufficient to meet EMI expenses, school fees, etc.,

What should one do with their existing equity investments?

- One must avoid liquidating the equity investments to meet expenses or other liabilities.
- One can withdraw from investment portfolios like deposits, gold, etc., rather than pulling out of equity schemes.

- Even though they have bounced back significantly, markets are still trading around 12% lower than the highs they had hit in January 2020.
- Many investors who would have started their SIPs 2-3 years ago may still find their capital in the negative.
- Equity SIPs will work if investments are disciplined and redemptions are planned.
- So one should book their profits when the markets are at a high, or when their financial goal has been achieved.
- Investors can have a diversified portfolio across asset classes like equities, fixed deposits, gold, debt mutual funds, etc.

6. EXTERNAL SECTOR

6.1 Dollar Swap Line

Why in News?

India is working with the United States (US) to secure a dollar swap line.

Are India's forex reserves enough?

- As per the RBI, India's foreign exchange reserves have fallen by $ 13 billion from March 6 to April 3, 2020.
- This is due to a sharp outflow of funds of the foreign portfolio investors, who wanted safer havens amidst the current global uncertainty.
- After a smooth run during which India's foreign exchange reserves rose week-on-week for nearly six months, they started to decline in March.
- According to RBI data, 63.7% of India's foreign currency assets are held in overseas securities, mainly in the US treasury.

What are the benefits of a swap line?

- A swap line with the US Federal Reserve would help in better management of the external account of India.
- It would also provide extra cushion in the event of an abrupt outflow of funds from the forex markets.
- So far, foreign institutional investors (FIIs) have been large sellers in the Indian equity and debt markets in March and April 2020.
- There is apprehension that the economic impact of COVID-19 will last for a significant length of time.
- So, the government and the Reserve Bank of India (RBI) cannot lower their guard on the management of the economy and external account.

How does a swap facility work?

- In a swap arrangement, based on the market exchange rate at the time of the transaction,
    1. The US Fed provides dollars to a foreign central bank, and
    2. The bank provides the equivalent funds in its currency to the Fed.
- The parties agree to swap back their currencies at a specified date in the future, at the same exchange rate as in the first transaction.
- These swap operations carry no exchange rate or other market risks, as transaction terms are set in advance.

Does India have a swap line with any other country?

- **Japan** - India has a $75 billion bilateral currency swap line with Japan, which has the second highest dollar reserves after China.

- This provides India with the flexibility to use these reserves at any time in order to maintain the balance of payments or short-term liquidity.
- **SAARC** - The RBI offers similar swap lines to central banks in the SAARC region within a total corpus of $2 billion for 2019-22.
- This facility will further the financial stability and economic cooperation within the SAARC region.

With which countries does the US have swap lines?

- **Temporary** - On March 19, 2020, the Fed opened temporary swap arrangements with the central banks of Australia, Brazil, Norway, etc.
- This is to be in place for at least six months for a combined $450 billion.
- **Permanent** - The Fed already has permanent swap arrangements with the Banks of Canada, England, Japan, the European Central Bank, etc,.
- Currently, India, China, Russia, Saudi Arabia and South Africa do not have a currency swap line with the US.

6.2 Revised FDI Policy

Why in news?

India revised its Foreign Direct Investment policy to prevent opportunistic takeovers of firms hit by the lockdown.

What was the amendment?

- India said that an entity of a country that shares a land border with India can invest in firms here only through government route.
- This applies to "beneficial owners" who is resident of a neighbouring country - even if the investing company is not located there.
- While the note did not name any country, analysts see the amendments as aimed at possible Chinese investments.

What is the current investment status?

- China's investment in India has been on an up curve in the last 5 years.
- According to a Brookings India study, the total current and planned investment by Chinese entities is over $26 billion.
- Chinese capital is invested in brick-and-mortar industries, technology and fintech start-ups.
- The move to control Chinese investment in Indian companies was always on the cards and COVID-19 was a good excuse to pull the trigger.
- The decision to introduce a layer of government approval is valid in the current circumstances.
- But the government could have adopted a more nuanced approach.

Why was this decision taken?

- FDI was banned because the Chinese investors may exploit cheap valuations in the depressed economic conditions post-lockdown.
- They may pick up equity interest in select companies.
- Italy, Spain, France and Australia have already taken similar action to protect their businesses from Chinese investors.
- These investors are fishing for distressed entities in need of cash in the post-COVID-19 scenario.

What was China's response?

- China has termed the move as violation of international trade principles.
- It has called for India to revise these "discriminatory practices" and treat investments from different countries equally.
- Chinese Embassy in India said that India's move violates WTO's (World Trade Organisation's) principle of non-discrimination.
- It says that India's move goes against the general trend of liberalization and facilitation of trade and investment.

What is India's argument?

- India maintains that its FDI policy is not aimed at any one country.
- It says that this move only aims to curb "opportunistic" takeovers of Indian firms, which are under strain.
- India says that the amendments are not prohibiting investments.
- It has only changed the approval route for investments.
- Many sectors in India are already subject to this approval route.

What is the ground on which India's move is discriminatory?

- India's move is seen as a discrimination against certain countries for non-security reasons.
- This may not be seen favourably on the global stage.
- Most of the countries that have tightened their investment regulations have done in such a way that it would apply to all countries.

What have other countries done?

- **European Commission** - It issued guidelines to ensure a strong EU-wide approach to foreign investment screening at such a time.
- The aim was to preserve EU companies and critical assets in areas like health, med research, infrastructure essential for security, etc.
- **Australia** - It temporarily tightened rules on foreign takeovers over concerns that strategic assets could be sold off cheaply.
- All foreign takeover and investment proposals will now be scrutinised by Australia's foreign investment review board.
- **Spain, Italy and the US** too have implemented investment-related restrictions.

Has India done this before?

- It is the first-time that a move to impose additional requirements for **certain countries** is taken.
- However, India has imposed such measures on investments into **certain sectors**.
- From 2011, the government had mandated approval for any FDI coming into the pharmaceuticals sector.
- In 2010, the government banned FDI in cigarette manufacturing.
- India had also blocked certain FDI investments during bilateral standoffs with China.

What approach the government could have adopted?

- **Greenfield investments** should have been kept out of the purview as they create new capacities and businesses in the country.

- [Greenfield investment is a type of FDI in which a parent company creates a subsidiary in a different country, building its operations from the ground up.]
- A **distinction** should have been made based on the class of investors.
- Venture capital funds are financial investors who may not necessarily be interested in taking over and running a business.
- While the FDI route has been plugged, it is not clear what happens to investments that come through the market route.

6.3 Crude Oil Below the $0 Mark

Why in news?

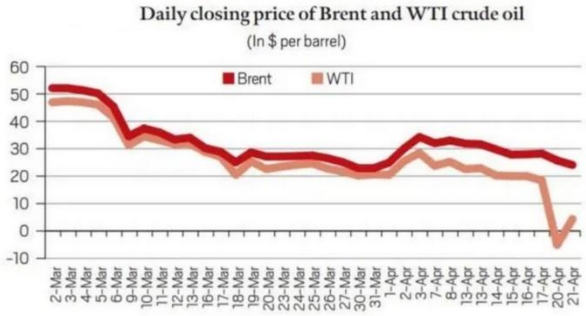
The oil prices of West Texas Intermediate (WTI), the best quality of crude oil in the world, fell to "minus" $40.32 a barrel in New York, US.

What is the key reason?

- Even before the Covid-19 induced global lockdown, crude oil prices had been falling over the past few months.
- They were closer to $60 a barrel at the start of 2020 and by March-end, they were closer to $20 a barrel.
- To a great extent, oil markets, globally and more so in the US, are facing an enormous glut.
- Certainly, the price fall is thus a result of the supply being more than the demand.
- [This is not only the lowest crude oil price ever known but also well below the zero-mark. The previous lowest was said to be immediately after World War II.]

What are the other recent developments?

- Historically, the Organization of the Petroleum Exporting Countries (OPEC) used to work as a cartel and fix prices in a favourable band.
- [The OPEC is lead by Saudi Arabia, the largest exporter of crude oil in the world (single-handedly exporting 10% of the global demand).]
- It could bring down prices by increasing oil production and raise prices by cutting production.
- In the recent past, the OPEC has been working with Russia, as OPEC+, to fix the global prices and supply.
- But in early March 2020, this cooperation that is crucial for the global oil market's seamless operations came to an end.
- Saudi Arabia and Russia disagreed over the production cuts required to keep prices stable.
- As a result, oil-exporting countries, led by Saudi Arabia, started undercutting each other on price.
- However, they continued to produce the same quantities of oil.



- The Saudi Arabia and Russia discord was sorted out recently, under pressure from US President Donald Trump.
- However, it was too late.
- The oil-exporting countries decided to cut production by 6 million barrels a day, the highest production cuts.
- But, the demand for oil has been shrinking by 9 to 10 million barrels a day.
- This was an unsustainable strategy under normal circumstances.

- The growing spread of Coronavirus made it even more calamitous.

How has the lockdown worsened the situation?

- Given the lockdown condition, there is a sharp reduction in economic activity.
- With fewer flights and fewer cars, the demand for oil has been shrinking (9 to 10 million barrels a day).
- The supply-demand mismatch continued to worsen right through March and April 2020.
- The mismatch resulted in almost all storage capacity being exhausted.
- Trains and ships, which were typically used to transport oil, too, were used up just for storing oil.

What is the immediate cause?

- The May contracts for WTI, the American crude oil variant, were due to expire on April 21, 2020.
- As the deadline came near, prices started reducing, for two broad reasons.
- By April 20, 2020, many oil producers wanted to get rid of their oil even at unbelievably low prices.
- The other unattractive option was to shut production, which would have been much more costly to restart.
- The consumer side that is those holding these contracts could not go by the compulsion to buy more oil.
- This is because there was no space to store the oil if they were to take the delivery.
- It would be more costly for them to accept the oil delivery, pay for its transportation and then pay for storing it (possibly for a longer period).
- This desperation from both sides - buyers and sellers - to get rid of oil led to the present condition.
- In the short-term, for both the contract holders and the oil producers, it was less costly to pay $40 a barrel, and get rid of the oil.
- [This means the seller would be paying the buyer of crude oil $40 for each barrel.]
- All this meant that the oil prices not only dropped to zero but also went deep into the negative territory.

How does the future look?

- It is important to note that it was the WTI price for May 2020 in the US markets that went so low.
- Crude oil prices elsewhere fell but by not so much.
- Moreover, at least for now, oil prices for June 2020 are pegged at around $20 a barrel.
- It is likely that the WTI price was a one-off event and will not happen as producers are forced to cut back production further.
- However, there is still uncertainty given the continuing spread of Covid-19 and the demand falling every day.
- In all, it would be the demand-supply mismatch (adjusted for storage capacity) that will decide the fate of oil prices in the coming days.

