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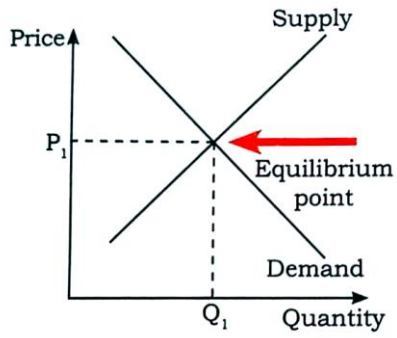
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Basics of Economics & Social Development

Economics is a social science that **studies production, distribution and consumption of goods and services**. It has been divided into **two main branches**:

- **Micro Economics:** It deals with the **behavior of individual economic agents** in the markets for different goods and services and helps determine how prices of goods and services are influenced through the interaction of individuals. Microeconomics majorly deals **with products' demand and supply.**
- **Law of Demand**: Demand of any product will be **inversely** related to its price provided other factors like **income, taste, price of other commodities remain unchanged**.
- **Law of Supply**: Supply of a product is **positively related to the price of the product**, if factors like technology, input price, taxes, etc., remain same.
- **Diminishing Marginal Utility**: Utility derived from any product keeps on decreasing with consumption of successive units of the product.
- **Market Equilibrium**: It is the point at which a **complete match between demand and supply of a product takes place**. For example, at prices below equilibrium price, excess demand for the product enables seller to charge higher prices; resulting in an automatic shift towards equilibrium.



- **Macro Economics** is concerned with the **aggregate economic variables of an economy** and takes into account various inter-linkages that exist between different sectors of an economy.
- **Aggregate Demand (AD):** It is **the sum total of expenditure that all households, firms and governments** are willing to make on goods and services at various price levels, produced in an economy.
- **Aggregate Supply (AS): Total monetary value of goods and services that the producers in an economy** are willing to sell at different price levels.
- **When Aggregate Demand equals Aggregate Supply**, a short-run macroeconomic equilibrium is attained where total supply by producers is exactly purchased or exhausted by consumers in the economy.

Factors of Production

Resources available at nation's disposal for its economic needs are called factors of production. They have an associated cost or remuneration attached with them.

- **Land:** All **natural resources**, for example, soil, water, forests, mountains, mines, deserts, air, sun, etc available to mankind. Associated cost of land. Resource is rent.
- **Labour: Physical or mental effort of human being** in the process of production. The remuneration given to labour is called wages.
- **Capital:** Machines, tools, buildings, roads, bridges, raw material, trucks, factories, etc are included in capital. Its remuneration is interest.
- **Entrepreneur:** Firms undertake risk of hiring other three factors of production, bring them together organize and coordinate them to earn. Its remuneration is profit.

National Income Accounting

National Income refers to the **total income generated by residents of a country in a year**. It measures **monetary value of total output of goods and services produced in one year**.

There are four ways to measure National Income:

Gross Domestic Product (GDP): Total money value of all final goods and services produced within domestic territories of the country during a financial year.

- **Only final goods and services are considered while estimating GDP**. (Final goods are those goods that are not used in further production of other goods and are ultimately consumed. For example, a car sold to consumer is a final good; its components such as types are intermediate goods used to make the final goods.)
- **Personal:** Additionally, **only newly produced goods are counted**. Transaction goods previously produced such as buying and selling of second-hand goods are not included.
- Transactions that do not get counted in GDP are: **Sale of goods that were produced outside domestic borders (foreign goods)**
- Intermediate goods Sale of used goods
- Illegal sales of goods and services (black market)
- Transfer payments (pensions, scholarships, etc.) Made by the government.

GDP is measured at two different prices:

- GDP at current prices: Current price reflects prevailing market prices. When GDP is measured at **current prices** it is called Nominal GDP.
- GDP at constant prices or base year prices: When measured at **constant prices** it is called Real GDP. Real GDP is calculated in a manner that goods and

services are evaluated at some constant set of prices and as the prices remain fixed, it reflects changes in volume of production. (Base year is the year which is normally free from the high fluctuations of price.)

- The difference between the constant and current prices is only that of the impact of inflation. GDP at current price (Nominal GDP) **is not used to measure macroeconomic variables** as it can present a distorted picture of actual growth in GDP owing to price changes. Real GDP reflects the true state of economy.
- **Gross National Product (GNP):** Total value of all final goods and services produced by **normal residents** of a country during a financial year. It is the GDP of a country added with its income from abroad.
- So the basic difference between GNP and GDP is the **geographical boundary**.
- Net Foreign Income or the Net Factor Income from Abroad (NFIA) is the difference between **factor income received by normal residents of the country and factor income paid to foreign residents in Indian domestic territory**.

NFIA- Income of Indians Abroad-Income of Foreigners in India
GNP - GDP (+)NFIA

- GNP GDP (-) NFIA in case when income paid to foreign residents exceeds the income received from abroad, i.e., **NFIA is negative**.

Concept of Depreciation

- **Loss of value of fixed capital like machinery, buildings, etc,** due to Normal wear and tear, change in production technologies, etc. The Expenses incurred for their repairing or replacement are termed as depreciation expenditure
- Hence, **depreciation is subtracted from gross value of goods to obtain The net value** goods- Depreciation - Net

- While GDP shows production **within the boundaries of the country** by both the citizens and the foreigners, GNP is a measure of the value of the output produced by normal residents of a country- **both within the geographical boundaries and outside.**
- Income is counted as part of GNP on the basis of who owns factors of production rather than **where the production takes place**. For example, in the case of a US based automobile company operating in India, the profits from the company will be counted as part of US GNP rather than Indian GNP. However, wages of the Indian workers working in the company will be part of Indian GDP.
- In an open economy with higher foreign investment (FDI) and lesser out bound investment, its **GDP is likely to be larger than GNP**. But GDP will be equal to GNP if it is a closed economy.

Concepts of Market Price and Factor Cost

- Market price is the actual transacted price at which goods and services are bought and sold. It includes all **indirect taxes like excise duty, sales tax, service tax, custom duty**, etc.
- Production costs at which goods and services are produced by the firms and industries in an economy are considered as the factor costs. It includes **costs of all factors of production such as land. Labour, capital, raw materials etc. It includes government grants and subsidies but excludes indirect taxes.**
- Hence, the relationship between market price and factor cost can be established as

GDP@ Factor cost = GDP@ Market price - Indirect taxes + Subsidies

GNP@ Factor cost = GNP @ Market price - Indirect taxes + Subsidies

- **Net National Product (NNP):** Calculated by deducting depreciation expense from gross national product.

NNP= GNP-Depreciation

- **Net Domestic Product (NDP):** Calculated by deducting depreciation expense from gross domestic product and is stated as

NDP = GDP Depreciation

Methods of Estimating National Income

National income is usually calculated using three different approaches:

- **Income Method**: Incomes earned through all four factors of production **rent (land), wage (labour), interest (capital) and profit (entrepreneur**) are added to calculate GDP.
- Hence, GDP in this case is stated as

  GDP = W+P+In+R

  Where W stands for wages,

  P for profit, in for interest and R for rent.
- **Production (Value Added) Method**: Aggregate annual value of **goods and services produced is calculated to measure GDP**. It estimates the value added i.e. **Net contribution made by all the firms in a year.**
- Value added by a firm is the **difference between value of total production by the firm and value of intermediate goods used by the firm**. Hence, **Value added = Value of Output - Value of (non factor) inputs**

- This method gives GDP at Market Price (MP) as it includes depreciation and taxes. Hence, National Income (NNP at FC) is calculated by following steps:
- **Add Net Factor Income from Abroad (NFIA) to GDP: GNP at MP = GDP at MP + NFIA**
- **Subtract Depreciation: NNP at MP = GNP at MP – Depreciation**
- **Subtract Net Indirect Taxes: NNP at FC = NNP at MP - Net Indirect Taxes.**

Expenditure Method: Measures national income in terms of amount spent on final consumption by households, corporate and government. It is stated as **GDP at MP=C+I+G+(X-M).**
Where, C- Private sector's expenditure on final consumer goods, I- Firm's investment or capital expenditure, G=Government's expenditure on final consumer goods, X-Exports, M-Imports, X-M Net exports or the export revenues.