How will this impact India?

- The Indian crude oil basket does not comprise WTI.
- It only has *Brent* and oil from some of the Gulf countries.
- So, technically, there is no direct impact on India.

Brent Crude

- When it comes to physical oil, there are different grades.
- The most popular traded grades are:
- Brent North Sea Crude (commonly known as Brent Crude)
- West Texas Intermediate (commonly known as WTI)
- Brent refers to oil that is produced in the Brent oil fields and other sites in the North Sea.
- Brent Crude's price is the benchmark for African, European, and Middle Eastern crude oil.
- The pricing mechanism for Brent dictates the value of roughly two-thirds of the world's crude oil production.

- However, oil is traded globally, and weakness in WTI gets reflected in the falling prices of the Indian basket as well.

What concerns does this pose?

- India has wisely been using the sharp fall in both crude prices and domestic demand to accelerate the build-up of its strategic oil reserve.
- The sliding oil prices would help significantly cut India's energy import bill.
- However, a prolonged demand drought would end up hurting the government's tax revenues severely.
- This is especially impactful at a time when the government badly needs every additional rupee it can garner.
- Also, such low oil prices risk damaging the economies of producer countries including those in West Asia.
- This would, in turn, hurt the inward remittances for India.

What options does India have?

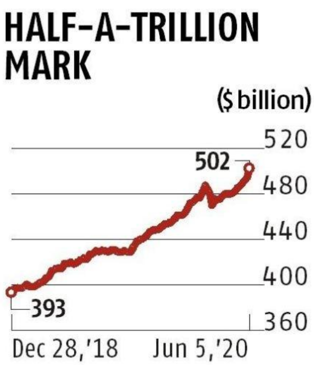
- There are two ways in which this lower price can help India.
- The government can pass on the lower prices to consumers.
- In this case, whenever the economic recovery starts in India, individual consumption will be boosted.
- The other option is for the governments (both at the Centre and the states) to decide to levy higher taxes on oil.
- This can work to boost the government revenues.
- If it chooses to cut retail fuel prices by foregoing some excise revenue for a while, the wider economy could get the much-needed momentum.

6.4 Rising Forex Reserves

What is the issue?

- India's forex reserves crossed $500 billion for the first time ever in the week ended June 5, 2020.
- However, the nature of factors contributing to it and the economic uncertainties posed by the pandemic call for a cautious approach.

What are forex reserves?



- Forex reserves are external assets accumulated by India in the form of -
  i. Gold
  ii. SDRs (special drawing rights of the IMF)
  iii. Foreign currency assets (capital inflows to the capital markets, FDI and external commercial borrowings)
- These are controlled by the Reserve Bank of India.

Why is the present reserves position encouraging?

- The RBI was able to increase its reserves by $79 billion over the past year (FY19) and by $29 billion since the beginning of the 2020-21 fiscal year.
- The $500 billion mark comes as an encouraging development amidst the current gloomy economic scenario, given the COVID-19 pandemic.
- The reserves will be useful if global financial conditions deteriorate further, causing turbulence in currency markets.

What were the contributing factors?

- The dollar-rupee swap auctions conducted in March and April 2020 have helped increase reserves to some extent.
- But besides this, there is also a couple of other unplanned and some fortuitous developments as well.
- Notable among them are the rising external commercial borrowings (ECB) and an unexpected trade surplus.
- Global central banks are pumping in enormous amount of money into the global economy and moving interest rates lower.
- With this, Indian companies have found it easier to raise funds overseas at cheaper cost.
- Resultantly, ECBs raised in FY20 were 127% higher compared to FY19.
- In the first two months of 2020-21 fiscal, corporates had already borrowed over $2 billion.

What is the need for caution though?

- Increased overseas borrowing has downsides too.
- Corporates can struggle to roll over the loans if the rupee continues depreciating or if the interest rate cycle overseas turns adverse.
- It is also essential to be cautious about the favourable trade balance.
- This is because the current trade surplus is caused mainly by declining demand.
- Merchandise imports were sharply lower in April and May 2020, in line with contraction in global trade.
- Once domestic demand revives with the economy unlocking, demand for petroleum and other products is likely to revive.
- So, there might be pressure on the trade balance once again.
- On the other hand, foreign portfolio investments have not been too robust in 2020.
- FPIs (Foreign Portfolio Investors) have turned net buyers in equities in May and June 2020.
- However, they could turn net-sellers again if risk-aversion spikes.
- That might cause outflows from global emerging markets, if the pandemic does not settle down by the end of this year.
- Likewise, foreign direct inflows were strong until March 2020.
- Inflows in FY20 were 40% higher compared to the previous fiscal year.
- But, direct investments are likely to be much lower in FY21 as businesses struggle to stay afloat amidst the pandemic.
- Remittances from NRIs are also likely to be lower with many overseas Indians witnessing pay-cuts or job losses.

How does the future look?

- Given the above uncertainties, the RBI is being only prudent in its strategy to continue buying dollars.
- This adds to the buffer as well as helps to keep the rupee weak, making it competitive in the export market in relation to its peers.
- [Notably, the Indian currency is down 4.5% so far in 2020.]
- Other countries have also witnessed an increase in their forex reserves in the May and June 2020.
- This highlights the fact that India needs to be ready to face future turbulence.

6.5 Negative List of Defence Imports

Why in news?

Defence Minister has announced a list of 101 items that the Defence Ministry will stop importing.

What is the decision?

- The negative list means that the Armed Forces will only procure all of these 101 items from domestic manufacturers.
- [Armed Forces - Army, Navy and Air Force.]
- The manufacturers could be private sector players or defence Public Sector Undertakings (DPSUs).
- The manufacturers can develop these items by using their own design and development capabilities.
- Or they can also adopt the technologies that can be designed by the Defence Research and Development Organisation (DRDO).

Why this decision was taken?

- As per Stockholm International Peace Research Institute, India has been the second largest importer between 2014 and 2019.
- The government wants to reduce the dependence on imported items in defence.
- By denying the possibility of importing the items on the list, the domestic industry is given an opportunity to manufacture for the needs of the forces.
- Announcing the policy, the Defence Ministry is now ready for a big push to Atmanirbhar Bharat initiative.
- The Ministry will introduce import embargo on 101 items beyond given timeline to boost indigenisation of defence production.
- The government has been hoping that the defence manufacturing sector can play a leading role in boosting the economy.

What does the list include?

- The negative list includes a range of items from simpler items to advanced technologies.
- The items include water jet fast attack craft to survey vessels, pollution control vessels, light transport aircraft, GSAT-6 terminals, radars, unmanned aerial vehicles, etc.,
- It also includes simpler items like certain rifles, artillery guns, bullet proof jackets, missile destroyers, etc.
- Almost 260 schemes of such items were contracted by the Armed Forces at Rs 3.5 lakh crore between April 2015 and August 2020.
- The government expects that contracts worth Rs 4 lakh crore will be placed upon the domestic industry within the next 6 to 7 years.

Were the Armed Forces consulted?

- The government announced the list after due consideration by all stakeholders involved.
- This includes the three services who use the equipment, weapons and platforms that will be embargoed.
- The Ministry also consulted the public sector and private players.
- They were consulted to assess the capabilities of the Indian industry for manufacturing various ammunition & equipment within India.
- The items mentioned on the list worth almost Rs 1,30,000 crore each are anticipated for the Army and the Air Force.
- The items worth almost Rs 1,40,000 crore are anticipated for the Navy over the same period.

Will it come into effect immediately?

- Not immediately, but it will be starting this year.
- However, not all the 101 items mentioned in the list will be embargoed starting this year.
- The embargo on imports is planned to be progressively implemented between 2020 to 2024.
- The government wants to apprise the Indian defence industry about the anticipated requirements of the Armed Forces.
- So that they are better prepared to realise the goal of indigenisation.
- The list may grow as more such equipment for import embargo would be identified by the Department of Military Affairs after consulting all stakeholders.
- A due note of this will be made in the Defence Acquisition Procedure to ensure that no item in the list is processed for import in the future.
- One item in the list, Long Range – Land Attack Cruise Missile will not be allowed to be imported after December 2025.

Is this a new policy?

- It was announced in May 2020.
- Defence Minister has taken cue from Prime Minister Narendra Modi's 'Atamnirbhar Bharat' announcement.
- The Defence Ministry has bifurcated the capital procurement budget for 2020-21 between domestic and foreign capital procurement routes.
- A separate budget head has been created with an outlay of nearly Rs 52,000 crore for domestic capital procurement in the current financial year.

What are the future plans of the Ministry?

- The Defence Ministry wants to raise the Foreign Direct Investment in defence manufacturing from 49% to 74% under the automatic route.
- It also wants to improve the autonomy and accountability of the Ordnance Factory Board by their corporatisation.
- It also wants to build a time-bound defence procurement process and faster decision-making.

6.6 China's Renminbi

Why in news?

Four commercial banks in China began large-scale testing of the digital currency, Renminbi.

What does this testing mean?

- The state-run lenders are no 'small change'.
- They are Bank of China, China Construction Bank, Industrial and Commercial Bank of China, and Agricultural Bank of China.
- These are the largest banks of the world, with a customer base that runs into many millions.
- This means, if their tests come out cool, the digital renminbi will become the world's first sovereign digital currency.

Why does China want a digital currency?

- China is one of the most digitally penetrated countries in the world.
- It has seen impressive acceptance of financial technologies and digital payments.

- China's digital payments ecosystem is more advanced than many of its Western counterparts, including the US and the EU.
- China's new financial system is built on digital wallets, QR codes, and runs through its own big tech firms: Alipay of Alibaba, etc.
- So, it is natural that the government has planned to take the next step and experiment with an all-encompassing digital currency.

Is China the only country planning an e-currency?

- According to the Bank for International Settlements (2019), most central banks (80%) are fiddling with the idea of a sovereign digital currency.
- This includes the US and the European Central Bank.
- The G7 countries have been planning a collective move on central bank-sponsored digital currencies.
- Even the RBI has been contemplating bringing out a national digital currency if and when safe technologies emerge.
- National Blockchain Strategy of India envisages a sovereign digital currency.
- But it seems China has gone ahead with its plans and is set to roll out one for mass use.

What is China actually testing?

- Now, its citizens can use the e-wallet to top up accounts, purchase, withdraw and transfer money after pairing the digital currency with the phone number.
- The Chinese banks are also testing if the e-currency can be exchanged offline, that is, without the Internet.

How different is this from bitcoin or Facebook's Libra?

- It is different in many ways.
- To start with, this is **legal tender**, endorsed by the state.
- Bitcoin is not legally accepted in many geographies, including India.
- A 2018 RBI order disallowed the use and exchange of cryptocurrencies by financial institutions it monitors.
- India is contemplating a law banning cryptocurrencies altogether.
- Bitcoin is designed to be anti-authority and is not controlled by a central bank or a government.
- This makes it prone to giant fluctuations in value.