Gross Domestic Capital Formation (GDCF)

- GDCF is that part of production that is not consumed during the year and generally consists of machineries and infrastructure like roads, bridges, etc
- Savings, provisions for depreciation (annual depreciation amount) and net borrowings from abroad finance GDCFs.

Problems in Estimating National Income (or GDP)

- **Lack of reliable data** makes the task of estimation of national income more difficult.
- **Data fabrication** is another problem that hinders creation of a reliable data.
- **Existence of parallel economy**, also known as shadow or underground economy - GDP does not take into account the transactions of **'parallel economy as the (black) money** generated through illegal activities.
- **Non-monetization of many sectors**, especially in rural economy.
- **Not all goods and services are sold at market price or at market place**. When computing GDP, value of such goods and services has to be estimated, or imputed. For example, a large chunk of output is retained by small farmers for their self-consumption. **Environmental costs incurred in the production of goods are not included in the GDP estimates.** For example - CO_2 emissions from automobiles pollute the environment; climate is being impacted by use of fossil fuels, etc.

GDP as a Measure of Economic Development

- Estimation of economic development has two main approaches:
- In the first approach, economic development is seen as synonymous with **economic growth** and defines development strictly in economic terms i.e. sustained annual increase in GNP or GDP.
- The second approach defines economic growth in terms of the sustained increase **in per capita income or output.**
- Though, countries with **higher GNP often score high welfare measures like life expectancy, there are limitations to the usefulness of GDP/GNP** as a on measure of welfare or development:
- **Intangibles** like quality of life, nutrition, health, sanitation are not valued through GDP.
- GDP does not reflect upon the **equitable distribution of income and wealth.**
- Improvements in the condition of poor are not indicated. Similarly, growth in GDP figures does not reflect upon issues like gender disparities.
- High GDP can also be temporarily achieved by **over-exploiting natural resources**. Hence, rise in GDP cannot ensure sustainability in the long run.
- **Environmental impact** of economic activity is also not accounted for in GDP.
- However, 'even' growth of output per head of population has its own limitations: **Per Capita Income**
- Standard of living of the masses may not necessarily rise with an increase in PCI.
- If the increased income goes to the hands of few rich, the poor is hardly benefitted.
- Thus, even PCI is not an indicator of fair distribution of wealth.

Sectors of Indian Economy

Primary Sector (Agriculture and Related Sector)

- The primary sector is concerned with the **extraction of raw materials**. There are many activities that are undertaken by directly using natural resources. The primary sector continues to be the largest employer in Indian economy.
- When we produce a good by **exploiting natural resources**, it is an activity of the primary sector because it forms the base for all other products that we subsequently make.
- For example, agriculture, dairy, fishing, forestry, mining.

Secondary Sector (Industrial Sector)

- Activities in which **natural products are changed into other forms through ways of manufacturing** that we associate with industrial activity.
- The product is not produced by nature but has to be made and therefore some process of manufacturing is essential. This could be in a factory, a workshop or at home.
- For example, manufacturing industries.

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Tertiary Sector (Service Sector)

- Activities that **help in the development of the primary and secondary sectors**.
- Tertiary sector activities, by themselves, do not produce goods but they are an aid or a support for the production process. The tertiary sector in India Has observed the **maximum growth** in recent times.
- For example, **Transport, storage, communication, banking, trade.**

Quaternary Sector

- **Activities which demand a separate classification and are specialized in the knowledge sector**.
- Example of such services are elementary schools and university classrooms, personnel working in office buildings, hospitals and doctors' offices, accounting and brokerage firms etc.

Quinary Sector

- **Services focusing on the creation, rearrangement and interpretation of new and existing ideas**.
- Often referred to as 'gold collar' professions, they represent specialized and highly paid skills like business executives, research scientists, government officials, financial and legal consultants, etc.

Division of Sectors as Organized and Unorganized

- Organized sector covers those enterprises or places of work where the **terms of employment are regular** and therefore, people have assured work.
- Workers in the organized sector enjoy security of employment.
- They are registered by the government and have to follow its rules and regulations which are given in various laws such as the Factories Act, **Minimum Wages Act, Payment of Gratuity Act, Shops and Establishments Act,** etc.
- They are expected to work only a fixed number of hours. If they work more, they have to be paid overtime by the employer.
- They also get several other benefits from the **Employers like paid leave, payment during Holidays, provident fund, gratuity** etc.
- The unorganized sector is characterized **by small and scattered units which are largely outside the control of the government.**
- Jobs here are low-paid and often not regular.
- There is no provision for overtime, paid leave
- Holidays, leave due to sickness etc.
- **Employment is not secure**. When there is less work, some people may be asked to leave.

Sectors in Terms of Ownership

- Public Sector: **Government owns most of the assets and provides all** the services, for example railways, post office etc.
- The purpose of the public sector is **not just to earn profits**. Governments raise money through taxes and other ways to meet expenses on the services rendered by it.
- Private Sector: **Ownership of assets and delivery of services is in the hands of private individuals or companies.** Activities in the private sector are guided by the motive to earn profits.

Economic Systems

- Capitalist/Market Economy: Economic activities are organized through the market where **economic agents freely exchange their products**. Decisions are based on price mechanism, e.g. USA, Japan, and Singapore.
- State Economy/Centrally Planned Economy: **Means of production, distribution and price determination are generally controlled by the government** (or the state). There can be two broad versions of a state economic system:
- Socialist economy: Assigns **large role to state in running the economy,** e.g. Erstwhile USSR, Cuba.
- Communist economy: assigns absolute role to state in running the economy, e.g. Pre 1985 China.
- Mixed Economy: Both capitalism and socialism co exist. **Private and public sector coexists** and complement each other. E.g. India.

EXTERNAL SECTOR OF INDIA

External sector **deals with export and import of good and services**, and financial capital between two countries

Balance of Payment (BOP): A financial statement that summarizes an economy's transactions with the rest of the world for a specified time period.

It **systematically records all transactions** in ar economy in the form of double entry book keeping with entries credited as inflows and outflows.