What is China trying to do?

- China expects to cash in on the global trend towards digital currencies by being an early-mover (the digital renminbi was announced in 2014).
- Also, it eyes the global disruption it can cause in the currency markets with renminbi.
- The fiat renminbi is often accused of being subjected to manipulation by China's Communist government.
- So, the future of an e-renminbi will also be shrouded in secrecy.
- Still, experts say China thinks that it is much easier to transfer e-payments across the border while controlling it from within the country.

Is it trying to create a universal currency, then?

- Unlikely, as things stand now.
- China doesn't enjoy the political goodwill to moot an alternative to the dollar, however weak the US economy seems today.

- But, China enjoys a clout in the international money market.
- Also, it secretly aims to plug the yuan as the global currency.
- If the digital renminbi rolled out for regular use soon, it could lead to major shifts in the way money moves within China and beyond.

7. GENERAL ECONOMY

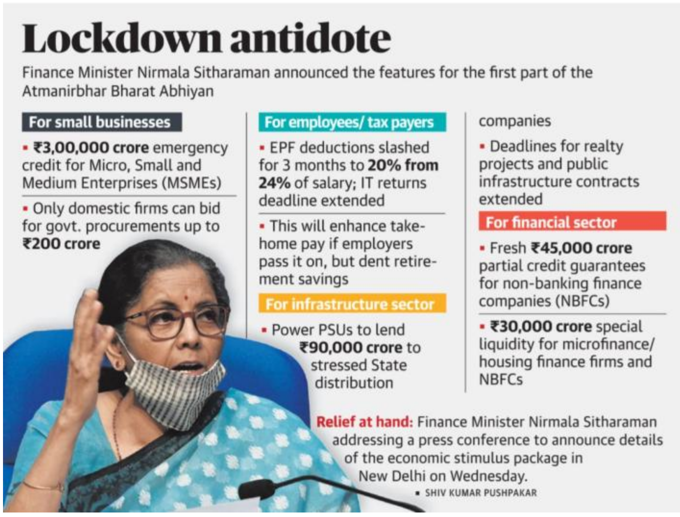
7.1 Atmanirbhar Bharat Abhiyan

Why in news?

The Minister of Finance made a set of announcements under the Atmanirbhar Bharat Abhiyan (Atmanirbhar meaning self-reliant).

What are the welcome measures?

- The measures announced will go a long way in lifting the spirits of the two key and troubled sectors:
    1. micro, small and medium enterprises (MSMEs)
    2. non-banking finance companies (NBFCs)
- While for the former, it is an existential crisis, for the latter, it is a liquidity issue.
- **MSMEs -** The massive Rs. 3-lakh crore collateral-free assistance handed out to MSMEs will help them revive their operations.
- Extending a sovereign credit guarantee for the complete amount is a welcome move.
- This is because banks may otherwise have been reluctant to support troubled borrowers.
- Two of the feature that would help boost the equity portion on MSME finances are:
    i. the Rs. 20,000 crore partially guaranteed subordinated debt programme
    ii. the Rs. 50,000 crore fund of funds scheme
- **NBFCs -** NBFCs, housing finance firms and micro finance entities got a much-required liquidity boost.
- A Rs. 30,000 crore scheme is announced wherein their debt paper will be fully guaranteed by the government.
- This works along with the partial credit guarantee scheme of Rs. 45,000 crore.
- With these, the government has broken the logjam wherein banks were unwilling to extend credit despite the RBI's strong push.
- This will largely address the liquidity crisis in the non-banking space for now.
- **DISCOMS** - The liquidity issues of power distribution companies were addressed through a Rs. 90,000 crore infusion.
- This will be securitised on their receivables and backed by a State government guarantee.



What are the shortfalls?

- The finer details of the debt programme and the funds scheme for MSMEs should be more clear.
- The government could have specified the interest cap on the loans without leaving it to individual lenders.

- Now each of them has its own rate structure.
- Again, the scheme could have been extended until the end of this financial year instead of until October 31, 2020.

What is the overall objective?

- The announcements are focused on the liquidity part of the crisis.
- The reality is that the government will be called upon to bear the liability of these big numbers only if the economic situation becomes hopeless.
- But, hopefully, it may not come to that point.
- So, the announcements have in effect addressed the issue of lack of confidence in the credit market.
- Notably, liquidity was always there but only for the most credit-worthy of borrowers.
- The government has now just given the assurance to lenders and borrowers that it is willing to support their commitments.
- This is the signal that MSMEs and their lenders needed and so, overall, the measures are welcoming.

7.2 MSMEs and Economic Lockdown

What is the issue?

With economy on a standstill in times of the lockdown, here is a look at its impact on micro, small and medium enterprises (MSMEs) and the modes of financing them.

What comprises the MSME sector?

- MSME sector form the second-biggest employer in the country with a 31% share in India's GDP.
- Section 7 of the MSMEs Development Act, 2006 specifies the size of the MSMEs on the basis of investment.
- Among manufacturing units, micro enterprises are those that have invested up to Rs 25 lakh in plant and machinery.
- The comparable figure for small units is Rs 25 lakh-Rs 5 crore and for medium units, Rs 5 crore-Rs 10 crore.
- For services, the investment thresholds are lower - up to Rs 10 lakh, Rs 10 lakh-Rs 2 crore and Rs 2 crore-Rs 5 crore respectively for the categories.

Why do they need more attention now?

- Unlike big industries, the MSMEs' resilience during the current crisis is lower.
- Many of the MSMEs are probably eating into their capital to stay afloat.
- The RBI has already asked banks to offer a three-month moratorium on loan repayments by such units.
- Beside, the RBI has arranged for opening a window from where banks can borrow money and lend to the sector.
- However, banks are afraid of loans given to these units turning bad.

How has the credit support been?

- A recent study shows that the MSMEs' exposure to the financial system in December 2019 was Rs 11.04 trillion.
- Of these, the share of very small businesses (up to Rs 10 lakh exposure) is Rs 54,000 crore.
- In December, in commercial credit (excluding agriculture and retail), the share of MSMEs (up to Rs 50 crore exposure) was a little less than 28%.

- The maximum loans were in the Rs 1 crore-Rs 15 crore basket (Rs 8.74 trillion), followed by Rs 15 crore-Rs 50 crore (Rs 4.68 trillion).
- Notably, the corpus of less than Rs 10 lakh loans was the smallest, at Rs 93,000 crore.
- Maharashtra has the maximum share of MSME credit, 17.36%, followed by Tamil Nadu (10.77%), Gujarat (8.85%), Delhi (7.13%) and UP (6.5%).

How creditworthy are MSMEs?

- Loans to the MSME segment had grown 4.7% between December 2018 and December 2019.
- Indeed, the bad loans in the segment have been on the rise over the past few years and reached 12.6% in December 2019.
- The study keeps the Rs 2.32 trillion MSME exposure of banks in the highest risk bracket (of this, the micro units' share is just about Rs 13,600 crore).
- But there are millions of creditworthy borrowers outside this.
- The study has found that 74% of the close to 8.9 million MSMEs is creditworthy.
- The banks must grab this opportunity to fuel growth in the economy as well as their loan books.

What are the other hurdles in financing MSMEs?

- The banking system is the main source of money for the MSME segment.
- Added to this, the microfinance institutions (MFIs) meet the credit needs of retail borrowers at the so-called bottom of the pyramid.
- Notably, there is not much stress in the portfolio of micro loans offered by the MFIs and NBFCs (non-banking financial companies).
- So, presently, they are not suffering from risk aversion but most of them do not have the money to lend.
- Initially, the banks were reluctant to offer moratorium to the MFIs and NBFCs on their repayment of loans to the banks.
- They had felt that it was meant for the loans given for productive purposes and not to financial intermediaries.
- Now, most banks are offering the moratorium to MFIs too.
- But the Small Industries Development Bank of India (SIDBI) and Micro Units Development and Refinance Agency Ltd (MUDRA) are not that liberal.
- Notably, these two government agencies have around Rs 3,000 crore of exposure to the MFIs.
- Apparently, the NBFCs and MFIs borrow primarily from banks and on-lend to their customers.
- If the banks close the outlet, then NBFCs and MFIs cannot survive, which could in turn hamper the economy; this needs intervention.

7.3 Trade Ban on China

What is the issue?

- The Indian government has responded to the border dispute with China by training its guns on trade.
- Turning a defence dispute into a trade one is an ill-advised move.

What are the reasons that say this is an ill-advised move?

- **Trade deficits are not necessarily bad** - Having a trade deficit against a country does not make the domestic economy weaker.

- If one looks at the top 25 countries with whom India trades, it has a trade surplus with the US, the UK and the Netherlands.
- But, that does not mean the Indian economy is stronger than these three.
- Similarly, it has a trade deficit with the other 22 of them (including China), regardless of their size and geographic location.
- Yet, a trade deficit with China only means that Indians buy more Chinese products than what Chinese from India.
- But per se that is not a bad thing as it shows that Indian consumers, as well as the Chinese producers, gained through trading.
- Both sides are better off than what they would have been without trade.
- While a persistent trade deficit merits the domestic government to put in place policies and create the infrastructure that raises competitiveness.
- **Will hurt the Indian poor the most -** The poorest consumers are the worst-hit in a trade ban because they are the most price-sensitive.
- Similarly, the Chinese products that are in India are already paid for.
- By banning their sale, Indians will be hurting fellow Indian retailers.
- Again, this hit would be proportionately more on the poorest retailers because of their relative inability to cope with the unexpected losses.
- **Will punish Indian producers and exporters** - Some may argue that trading with China hurts many Indian producers.
- This is true, but it is also true that trading hurts only the less efficient Indian producers while helping the more efficient Indian producers.
- Several businesses in India import intermediate goods and raw materials from China.
- These, in turn, are used to create final goods - both for the domestic Indian market and the global market (as Indian exports).
- A blanket ban on Chinese imports will hurt all these businesses at a time when they are already struggling to survive.
- This ban will also hit India's ability to produce finished goods.
- **Will barely hurt China -** In any case, India has trade deficits with most countries so why single out China.
- Still, some may argue that we want to single out China because it has killed our soldiers at the border.
- If India and China stop trading, China would lose only 3% of its exports and less than 1% of its imports.
- But India will lose 5% of its exports and 14% of its imports.
- In the short to medium term, it would be both difficult and costly to replace Chinese products.
- India and Indians will be far more hurt than it will hurt China.
- **India will lose policy credibility** - It has also been suggested that India should renege on existing contracts with China.
- This would be hugely detrimental for India, which has been trying to attract foreign investment.
- One of the first things an investor tracks is the policy credibility and certainty.
- If policies can be changed overnight, or if taxes can be slapped with retrospective effect, no investor will invest.
- Or, if they do, they will demand higher returns for the increased risk.