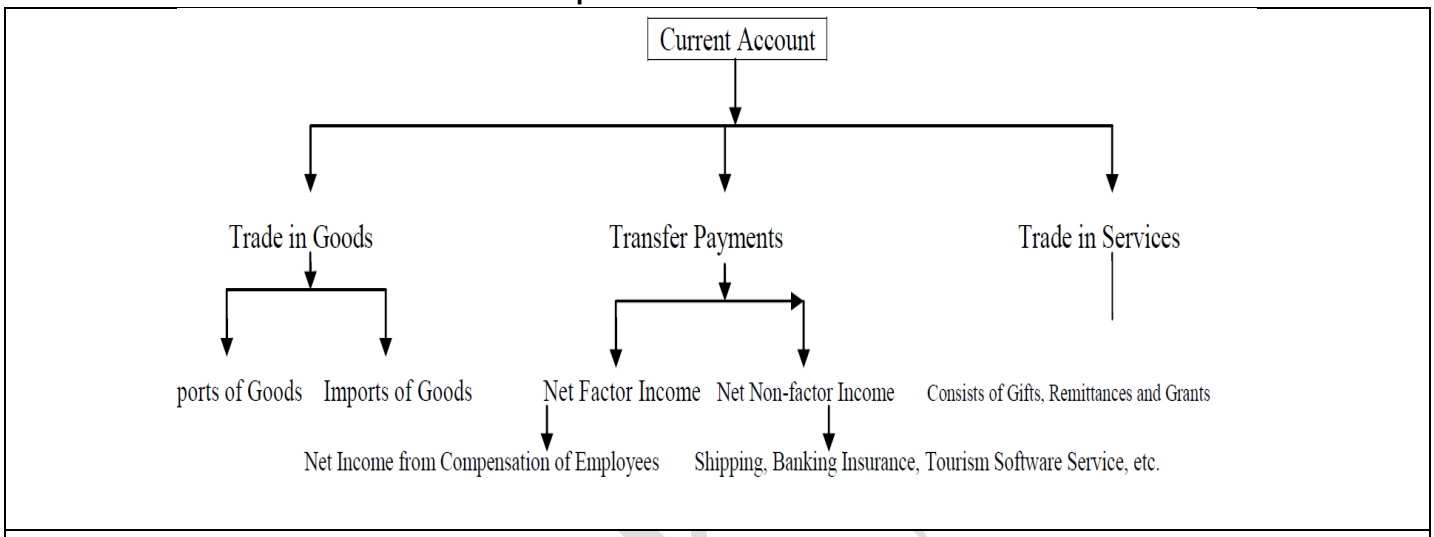
- **Current Account:** Single time and one way transactions, comparable with **revenue receipts and revenue expenditures of the government**.
- **Export:** Export receipts are the receipts against export of merchandise goods (not services) to other countries.
- **Import:** Payments for imports of merchandise goods from other countries are included under import.
- **Trade Balance:** The difference **between export receipts and import payments is referred to as trade balance.** It may be favorable when positive and unfavorable when negative
- **Invisibles**: Service, income and transfer **receipts and payments across countries** contribute to the invisible trade.

  Examples: **FDI, Equity Capital, Reinvested Earnings and other Direct Capital Flows.**

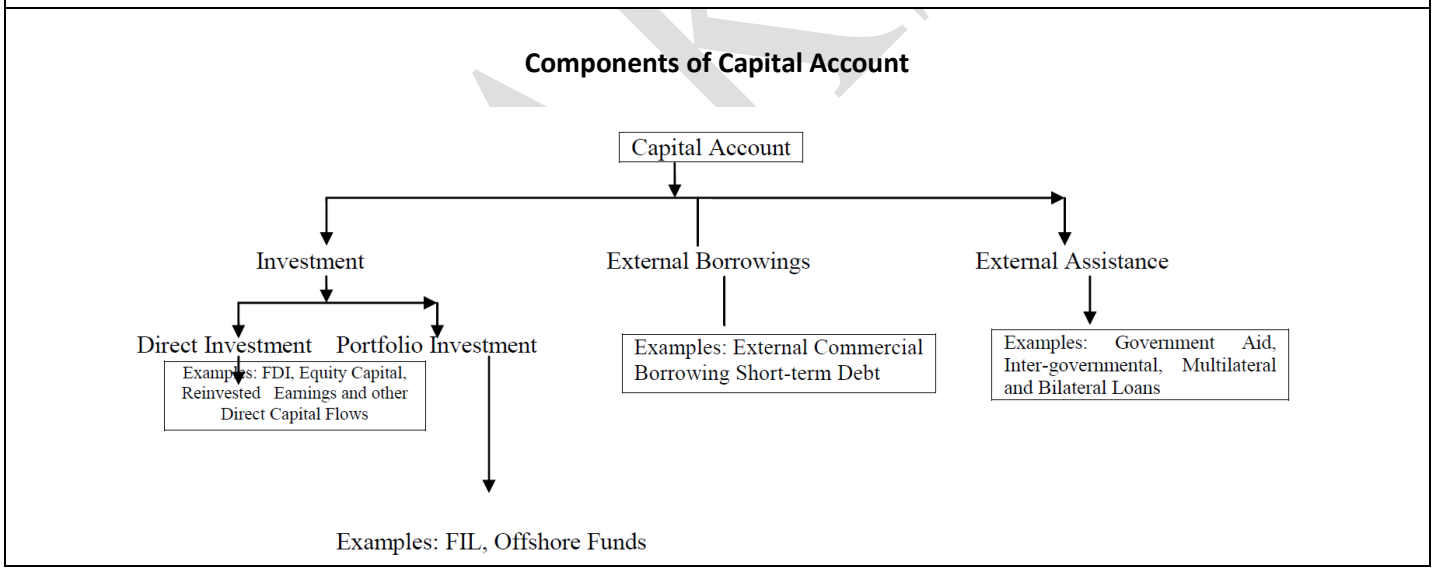
- **Services:** Export and import of services like travel Transportation, insurance, etc contribute to Services.
- **Income:** It includes transactions regarding income Remittances, dividends, profits and interest.
- **Transfers:** Payments like **gifts, grants, etc. Are Covered under this head**.
- Capital Account shows net change in physical and **financial assets of a nation and includes foreign direct investment (FDI), portfolio and other investments**.

- **Foreign Direct Investment:** Investment made by a **foreign company** through mode other than the stock exchange is called foreign direct investment in India. There are two routes for **FDI investment** in India:
- **Automatic route:** By this route FDI is allowed without prior approval by Government through Reserve Bank of India.
- **Government route:** Prior approval by government is needed via this route.

Components of Current Account



Components of Capital Account





Participatory Notes (P-Notes

- **Offshore derivative instruments** that are used by foreign investor for making investments in **domestic stock markets**.
- These instruments are not used within the country and are used **outside the domestic country for investing in shares listed on the Indian stock.**

Advantages

- **Anonymity:** Entities investing in participatory notes are **not required to register with SEBI** which enable large hedge funds to carry out Operations without disclosing identity.
- **Ease of Trading:** Trading through participatory notes is easy by transferable endorsement and delivery.
- **Tax Saving:** Some of the entities route their investment through **Participatory notes** to take advantage of the tax laws of certain preferred countries.

Disadvantages

- They can be used to invest **unaccounted, illegal money** into the Indian Securities market for huge profits during the booming period and become A source of **'hawala'** kind of illegal channel.
- Additionally, they can be **used by terrorist organizations to fund** related activities.
- Portfolio Investment: **Investment made through stock exchange** (also secondary market) wherein various financial instruments like shares, debentures of a company are invested is termed as portfolio investment.
    - **Three major types of portfolio investment are Foreign Institutional Investment, depository receipts and offshore funds**.
    - **Foreign Portfolio Investors includes: Foreign Institutional Investors (FILs), Qualified Foreign Investors (QFIS) and subaccounts, etc**.

Positives of FDI

- **Favors Economic growth** by providing opportunities for cash deficient domestic retailers to bridge gap between capital required and raised.
- **Distribution efficiencies, coupled with capacity building** and introduction of modern technology helps arrest wastage.
- The **entry of many multinational corporations** promotes competition between domestic companies resulting in improved quality, reduced prices, and infrastructure development. Additionally, FDIs help improve storage facilities and logistics.
- Entry of foreign companies not only creates employment opportunities but also **ensures quality in them.**

Negatives of FDI

- Domestic companies may not be able to compete with big global giants and might have to give up by **losing their self-competitive strength**.
- **Lack of transparency** and proper regulation norms in FDI would act as another source of increasing corruption and red tapism in the country
- The organized retailers tend to dominate the entire consumer market resulting in unfair competition and large-**scale exit of domestic retailers**
- **Structural changes** brought by foreign retailers who might directly procure from main supplier can create unemployment on the front end.