- **Raising tariffs is mutually assured destruction** - It has been argued that India should slap higher import duties on Chinese goods.
- Others suggested that India can allow primary and intermediate goods from China at zero duty, but apply prohibitive tariffs on final goods.
- This would be in violation of the rules of the World Trade Organization.
- Also, it is relatively easy for the world to bypass India and carry on trading if India does not play by the rules.

7.4 Ban on Chinese Apps

Why in news?

India has banned 59 apps originating from China, including very popular ones like the TikTok, UC Browser, ShareIt, and CamScanner.

What is the legal basis for India's action?

- The ban has been enforced under Section 69A of the Information Technology Act, 2000.
- It offers the power to issue directions for blocking for public access of any information through any computer resource.
- This is done in the interest of -
    - i. sovereignty and integrity of India
    - ii. defence of India, security of the State
    - iii. friendly relations with foreign States
    - iv. public order (or)
    - v. for preventing incitement to the commission of any cognizable offence relating to above
- The Ministry of Information and Technology said that it has received many complaints in this regard.
- There were reports on misuse of some mobile apps.
- There was stealing and secretly transmitting users' data in an unauthorised manner to servers that have locations outside India.
- The notification is expected to be followed by instructions to Internet service providers to block these apps.
- Users will soon see a message saying access to the apps has been restricted on the request of the government.
- [The list of the banned apps is provided below]

1. TikTok
2. Shareit
3. Kwai
4. UC Browser
5. Baidu map
6. Shein
7. Clash of Kings
8. DU battery saver
9. Helo
10. Likee
11. YouCam makeup
12. Mi Community
13. CM Browers
14. Virus Cleaner
15. APUS Browser
16. ROMWE
17. Club Factory
18. Newsdog
19. Beutry Plus
20. WeChat
21. UC News
22. QQ Mail
23. Weibo
24. Xender
25. QQ Music
26. QQ Newsfeed
27. Bigo Live
28. SelfieCity
29. Mail Master
30. Parallel Space
31. Mi Video Call – Xiaomi
32. WeSync
33. ES File Explorer
34. Viva Video – QU Video Inc
35. Meitu
36. Vigo Video
37. New Video Status
38. DU Recorder
39. Vault- Hide
40. Cache Cleaner DU App studio
41. DU Cleaner
42. DU Browser
43. Hago Play With New Friends
44. Cam Scanner
45. Clean Master – Cheetah Mobile
46. Wonder Camera
47. Photo Wonder
48. QQ Player
49. We Meet
50. Sweet Selfie
51. Baidu Translate
52. Vmate
53. QQ International
54. QQ Security Center
55. QQ Launcher
56. U Video
57. V fly Status Video
58. Mobile Legends
59. DU Privacy

What is the impact of the ban?

- Some apps on the banned list are very popular in India.
- The TikTok app, especially, has over 100 million active users in the country.
- About 30% of TikTok's downloads is said to be coming from India.
- Google-owned YouTube has more users in India than TikTok.
- But TikTok was seen as having more potential in terms of personalisation of content and overall influence.

- TikTok made relentless push into India's hinterland. Evidently, the app supports over 15 Indian languages.
- This enabled the app to work on regional talent in a very personalised manner.
- New social media platforms like Helo and Likee, as well as video chat app Bigo Live, are immensely popular among Indians who are not comfortable in English.
- These users will have to look for substitutes.
- Also, most of these platforms have Indian creators, for many of whom this is the only source of income.
- Many of these apps have offices and employees in India, and a few thousand jobs could be at stake now.

Has TikTok been banned earlier?

- TikTok has been blocked in India once earlier.
- In, May 2019, in the run up to the general elections, the government banned the app's downloads for 2 weeks following a Madras High Court ruling.
- The Court observed that it could expose children on the app to graphic content or predators.
- TikTok had appealed and the court subsequently reversed its ruling.
- But this time, though, the ban could be there to stay.

How strategic is the move and how does it impact China?

- The move comes as an exercise of coercive diplomacy with China amid the tense standoff in Ladakh.
- The decision has been taken in a specific strategic and national security context.
- So, it could be a warning to bigger Chinese businesses in India, and to China itself.
- However, the government has, for now, picked up a low-denomination item - mobile apps.
- This has only a limited impact on Indian businesses.
- But it has a disproportionately large presence in the mass consumer segment.
- This may not hurt India given the alternatives in the app space.
- But for China, the Indian app market is growing and valuable.
- More so because internet costs here are one of the lowest in the world, and consumers number over 800 million.
- Nearly half of these smartphone users are below 25 and hungry for content on their devices.
- A decision at stopping physical goods could have been challenged by China at the WTO.
- Instead, this move focuses on the technology sector.
- A ban on physical goods would have also adversely affected India's business and economy while hardly making a dent on China's.
- The move is thus being seen as one that could be more effective from New Delhi's perspective.

7.5 GeM's Country of Origin Flag

Why in news?

The government made it mandatory for sellers on the GeM portal to clarify the country of origin of their goods when registering new products.

What is the GeM portal?

- Government e-Marketplace (GeM) is the Commerce Ministry's online marketplace.

- It procures goods and services by various Ministries and government bodies.
- Products sold on the portal range from stationery used by government officials to medical products that are used on patients.

What does this decision mean?

- The GeM portal will now have the **'country of origin' flag** for their products.
- The portal already has a **'Make in India' filter**.
- Therefore, the government offices can ascertain which products have a higher content of indigenously produced raw materials.
- This would help them choose products that meet the 'minimum 50% local content' criterion when selecting bidders for their tenders.
- The portal now allows buyers to reserve a bid for Class I local suppliers, or suppliers of those goods with more than 50% local content.
- For bids below Rs 200 crore, only Class I and Class II (those with more than 20% local content) are eligible.

Why this decision was taken?

- The decision comes in the backdrop of the government's **push for Aatmanirbhar Bharat**.
- [Aatmanirbhar Bharat intends to promote self-reliance by boosting the use of locally produced goods.]
- The decision also follows the **clashes between the troops of India and China** in Galwan Valley.
- This prompted several government departments to launch an offensive against imports from China.
- The Confederation of All India Traders is pushing for a country of origin tag in the private e-commerce firms.

What would be the impact?

- Over the time, the use of imported goods in government offices and facilities may be filtered out, as the following are combined,
    1. Announcement of the 'country of origin' of the products sold on the GeM portal,
    2. Make in India campaign &
    3. A push for Aatmanirbhar Bharat.
- This might provide an opportunity to Indian manufacturers across industries to push their products in government facilities.

7.6 Policy on Strategic Sectors - Privatisation

Why in news?

The central government has said that guidelines on the privatisation of the public sector companies would be out soon, along with the policy on strategic sectors.

What does strategic and non-strategic sectors mean?

- Currently, there is no clear definition of strategic sector.
- According to some regulatory purposes, only space and atomic energy are considered strategic.
- The Railways is categorised as a sector involving social good, and so eligible to be in the government sector only.
- Now, Banking, insurance, defence, and energy are likely to be part of the strategic sector list, which is expected to have as many as 16 sectors.

- Under the new definition, non-strategic sectors will include hotel & tourist services, transportation vehicle & equipment, industrial & consumer goods, trading & marketing, and transport & logistics.

What is the proposed plan?

- The government had announced the Atmanirbhar Bharat economic support package in May 2020.
- The Finance Minister had said that the proposed policy would notify the list of strategic sectors.
- These would require the presence of at least one state-owned company along with the private sector.
- In all other sectors, the government plans to privatise public sector enterprises, depending upon feasibility.
- The number of enterprises in strategic sectors will be only one to four, to minimise wasteful administrative costs.
- Others would be privatised/merged/brought under a holding company structure.
- The policy will put out a "general framework."
- Specific decisions, on which company is to be privatised, merged, or put under a holding company structure, would be taken later on.
- This is expected to be a long-term process rather than a one-time move on the privatisation of companies.
- After inter-ministerial consultations to finalise strategic sectors, the policy will be put up before approval of the Union Cabinet.

What is the significance?

- This is the first time since 1956 that the government has said it will not have state-owned companies in the non-strategic sector.
- In other words, there will be complete privatisation of companies in the non-strategic sectors once the strategic sectors policy is in place.
- Also, the number in the strategic sectors is said to be reduced.

What is the possible sector-wise categorisation?

- Nuclear Power Corporation of India, Antrix Corporation and PowerGrid will be among a small handful of state-owned companies to continue to enjoy immunity from privatisation.
- Indian Railways, National Highways Authority of India and Food Corporation of India will obviously remain under full government control.
- These are monolithic entities supported by specific Central laws.
- They also have functions inseparable from well-entrenched, flagship government policies.

What are the ongoing processes?

- The government has already set in motion privatisation plans for large PSU companies.
- These include BPCL, Air India, Container Corporation of India, and Shipping Corporation of India.
- Budget 2020-21 had announced plans -
    i. to sell part of the Centre's stake in Life Insurance Corporation (LIC) through an initial public offer (IPO)
    ii. on the sale of equity in IDBI Bank to private, retail and institutional investors

What are the expected changes?

- The policy offers significant scope for large-scale privatisation and/or consolidation of central PSUs.
- The emphasis on privatisation could see companies in chemicals and infrastructure space being privatised.

- The move could also see the entry of private players into atomic energy and space sectors.
- However, the sole state-run entities in these sectors (Nuclear Power and Antrix) will retain their public sector character.
- The government has also stated its intent to reduce the number of state-owned banks, with government having just few very large banks under its fold.
- This could see some smaller banks being privatised in due course.
- A holding company structure could also be used to house equity of smaller banks in one entity.

7.7 The Companies (Amendment) Bill, 2020

Why in News?

The Companies (Amendment) Bill, 2020 was introduced in the Lok Sabha in March 2020.

Why this Bill was introduced?

- The Ministry of Corporate Affairs (MCA) wanted to facilitate ease of doing business in India.
- It also wanted to decriminalise the Companies Act, 2013.
- Therefore, it introduced the Companies (Amendment) Act, 2019, and the Companies (Amendment) Bill, 2020.

What did the Companies Act, 2019 do?

- It decriminalised 16 sections of Companies Act, 2013 to civil violations.
- It eliminates the criminality of these violations by levying monetary penalties instead of criminal fines.
- Levying these penalties has been shifted from courts to in-house adjudication mechanisms (IAM) under Section 454 of the Act.
- The adjudicating officers who are to be appointed by the Central Government determine the offences.
- These officers also enable companies to promptly communicate, represent, and resolve defaults.

Why was the CLC, 2019 constituted?

- The Company Law Committee (CLC) was constituted to further decriminalise the 2013 Act.
- It decriminalises the technical and minor non-compliance.
- But, it retains the strict criminal enforcement for serious, fraudulent offences that jeopardise and prejudice public interest.
- This decriminalisation will instil confidence in both domestic and global players and boosts foreign investments.