FPI's	
Pros	**Cons**
Feasible for retail investors	No direct control/management of investments
Highly liquid	Cause of economic disruption(if withdrawn)
Quicker return on investment	Volatile

- External Commercial Borrowings (ECBS): **Loans in the form of buyer's credit, bank loans, securitized instruments and supplier's credit that are availed by an Indian entity from a non-resident lender**,
- It also includes commercial borrowings from multilateral financial institutions **like International Finance Corporation (IFC), Asian Development Bank, etc.**
- Other items of **Capital Account**: Loans in the form of external assistance, external commercial borrowings and trade.

Current Account Deficit (CAD)

Measurement of a country's trade, where the **value of goods and services it imports exceeds the value of the goods and services it exports**. It is sometimes referred to as a trade deficit.

Effects of CAD on the Economy

- Generally, CAD is financed through borrowing which may prove to be **unsustainable in the long run.**
- When CAD is financed by attracting foreign capital flows, it puts **the domestic economy at certain risks from external factors like sudden withdrawal of investment, etc.**
- High CAD may create **low confidence** by foreign investors.
- However, a CAD is not necessarily harmful because it also implies an excess of investment over savings, it

could equally be pointing to a **highly productive, growing economy**.
- If the deficit reflects low savings rather than high investment, it could be caused by reckless fiscal policy or a consumption binge.

Convertibility
- Currency convertibility is the ease with which a **country's currency can be converted into gold or another currency**. Convertibility is extremely important for international commerce.
- When a currency is inconvertible, it poses a risk and barrier to trade with foreigners who have no need for the domestic currency.
- Current Account Convertibility: **It allows free inflows and outflows for all purposes other than for capital purposes such as investments and loans.** In other words, it allows residents to make and receive trade related payments-for export of goods and services and pay for import of goods and services, studies abroad, medical treatment and gifts, etc.
- **Current account is fully convertible** in India after it was obliged to do so under **IMF pre-conditions**.
- **Capital Account Convertibility**: It is the freedom to convert local financial assets into foreign financial assets and vice versa **at market determined rates of exchange.**
- Though India still has **partial convertibility in the capital account**, enough reforms have been made to allow full capital account convertibility. For example, Indian corporate are allowed full convertibility under the automatic route up to $500 million overseas ventures.

Purchasing Power Parity (PPP)
- It is an economic theory which states that **residents of one country should be able to buy the goods and services at the same price as inhabitants of any other nation over time**.
- In other words, the expenditure on a similar commodity must be same in both currencies when accounted for exchange rate.

Tarapore Committee on Capital Account Convertibility II (2006)
- The committee's view was that fuller convertibility is required to get foreign funds for huge investment needs of the economy.

Specific Recommendations
- The report recommended that future implementation of full capital account convertibility be done **in three phases** spread over five years.
- The report sought a **ban on participatory notes** as a mode of investment in Indian equities and easing the direct investment routes for foreigners.
- It suggested that **foreign individual investors should be brought at par with non-resident Indian investors.**
- The committee recommended the **restrictions on overseas borrowings by Indian firms** and banks be eased. It recommended that the limit on remittances by individuals should be increased.

But before making rupee fully tradable, financial and banking standards and regulation must be in order. **The fiscal deficit needs to be brought under control** otherwise a large deficit will make India's economy vulnerable to shocks. It proposed the formation of a monetary policy committee as well.