What did the Companies (Amendment) Bill, 2020 propose?

- Based on the recommendations of the report, the Bill proposes to decriminalise the Act under the following frameworks.
- **Re-categorization of 23 compoundable offences to the IAM -**
- Offences that do not involve objective determination and that are easily determined by the MCA21 system may be treated as civil wrongs.
- The IAM framework will determine these offences.
- **Omission of 7 compoundable offences** - These offences proposed to be omitted are those that may be dealt with through other laws.

- **Limiting 11 compoundable offences to criminal fine only** - These are offences that are substantial enough to warrant criminal liability, but don't warrant punishment by incarceration upon conviction.
- **Alternate framework for 5 offences** - This proposal could better achieve the intended aim of certain penal provisions in the Act with the company liquidator.
- For this, the corresponding provisions of the Insolvency and Bankruptcy Code (IBC) may be inserted.

What is the significance?

- **Lesser penalties for certain offences**: For this, the Section 446B is amended.
- Non-compliance by certain type of companies or by any of its default officer are only liable to one-half the penalty specified in the respective provisions.
- **Benefit to IDs**: The amendments are vital for Independent Directors (IDs) to dissociate them from personal liabilities of the operational lapses and violations.
- The Ministry's notification directs that unless there is sufficient evidence, civil or criminal proceedings should not be initiated against the IDs.
- It added that if the proceedings were already initiated, they must be reviewed.
- These recommendations seek to accelerate the processes of rectifying defaults by paying penalties, instead of fighting a criminal trial.

What goals do these amendments seeks to achieve?

- These amendments are admirable steps towards the 3-pronged goal of:
    1. Reducing the burden on company courts,
    2. Ensuring investor interests, and
    3. Facilitating the ease of doing business while collaterally incentivizing senior management to remain invested.
- This could well be the step towards showing intent to incentivize domestic and global investments, especially post COVID-19.

7.8 National Policy on Migrant Labour

What is the issue?

- Insecurities (job, income and food) coupled with a fear psychosis forced migrant workers to reverse migrate to their homes.
- There is a need for a national policy on migrant labour to protect the interests of the migrant workers.

What is the condition of migrant workers?

- The migrant workers account for 20% of the total workforce.
- They are said to be responsible for 10% of GDP.
- But, they are paid less and are denied formal contracts even though they work harder and put in longer hours.
- They are not given gratuity or medical benefits and are not entitled to any leave with pay.
- When at work, they do not have adequate occupational safety.
- Out of work, they lack a social safety net.
- They lack political support as they are disenfranchised (they rarely get an opportunity to cast their vote).
- The local population hates them as they are seen as job-stealers.

Why do they still migrate?

- Even under the above circumstances, they continue to migrate for work.
- This is because they earn much more than what they can back home.
- Despite the relatively poor pay, they manage to save and wire money back home to supplement the family's income.
- But the traumatic experience they were subjected to post-lockdown would deter them from migrating in search of work again.

What is the current reality?

- With lockdown easing across the country and manufacturing picking up pace, industry is beginning to miss the migrant workers.
- Some companies in host States have already sent buses all the way to Odisha, UP and other home States to fetch the workers.
- Migrant workers, on their part, have realised that there is no way they can earn enough staying back in their villages.
- The demand for jobs under MGNREGS is far more than what is being offered.
- The migrant workers' return is critical for the country's rapid economic revival post-Covid.
- But, it is only fair that when they do come back, they are treated with the respect they deserve.

What is the existing legislation?

- Inter-State Migrant Workmen Act, 1979 is a law to prevent exploitation of migrant labour.
- It calls for registration of all establishments employing migrant labour and licensing of contractors.
- Contractors are mandated to provide details of immigrant labour they have deployed to the relevant authority.
- They should also ensure regular payment, suitable accommodation, no discrimination, free medical facilities and protective clothings.
- There is a reason why this law has remained just on paper.
- It is onerous to implement and makes the cost of hiring a migrant labour more than a local.
- Yet another case of an over-enthusiastic bureaucrat defeating the very purpose for which the law was made.

How would a policy protect the migrant workers' interests?

- The national policy should ensure that a migrant worker's economic, social and political rights are protected.
- They should not be discriminated against when it comes to pay and other benefits that regular workers get.
- They should be registered and given an ID which can be linked to their Aadhaar and Jan Dhan account.
- Once this is done, the government can use direct benefit transfer to send their benefits.
- The Government's plan to have a one nation-one ration card will help them source their entitlements from whereever they are based.
- Similarly, their voter ID card has to be made portable.
- The policy should also ensure that contractors and the employers are made accountable when they employ migrants.
- Efforts should be made to skill/re-skill the labourers and a national registry created for them based on their skills.

7.9 Assemble in India

What is the issue?

- There is a proposal to promote 'Assemble in India' as a ground for 'Make in India'.
- This move may revive Indian exports which have failed to compete in global markets, but widens the skills gap.

What is the export status of India?

- India has the lowest manufacturing share in gross exports in Asia.
- India is no longer the fastest growing economy in the region.
- It lags behind Bangladesh, Vietnam and Cambodia in terms of growth performance.
- Weakening of exports is a gloomy sign for India's already deteriorating GDP growth, which is estimated to decelerate to 5% in 2019-20.
- When the production process is getting fragmented globally, the idea to boost production alone does not go very far in alleviating exports.
- Nor does it help the 'Make in India' cause of the government.

What is the 'Assemble in India' proposal?

- The Economic Survey 2019-20 proposed a scheme to **integrate 'Assemble in India' into 'Make in India'**.
- This will encourage Multinational enterprises to begin assembling the network products in India.
- The Economic Survey predicts that by this integration, 4 crore well-paid jobs can be created by 2025 and 8 crore by 2030.
- The estimate of creating 8 crore jobs is based on the premise that India can increase its world export share of network products from 0.6% currently to 6% by 2030.
- This is premised assuming that India can mimic China's export performance during the first decade of the China's export market entry in network products.

What does it mean if these estimates are true?

- If these estimates are believed to be true, then the country is heading towards a **widening skills gap**.
- A chunk of jobs created by India's export of network products has been for workers with above secondary education.
- This is in sharp contrast to the corresponding share in case of overall manufacturing exports.
- The **requirement for high-educated workers** is only going to **rise** at the cost of uneducated and less educated.
- This is so, as the transnational companies are the ones that largely control the production process of network products.
- Greater integration into Global Value Chains (GVCs) for network products will require India to close the quality gap faced among its peers, requiring its manufacturers to leapfrog to newer technologies.

What will be the consequences?

- A World Economic Forum study (2018) - The adoption of Industry 4.0 may impact low-skilled employees because of their vulnerability to automation.
- In the process, the less educated workers are likely to remain excluded.

- While integrating into GVCs seems the way forward, one must be mindful of the distributional consequences on the jobs so created.
- The employment and wage gains through GVC integration have been largely biased towards more skilled workers.

7.10 Regulation of Indian Pharmacy Market

What is the issue?

- Earlier, large investors shied away from investing in the online pharmacy sector due to lack of proper regulations.
- But now, there is a sudden increase in activities in the sector.

What are the recent activities?

- India's online pharmacy market recently saw two significant merger and acquisition deals.
- Also, the e-commerce giant Amazon has launched its online drug delivery services.

Is the activity in the online pharma space a result of Covid-19?

- Covid-19 and the subsequent behavioural shift towards e-commerce may have catalysed growth for online pharmacies.
- But, the sector was already poised to grow 7-fold by 2023 to $2.7 billion.
- This was mainly due to the challenges faced by physical pharmacies that gave their online counterparts a problem to solve.
- Experts believe that e-pharmacies will be able to solve the problems that traditional pharmacies couldn't.
- But for this, they need to have a large-scale presence that calls for either huge investments or consolidation.

How the Indian pharmacy market is currently shaped?

- India has a fragmented market with over 8 lakh pharmacies.
- This gives online pharmacies an opportunity to capture their space without opposing large traditional retailers.
- Currently, companies in the Indian e-pharmacy space mainly operate three business models:
    1. Marketplace,
    2. Inventory-led hybrid (offline/online) and
    3. Franchise-led hybrid (offline/online).
- These models are dependent on the way the supply chain is structured.

What are the rules governing the pharmacy sector?

- The government had floated draft regulations for e-pharmacies but these guidelines never saw light of the day.
- The lack of proper rules governing the online pharmacy space has kept large investments at bay.
- But, it has allowed the existing players in the market to grow and overcome the challenges faced by traditional retailers.
- For pharmacies overall, India's drug regulations require retailers to get a licence to dispense medicines from the state in which they are being sold.

What are the rules governing the e-pharmacy sector?

- As the e-pharmacies are not regulated currently, their operations are mostly met with opposition from brick and mortar chemists.

- In the absence of clear regulations, online pharmacies currently operate as marketplaces.
- They cater to patients as a platform for ordering medicines from sellers that adhere to the Drugs and Cosmetics Act and Rules of India.
- Other regulations, like the Information Technology Act and the Narcotic Drugs and Psychotropic Substances Act, also apply.
- Works on regulations specifically for e-pharmacies have been in progress for several years now.

What do the draft e-pharmacy regulations propose?

- **Definitions** - Draft rules sought to define the online sale of medicines.
- It also defined what an e-prescription is and what type of licences online firms would need to get from regulators to operate.
- It also proposed to define e-pharmacies in a way that would allow them to distribute, sell and stock medicines.
- The proposed regulations prevent them from selling habit-forming drugs like cough syrups specified in Schedule X of the Indian drug regulations.
- **Licence -** It also proposed to allow e-pharmacies to get a central licence to operate from the country's apex drug regulator.
- This licence could be used to allow them to operate across the country.

What is the status of the regulation?

- Regulations for online pharmacy players have been in the works since 2016 but are yet to come out.
- The last attempt to clear these regulations saw the draft rules being pushed through two expert committees under the CDSCO in 2019.
- [Central Drugs Standard Control Organisation (CDSCO) is India's apex drug regulatory body.]
- That iteration of the proposed regulations suggested the inclusion of provisions for uploading e-prescriptions.
- However, the regulations ended up with a high-level group of ministers said to include certain top ministers.

8. INFRASTRUCTURE

8.1 Unified Ministry for Energy Sector

What is the issue?

A single unified ministry for the energy sector is necessary to ensure energy security, sustainability and accessibility.

How is the energy sector currently managed?

- Five different ministries along with a multitude of regulators govern India's energy sector.
- Petroleum and natural gas, coal, renewable energy and nuclear energy have separate ministries or departments.
- There is the Ministry of Power, along with State-level bodies that regulate electricity distribution companies (DISCOMS).
- Moreover, there are different regulators for each type of fuel and energy source.
- This makes it cumbersome for businesses operating in the energy sector.
- Further, the petroleum and natural gas sector has two regulators:
    i. Directorate General of Hydrocarbons for upstream activities

ii. Petroleum and Natural Gas Regulatory Board for downstream activities

What are the constraints in data management?

- No single agency collects energy data in a wholesome and integrated manner.
- Data pertaining to consumption are barely available.
- There are also shortcomings in the supply side data collected by agencies of respective ministries.
- The Ministry of Statistics and Programme Implementation collates data available from various ministries.
- It also conducts surveys at sporadic intervals.

How is the governance model?

- On the energy efficiency front, the Bureau of Energy Efficiency is the sole statutory authority.
- Its mandate is to regulate energy efficiency on the consumption side.
- There is no agency or body for the same purpose on the supply side.
- This stands in stark contrast to most other nations with their varied energy governance models.
- Developed countries such as the U.S., U.K., Germany, and France have their energy sectors administered by a single ministry or department.
- There are also instances where the energy ministry is in conjunction with other portfolios such as environment, climate change, mines and industry.
- E.g., the U.K. - "Department for Business, Energy & Industrial Strategy", France - the "Ministry of the Environment, Energy and Marine Affairs"

How will a unified ministry help?

- A single unified ministry of energy would help India to have an integrated outlook on energy.
- This would enable India optimise the limited resources to meet the goals of energy security, sustainability and accessibility.
- A single energy ministry would also allow for a quicker policy response.

What are the recommendations in place?

- The Kelkar Committee has highlighted the issue in its report "Roadmap for Reduction in Import Dependency in the Hydrocarbon Sector by 2030" (2013).
- It says that presence of multiple ministries and agencies present challenges of coordination and optimal resource utilization.
- These drawbacks undermine the efforts to increase energy security in India.
- In the Draft National Energy Policy (NEP), the NITI Aayog has advocated that a Unified Ministry of Energy be created.
- This is suggested by merging the Ministries of Petroleum and Natural Gas (MoPNG), Coal (MoC), New and Renewable Energy (MNRE) and Power (MoP).
- The Department of Atomic Energy (DAE) has been left out as it has implications beyond the scope of energy, involving national security issues.
- The proposed ministry would have 6 agencies under it to handle various aspects of the energy sector.
- These are the agencies of Energy Regulatory, Energy Data, Energy Efficiency, Energy Planning and Technical agency, Energy Schemes Implementation and Energy R&D.

8.2 Restructuring Railways

Why in News?

- The Cabinet has recently decided to merge all central service cadres of Railways officers into a single service.
- It has also approved the trimming of the Railway Board from a nine-member board to a five-member one.

What are the decisions taken?

- **IRMS** - All the central service cadres of Railways officers will be merged into a single Indian Railways Management Service (IRMS).
- Now, any eligible officer could occupy any post, irrespective of training and specialisation, since they all will belong to IRMS.
- **Board** - The five members of the Board, other than a Chairman-cum-CEO, will be the Members Infrastructure, Finance, Rolling Stock, Track, and Operations and Business Development.
- The Board will also have independent Members, who will be industry experts with at least 30 years of experience, but in non-executive roles, only attending Board meetings.
- The move has led to protests from serving civil servants, prompting the Railway Board to reach out to them to allay their concerns.

What is the present system like?

- The Indian Railways is governed by a pool of officers, among whom engineers are recruited through the Indian Engineering Service Examination, and civil servants through the Civil Services Examination.
- The **civil servants** are in the Indian Railway Traffic Service (IRTS), Indian Railway Accounts Service (IRAS) and Indian Railway Personnel Service (IRPS).
- The **engineers** are in five technical service cadres: Indian Railway Services of Engineers (IRSE), Mechanical Engineers (IRSME), Electrical Engineers (IRSEE), and Signal Engineers (IRSSE); and the Indian Railway Stores Service (IRSS).

Why was the reform needed?

- The government wants **to end inter-departmental rivalries**, which it says have been hindering growth for decades.
- Several committees including the **Bibek Debroy committee** (2015) have noted that "departmentalism" is a major problem in the system.
- The Debroy report recommended merging of all services to create two distinct services: Technical and Logistics.
- But it did not say how to merge the existing officers.
- A separate exam under the Union Public Service Commission is proposed to be instituted in 2021 to induct IRMS officers.

Why are officers opposed to the move?

- The opposition started with a proposal to merge officers in the eight services to prepare a common seniority list and a general pool of posts.
- Those protesting the government's decision say that the merger is unscientific and against established norms.
- They say that the proposal is trying to merge two fundamentally dissimilar entities, with multiple disparities.
- The civil servants come **from all walks of life** after clearing the Civil Services Examination, not like the engineers who usually sit for the Engineering Service examination right after getting a degree.

- Various studies have noted that engineers join the Railways around the age of 22-23, while the civil servants join around 26, barring exceptions.
- The **age difference** starts to pinch at the later stages of their careers, when higher-grade posts are fewer.
- There are **more engineers** than civil servants.

How pronounced is this skew?

- The Railways have legitimised a system wherein an officer with a certain number of years left in service will be considered eligible for **general-management higher posts**.
- The most important of these posts is the General Manager post, who heads zones and production units.
- An officer, irrespective of seniority in his batch and acumen, requires at least two years of service left for being eligible for GM.
- The civil servants have often found themselves at a disadvantage since they don't have the required service tenure left.
- In the fields where the Railways are actually operated, the share of civil servants in junior-to-middle levels is over 40%, but in higher management, it is around 16-17%

What will change with the restructure?

- In inter-departmental seniority, problems arise when different services compete for posts that are open to all like those of Divisional Railway Managers (DRMs), GMs and the Chairman Railway Board.
- If all present cadres are merged and higher departmental posts become open to all, **engineers may end up occupying most posts**, if not all.
- Another aspect is the **suitability of jobs**.
- The move emerges from the belief that while non-technical specialists cannot do technical jobs, technocrats can do both.
- The **counter-argument** is that civil servants in government, by virtue of the screening process and subsequent training, possess acumen and skills that go beyond academic specialisation.

How did the Railways get here?

- Departmental posts are ring-fenced; promotions happen within each department from officers of that service.
- A department needs a constant supply of posts in higher grades to keep promoting its seniors so that the juniors keep getting timely promotions.
- In the Railways, this has happened either organically when the government restructured the cadres and created new posts at intervals of several years, or through the execution of projects.
- For execution of each project, departments could create **temporary "work-charged" posts**, funded by the particular project for itself.
- Departments would seek more projects since the by-product was more work-charged posts and that meant more promotional avenues for the department's officers.
- In the cadre-restructuring exercise, overseen by the Cabinet and the Cabinet Secretary, **work-charged posts have been banned**.
- But a majority of the "temporary" posts were absorbed in regular cadres.

8.3 Integrated Housing Development

What is the issue?

- PURA (Provision of Urban Amenities to Rural Areas) was a policy measure to create a common development platform for rural and urban areas.
- Its potential goes beyond mere creation of economic infrastructure, and involves social infrastructure too, in which housing is a significant component.

What is PURA?

- There are growing disparities of material status in India.
- In this regard, PURA is a framework to mitigate the country's socioeconomic problems.
- It works at creating a common development platform for rural and urban areas.
- PURA is a scheme that proposes a holistic and accelerated development of compact areas around a potential growth centre in a Gram Panchayat(s).
- It is carried out through Public Private Partnership (PPP) framework.
- It aims at providing livelihood opportunities and urban amenities to improve the quality of life in rural areas.
- PURA's design goes beyond the mere creation of economic infrastructure and employment opportunities.
- It also aims to develop social infrastructure.
- To further this objective, access to good housing, including housing amenities, should become a priority.

What is the current housing scenario?

- Housing in rural areas is one sector that has consistently suffered from the lack of meaningful market interventions.
- Supply of developed land and financing for housing has been lacking.
- Due to incompatibilities in supply and demand, millions of Indians dwell in unsecured housing.
- This is largely driven by shortages in the supply of housing and a lack of redevelopment of collapsible or dilapidated units.
- Dilapidated units have contributed towards a high level of housing amenities deprivation.
- This is because they cannot safely be connected with electricity or solar energy, latrines, and drinking water, due to associated structural risks.

How does this reflect in poverty scenario?

- India did pursue effective poverty alleviation measures.
- But, in effect, the interventions carried out have hardly worked in minimising urban-rural divides.
- Officially, the incidence of housing-related poverty is in the order of 25.85 million.
- This is roughly 82% in rural areas and 18% in urban areas.
- Menial occupation workers and low-income earners have been facing these forms of poverty the most.
- The poor housing scenario has resulted in multiple deprivations of:
    1. 45% of rural families without electricity, biogas and LPG
    2. over 69% without household latrines
    3. over 82% of families without treated water for drinking at household levels
- Thus, the composite deprivation is in the order of over 58%.
- However, the regional picture depicts two contrasting scenarios of lower and higher levels, respectively, in 19 and 9 independent States.

- The lower range of deprivations is at around 20-52% and higher range at around 60-75%.
- These lead to higher rates of internal migration both due to dissatisfaction with housing arrangements and prospect of better housing elsewhere.

What do these call for?

- India needs an integrated housing development strategy for the rural context to be implemented in "mission mode".
- Most importantly, it requires political will as expressed in party election manifestos.
- Development interventions must focus on rural and urban areas with due consideration for new construction and redevelopment of existing, dilapidated units.
- There must also be accountability in terms of implementing the mission agenda on a continuous basis, with social audits at multiple levels of governance.
- Also, a realistic resource allocation is required given the cost of redevelopment and new housing units besides other development costs.
- For these, penetration of the market, including the cooperative sector for the supply of critical inputs such as land and finances, is essential.
- Public-private-partnership projects should be encouraged on public or government-owned lands, with fiscal and other incentives.
- Landowners should be encouraged to develop incentive-based affordable housing projects.
- The people facing housing poverty must be made partners.
- Micro finance and self-help groups could also be roped in to this end.

8.4 102 Lakh Crore Infrastructure Plan

Why in News?

Finance Minister Nirmala Sitharaman recently unveiled a plan to push the infrastructure investment adding up to Rs.102 lakh crore over the next 5 years.

What is NIP?

- Projects in **energy, roads, railways and urban infrastructure** under the National Infrastructure Pipeline (NIP) have been identified by a task force.
- About 42% of such identified projects are already under implementation, 19% are under development and 31% are at the conceptual stage.
- The NIP task force appears to have gone project-by-project, assessing each for viability and relevance in consultation with the States.
- Considering that the NIP will be like a window to the future, a constant review becomes paramount if this is not to degenerate into a mere collation and listing of projects.

What this push is a welcomed step?

- The government's push on infrastructure development will enable **ease of living, create jobs and increase demand** for primary commodities such as cement and steel.
- From this perspective, this push to invest in infrastructure is welcome.
- Identifying the projects to be put on the pipeline is the easy part.
- Implementing and commissioning them will be the more difficult one.

What are the hurdles that the NIP task force needs to watch out for?

- **Financial position -** The financing plan assumes that the Centre and the States will fund 39% each while the private sector will chip in with 22% of the outlay.
- Going by the present fiscal situation, it will be a challenge for the Centre to raise Rs.39 lakh crore, even if it is over the next 5 years.
- The financial position of States is even more perilous.
- **Steep private investment -** The Rs.22 lakh crore expected from private investment also looks steep considering the lack of appetite for fresh investment by the private sector in the last few years.
- Given the scale of investment, debt will play an important role and it remains to be seen if banks have gotten over their apprehensions on infrastructure financing as a major part of their bad loans originated there.
- **States' cooperation -** The cooperation from States becomes very important in implementing infrastructure projects.
- The experience on this count has not been very happy till now.

8.5 Stimulating the Aerospace Industry

Why in News?

Addressing an industry gathering, the Defence Minister spoke about a series of targets for increasing the aerospace and defence production of India.

What are the targets?

- He urged the **private sector to boost annual defence production** to $26 billion by 2025.
- He also stated that the government aims to **double the aeronautics industry's size** from Rs 30,000 crore to Rs 60,000 crore by 2024.
- This aim is to be achieved through measures such as encouraging the global aerospace industry to source aero components from India.
- He stated that efforts are made to double the number of the micro, small and medium enterprises (MSMEs) in aerospace and defence (A&D).

What is the current production?

- Of the current annual aerospace production of Rs 30,000 crore, Hindustan Aeronautics Ltd (HAL) accounts for over Rs 20,000 crore.
- The remaining one-third consists of offset related production by biggies and the export related production of aerospace components by MSMEs.
- MSMEs have embedded themselves into the global supply chains of industry leaders such as Boeing, Airbus, Bell Helicopters and others.
- These MSMEs need to meet the demand of international benchmarks of high-quality production and on-time delivery.

How the production target is to be met?

- There are structural and functional limitations to how much HAL can realistically expand production.
- Meeting the aerospace production target of Rs 60,000 crore would have to come through MSMEs that are manufacturing for the global supply chains of the large "original equipment manufacturers" (OEMs).
- To support these firms and enable their growth, the fundamentals need to be set right first.

What policy hindrances do Indian companies face?

- Indian government must recognise that our firms competing for global orders are up against rivals that are supported by their governments.
- These governments support them with tax and export incentives and infrastructure that almost invariably surpasses India's.
- The high cost of capital and lack of access to funds are the greatest deterrent to growth of the Indian companies.
- This resulted in a loss of business and a missed opportunity for creating jobs and skills.

How these policy hindrances are to be overcome?

- The government could create **A&D Fund** to provide low cost capital quickly to enable our MSMEs to grab fleeting business opportunities.
- The government must introduce these MSMEs to the overseas OEMs, with the tacit assurance that New Delhi backs its companies.
- Simultaneously, it government must incentivise global OEMs with tax incentives for working with Indian MSMEs.
- It would be worthy to change the criteria for defining an MSME in terms of annual revenue with an upper limit of Rs 500 crore.

What could be done academically?

- The government must shift the skilling emphasis from quantity (numbers put through training) to quality (ability imparted).
- The AICTE must allow industry participation in creating curriculum and training infrastructure in consonance with industry needs.
- Already, several companies run their own training curricula.
- The government could recognise these programmes as valid academic qualifications for career advancement.
- It must create a legal intellectual property (IP), patents and inventions protection system on a par with global standards.

8.6 Stocking Petroleum

Why in News?

The Indian government has decided to boost the petroleum stocks in strategic reserve of India.

Why this decision was taken?

- On April 1, the Brent crude oil was traded at a low price that was under $25 a barrel.
- Now the price of a barrel in the international market has rebounded.
- However, it is still almost $22 a barrel cheaper than the average of the past year, which was $57.70 per barrel.
- Therefore, one should make use of this low price situation and buy more oil barrels to stock up the nation's petroleum reserves.

What is India's storage capacity?

- India's storage capacity in its strategic petroleum reserve is at under 40 million barrels.
- This low capacity would not be convenient at this point.
- This would satisfy Indian demand for less than 10 days.

- However, there is space for only about additional 15 million barrels at oil-storage farms located in Mangalore, Vizag, and Padur.

Where the additional oil will come from?

- The government had made efforts to tie up with West Asian oil producers (The Gulf) to have them store their own oil on Indian soil.
- The government continues its attempts to buy over 5 million barrels from the United Arab Emirates and over 9 million barrels for Padur.
- It has directed the state-owned refiners to deal with the collapse in domestic demand.
- Therefore, these refiners operate at 50% capacity by storing their excess crude oil supplies in the strategic petroleum reserve.
- Details of how these refiners will be compensated are as yet unclear.

What is the current significance of storage?

- Storage is at a premium at the moment since across the world, oil facilities are filling up.
- The global storage capacity is over 6 billion barrels, but only 1.6 billion barrels worth of capacity is empty at this point.
- A shortage of storage capacity has forced some producers in the US to lower their prices below zero (i.e.) paying people to take away their oil.
- South Korea and China have been proactive in recent years in building up their oil storage capacity.

What should India prove?

- **Increasing the Capacity** - India has planned to build its additional storage capacity of almost 50 million barrels.
- This capacity would take India to just over 20 days' worth of imports in its reserves.
- India should seek to have more than a month's at least.
- **Stabilizer of market** - India should signal that it is a responsible consumer of petroleum by trying to stabilise the crude oil market.
- Supporting the effort to keep output flowing and addressing the storage deficit are important steps in that direction.

What are the pillars of the India-Gulf economic ties?

- **Strong bilateral economic ties**: the India-Gulf trade stood around $162 billion in 2018-19, being nearly a fifth of India's global trade.
- India's import of crude oil and natural gas from the Gulf meets 65% of its total requirements.
- Some of these countries have large Indian investments.
- **Number of Indian expatriates** in the Gulf states is about 9 million.
- They remitted nearly $40 billion back home.
- Both the intertwined pillars of India-Gulf ties have been affected by the recent pandemic and the reduction in oil price.

How the India-Gulf ties could be protected?

- In the longer run, we need to find new drivers for the India-Gulf synergy.
- This search could begin with cooperation in healthcare.
- This cooperation should gradually extend to pharmaceutical research, petrochemical complexes.

- Building infrastructure as well as the economic activities in bilateral free zones along our Arabian Sea coast may lead to an India-Gulf Cooperation Council Free Trade Area.

8.7 Electricity Amendment Bill, 2020

What is the issue?

- The Electricity Amendment Bill 2020, recently drafted by the Union power ministry will amend the Electricity Act 2003.
- Due to this Bill, a big challenge lies ahead for Punjab that provides free power to the agriculture sector.

What does the Bill propose to do?

- The new bill has proposed providing subsidy on power to farmers through Direct Benefit of Transfer (DBT).
- This would be different from the prevailing 'free power' system.
- Experts and farmers say that under the garb of DBT, it is a move to stop the free power supply to them.

What is the current system of power subsidy for farmers in Punjab?

- At present, Punjab is supplying free power to 14.16 lakh electricity-run tube wells of the agriculture sector.
- These tube wells are getting power through 5,900 Agricultural Pump set Feeders (APFs).
- These APFs are metered and the Punjab State Power Corporation charges the state government Rs 5.26 per unit for consumed units recorded in metered APFs.
- There are no individual meters installed on every tube well in Punjab, which is among the first states to separate agriculture sector feeders.
- Farmers are getting power supply for their Kharif and Rabi crops from these feeders as per the recommendations of the Punjab Agriculture University (PAU).
- It is supplied for around 8 hours every day in Kharif season and 4 hours on alternate days during Rabi crop season.
- Punjab government pays Rs 6,000 crore power subsidy bill to Punjab State Power Corporation Limited (PSPCL) every year under its 'free power scheme' to the farming sector.

What would change under the DBT allowed under the 2020 Bill?

- Under DBT, farmers will have to pay the bill for the power consumed for agriculture purposes.
- After that, they will get the subsidy in their bank accounts through DBT.
- A meter would be installed on every individual tube well.
- In Punjab, the consumption per tube well, having motors with power rating between 7.5 and 12 horse power (HP), is 8,000-9,000 units.
- So the annual power bill will come to around Rs 46,000 to Rs 48,000, and farmers are required to pay a bill of Rs 4,000 per month.
- In Punjab, 67% farmers come under the small and marginal categories with 1-2 hectares land.
- Paying bills in advance is not possible for them due to debt.
- If farmers don't pay their bills, the department will disconnect their connection.
- This could lead to several clashes in Punjab between PSPCL employees and farmers' unions as well as power theft.

Can it work like DBT on LPG gas cylinders?

- It may or may not, only time will tell, said experts.

- The bill suggests the subsidy be paid directly to consumers in cash on the pattern of LPG subsidy.
- This proposal should be tried in a pilot project and if results are encouraging, only then it should be included in the amendment bill.
- In the agriculture sector, free or subsidised power is being provided on the basis of a load of pump sets to consumers in every state without any provision of meter on the basis of fixed charges.
- It is impractical to provide meters on every pump set up across India and then give cash subsidy every month after the consumer has paid the bill.

How will it affect PSPCL?

- Currently, PSPCL is maintaining only 5,900 power meters installed on feeders.
- But as per the new bill, PSPCL needs to installed electricity meters on every tubewell.
- This will require at least Rs 1,200 crore along with 10% recurring charges on these annually.
- PSPCL needs to appoint more manpower to maintain it.
- It will be a huge burden on PSPCL too.

What do farmers' organisations think of this?

- **Protest -** Farmers' organisations say that if the Punjab government agrees to this bill, they will fight it tooth and nail.
- They ask, from where will poor farmers pay such heavy bills when they get income after six months following the sale of their crop.
- Farmers' organisations have planned to hold massive protests opposing the bill.
- **Data discrepancy -** Punjab government seems to be in favour of the bill when it says it will benefit 26 lakh farmers against the 10 lakh currently who own tubewells.
- According to PAU, there are around 12.50 lakh farming households in Punjab.
- Even if the division has taken place among the brothers, they share the water of the same tubewell connections, which are installed in their joint properties.

8.8 Major Port Authority Bill, 2020

Why in news?

The Union Cabinet has cleared the Major Port Authority Bill, 2020 and it is expected to breathe new life into government-owned major ports.

What is the government trying to do?

- The Union government's Sagarmala project (2015) was aimed at modernising major port infrastructure.
- Having invested in port infrastructure, the Cabinet has taken the next critical step to enable ports to control that new infrastructure - **operating policy reform**.
- So, it approved the Major Ports Authority Bill, 2020 to comprehensively overhaul the governance structure of major ports.
- This Bill seeks to replace a 1963 Act and it will be sunset time for the **Tariff Authority for Major Ports** (TAMP).

Why such regulation is needed?

- Indian state-owned ports or major ports (12 in number) account for around 55% of maritime cargo traffic in the country.

- But, they still have to adhere to a tariff and policy regime that has its roots in the 1960s.
- The TAMP is the central authority that sets tariffs for the ports.
- It also holds the master key for many other operational and commercial matters. This is just a lot for it to deal.
- As a consequence, a substantial chunk of trade has shifted to the "non-major" or "private" ports.

What are the benefits of shifting to private ports?

- These ports operate under a much more **liberal regime** and are under the control of state governments.
- They are **operationally more efficient** and are crucially developed better linkages to the hinterland to enable smooth traffic flows.
- Currently, the private sector is involved in major ports in areas like cargo handling.
- Much more is needed by way of investment in areas such as dredging and adding new terminals.
- [Dredging - Done to increase the depth of the port to accommodate larger ships.]

What is the 2016 version?

- The latest Bill approved by the Cabinet is expected to be along the lines similar to the 2016 version of the Bill.
- The 2016 Bill granted major ports greater autonomy, including the ability to set tariffs on their own.
- It also enabled the board of an individual **port to raise funds** from banks and financial institutions without taking the permission of the central government.
- It provided for the setting up of a **centralised adjudication board** to resolve disputes in PPP projects between the port and private sector concessionaires.

What is the importance of the Bill?

- These measures could lead to major ports becoming more attractive to the private sector, both in terms of investment and as service providers.
- These reforms are critical if the investments made in the last few years are to pay off.
- The recent measures like the Sagarmala project, developing port-based SEZs, etc., gave a boost to the shipping sector.
- With the approval of the Port Authority Bill by the Parliament, a critical missing link will finally be in place.

8.9 Real-Estate Investment Trust

Why in news?

The country's second real-estate investment trust (REIT), Mindspace Business Parks, came out with a public issue recently.

What is the REIT?

- Office REITs are investment vehicles.
- They own, operate and manage a portfolio of income-generating office properties in order to generate regular returns for investors.
- It is regulated by the Securities and Exchange Board of India (SEBI).
- REITs are usually commercial properties that are already generating rental income.
- For now, in India, there are only two REITs (Embassy and Mindspace), predominantly owning office properties.

How does it work?

- The working of office REITs are similar to mutual funds where money is pooled from a number of investors.
- The only difference is that, in REITs, they invest in rent-generating properties.
- REITs come up with an initial public offer to be listed on the exchanges.
- While retail investors can buy/sell REITs in the secondary market, they do have minimum investment requirements of ₹ 50,000 (200 units).
- This was reduced from ₹ 2 lakh (800 units) by SEBI to encourage investor participation.

What is its structure?

- A REIT has a three-tier structure.
    1. There is a sponsor, who sets up the REIT.
    2. There is a fund management company, which is responsible for selecting and operating the properties.
    3. There is a **trustee**, who ensures that the money is managed in the interest of unit-holders.

Why is it important?

- For those investors looking to diversify a portion of their portfolio into real-estate, REITs are an option.
- According to SEBI guidelines, REITs are to mandatorily distribute 90% of their income to unit-holders.
- The distribution could be in the form of dividend or interest income or a combination.
- REIT earns income by way of capital appreciation at the time of sale of any of its underlying properties, thereby boosting investors' returns.
- 80% of the value of a REIT should be invested in completed and rent-generating properties, ensuring visibility in returns for investors.

What is the risk?

- REITs come with their own risks and investors should be wary.
- Both rent and capital appreciation from a REIT depends on location, infrastructure and industrial development of properties held by it.
- While this risk is mitigated with properties diversified across locations, challenges remain.
- With many working from home since the outbreak of the pandemic, office properties could face a significant slowdown in demand.
- Delays in construction of commercial properties and delays in leasing decisions could impact the REIT's revenue generation for the next 2-3 quarters.
- However, given the lack of quality office space in the country, some of these uncertainties could be temporary.
- Many real-estate players facing liquidity crunch in the last 2-3 years, mostly due to low demand.
- So, the rent-generating properties can be monetised by the developers in the form of REITs.
- They can generate a steady income stream for the investors.
- As long as the pandemic rages, even REITs are not immune.

8.10 Coal Mine Auctions

Why in news?

The Central government has launched the auction of 41 coal blocks for commercial mining.

What is the decision?

- The decision was part of the announcements made by the Centre under the Atmanirbhar Bharat Abhiyan.
- The private players will be allowed to mine coal for commercial mining purposes, **without any end-use restrictions**.
- Successful bidders will obtain leasing rights from State governments to mine a coal block for a certain period.
- A **revenue-sharing basis** is opted for payment as against the current method of paying fixed rupee per tonne.
- In the revenue-sharing basis, a percentage of revenue share (final bid) has to be paid to the government on the sale of coal.
- The operational efficiency parameters have been liberalised.

Why mining was nationalised previously?

- India has a long history of commercial mining, starting from 1774.
- In second half of 20th century, the private players could not make adequate **capital investments** to meet the energy needs of India.
- Some private miners were found to be using **unscientific coal mining** practices and providing **poor working conditions** for labour.
- This led to the Central Government to nationalise private coalmines.
- The nationalisation was done in **two phases**, from 1971-1973.
- The Coal Mines (Nationalisation) Act, 1973 was enacted for this purpose.
- This Act restricted coal mining operations mainly to government entities.

Does India import coal?

- India imports around **240 million tonnes** (mt) of coal a year valued at about ₹ 1.7 lakh crore.
- The 41 mines opened for auction now can hit a peak production of 225 mt in 2025-26, saving foreign exchange.
- A High Powered Expert Committee (2017) recommended a shift from the allocation of coal blocks for own consumption to commercial mining.
- Commercial mining would help **tap the locally available reserves**.
- It would also increase the availability of coal in the Indian market at a cheaper price making India **less dependent** on imports.

What is the significance of the decision?

- The private sector involvement would help realise ₹ 33,000 crore of **capital investment** in the next five years.
- It can give a leg up to the economic activity within the country.
- It would play an important role in **job and income creation**.
- Higher production and surplus availability of coal may lead to fall in its prices.
- This, in turn, may **reduce the cost of electricity** consumed by the households and industries.
- Currently, coal-fired plants generate about 70% of India's electricity.
- However, there needs to be a fine balance between short-term cost savings and long-term environmental impact.

8.11 Unified Gas Price System

Why in news?

The government has proposed for a unified gas price system.

How are tariffs decided currently?

- Tariffs for transportation of gas are set separately for each pipeline.
- It is set by the Petroleum and Natural Gas Regulatory Board.
- It is set based on the volume of gas transported on the pipeline and its operating life aimed at providing the operator a pre-tax return of 18%.
- Tariffs for pipeline usage are divided into zones of 300 km.
- Tariff increases for zones further away from the point where gas is injected.
- Further, if a buyer needs multiple pipelines even from the same operator, that transport tariff would increase.
- All of India's imported natural gas arrives at terminals on the west coast.
- So, the further east the buyers are located, the costs increases.

What is the proposed move?

- The government is aiming to cut down the cost of transportation of natural gas by fixing a tariff for longer distances to boost consumption.
- It is proposing a unified price system with,
    1. One price for those transporting gas nearby within 300 km and
    2. One price for those transporting gas beyond 300km.
- This proposal is part of an effort to boost the share of natural gas in India's energy basket from 6% currently to 25% by 2030.
- The move would fix tariff prices within an integrated pipeline network such as that of GAIL (Gas Authority of India Ltd.)
- GAIL has India's largest gas transportation pipeline network that prevents the buyers to pay charges for the use of multiple pipelines.
- Such a move would help connect new markets.
- It would benefit consumers in parts of the country far from the western coast.

How would the costs be?

- The cost of gas transportation for oil marketing companies and fertiliser plants that are closer to the points of gas injection may go up.
- This is because the government lowers rates for transportation of gas to areas farther away from points of supply.
- GAIL would hope that the average tariff per unit of gas transported will not be very different from current tariffs.
- GAIL would hope for increased utilisation as demand for gas increases.
- The government is also expecting that as India boosts gas imports, it will be able to negotiate better prices on gas imports.

8.12 India's Solar Plan

Why in news?

The Prime Minister inaugurated the 'Asia's largest solar power project' in Rewa, Madhya Pradesh.

What is the significance?

- This project inauguration sends a signal that India remains serious about clean energy.
- India's solar installed capacity is at about 40 GW today.
- This is in short of its goal of achieving 100 GW by 2022.

Why the pace of capacity additions has slowed?

- This happened after the imposition of safeguard duty on solar cells and modules from China and Vietnam with effect from August 2018.
- The two-year period for which this duty was imposed ends in a few days.
- Amidst a policy of Atmanirbharat, reports suggest that this levy may be continued in the form of a regular tariff.

Pradhan Mantri Kisan Urja Suraksha evam Utthaan Mahabhiyan (PM-KUSUM)

- The PM-KUSUM scheme was launched by the Ministry of New and Renewable Energy.
- It has a target to set up 25,750 megawatts (MW) solar capacity by 2022 to power irrigation pumps.
- The approved scheme comprises of three components:

1. Setting up of 10,000 MW of decentralised ground / stilt-mounted grid connected solar or other renewable energy based power plants
2. Installation of 17.5 lakh standalone solar agriculture pumps
3. Solarisation of 10 lakh grid-connected solar agriculture pumps.

Why costs are higher now?

- Notably, China accounted for over 75% of India's cell and panel imports at least before the imposition of safeguard duties.
- The remaining gap was plugged by Singapore, Thailand and Vietnam.
- A 'manufacturing-linked tender' given by the Solar Energy Corporation of India in January was based on a tariff of ₹ 2.92/kWh.
- This tender is more than contracts awarded sometime ago, based on a tariff of about ₹ 2.50/kWh.
- This **new tariff** has made the India's costs are higher now.
- It is not yet clear to what extent the cells and wafers will be indigenously sourced in such cases.
- **Domestically produced modules** are 33% more expensive than their Chinese counterparts are.
- The **cost of the raw materials** is estimated to account for a major share of the cost difference.

What is India's capacity?

- At present, India is estimated to have a module manufacturing capacity of 9 GW and a cell making capacity of 3 GW.
- Ironically, the indigenous manufacture of Photo Voltaic (PV) modules calls for a reliable supply of electricity.
- While China leads the world in PVs, making two-thirds of the world's modules, the EU is trying to make a comeback.

What should India do?

- India has a long road to traverse if it is to be both cost-effective and self-reliant in this sector.
- Given the ecological obligations, India should shift to non-hydro renewables soon.
- It is a sobering thought that solar power accounts for just 3.6% of India's electricity generated, and 9.8% of the total installed capacity.
- India should take a leaf out of China's policy book, and create the right demand and supply ecosystem.