Foreign Exchange Reserves (Forex)
- Reserve assets held by RBI in foreign currencies, used to back liabilities on their own issued currency as well as to influence monetary policy.
- Forex of India includes **foreign currency assets, total gold reserves and total special drawing rights (SDRS) of IMF.**

Exchange Rate Regime: The system that a country's monetary authority (generally the central bank) adopts to establish the **exchange rate of its own Monetary Currency against other currencies**.
- **Fixed Currency Regime**: A **country's official Exchange rate is tied to another country's currency** or to the price of gold by the government or the Central bank of the country.
- **Floating Currency Regime**: The currency price is **based on supply and demand compared with other currencies**. A domestic currency is left free to float against a number of foreign currencies in Its foreign exchange market and determine its own Value. Hence, it is also called as market driven Exchange rate.
- **Managed Exchange Rates**: A hybrid of fixed and floating exchange rate systems in which the **central Bank attempts to affect the exchange rate directly or indirectly by buying or selling foreign currencies and through monetary policy respectivel**y.

Foreign Exchange Market
Is the market where different currencies are bought and sold. This is an institutional framework for the exchange of one national currency with another.
- Nominal Effective Exchange Rate (NEER) of the rupee is weighted average of exchange rates before the Currencies of India's major trading partners.
- When the weight of **inflation is adjusted with the NEER**, we get the Real Effective Exchange Rate (REER) of the rupee.
- Since **Inflation has been on the higher side in recent Months, the REER of the rupee has been more than the NEER**.

Exchange Rate in India

- Earlier, the Indian currency was linked with the **British Pound Sterling** till 1948.
- With the coming up of IMF, India shifted to the fixed Currency system maintaining rupee's external value in terms **of gold or the US Dollar**.
- In 1992-93 financial years, India shifted to a dual Exchange rate under the floating currency regime.
- External Debt: **The portion of a country's debt that Borrowed from foreign lenders including commercial Banks, governments or international financial Institutions.**
- Hence, it is the component of total debt held by Creditors of foreign countries, non-residents Of the debtor's country,
- Placed within four broad categories:
- **Private non-guaranteed debt**
- **Public and publicly guaranteed debt**
- **Central bank deposits**
- **Loans due to the World Bank and IMF**

Growth of Indian Economy Under Planning Commission:

First Five Year Plan:

- It was launched for the duration of **1951 to 1956,**under the leadership ofJawaharlal Nehru.
- It was based on the **Harrod-Domar model** with a few modifications.
- Its main focus was on the **agricultural development of the country.**
- This plan was successful and achieve the growth rate of **3.6% (**more than its target of 2.1%).
- At the end of this plan, **five IITs were set up in the country**

Second Five Year plan

- It was made for the duration of **1956 to 1961**,under the leadership of Jawaharlal Nehru.
- It was based on the **P.C. Mahalanobis Model** made in the year 1953.
- Its main focus was on the industrial development of the country.
- This plan lags behind its **target growth rate of 4.5% and achieved a growth rate of 4.27%.**
- However, this plan was criticized by many experts and as a result, India faced a payment crisis in the year 1957.

Third Five Year Plan:

- It was made for the duration of **1961 to 1966,** under the leadership of Jawaharlal Nehru.
- This plan is also called **'GadgilYojna',** after the Deputy Chairman of Planning **Commission D.R. Gadgil**.
- The **main target of this plan was to make the economy independent**. The stress was laid on agriculture and the improvement in the production of wheat.
- During the execution of this plan, India was engaged in two wars: **(1) the Sino-India war of 1962 and (2) the Indo-Pakistani war of 1965. These wars exposed the weakness in our economy and shifted the focus to the defence industry**, the Indian Army, and the stabilization of the price (India witnessed inflation).
- The plan was a flop due to wars and drought. The target growth was 5.6% while the achieved growth was 2.4%.

Plan Holidays:

- Due to the failure of the previous plan, the government announced three annual plans called **Plan Holidays from 1966 to 1969.**
- The main reason behind the plan holidays was the **Indo-Pakistani war and the Sino-India war**, leading to the failure of the third Five Year Plan.
- During this plan, **annual plans were made and equal priority was given to agriculture** its allied sectors and the industry sector.
- In a bid to increase the exports in the country, the government declared devaluation of the rupee.

Fourth Five Year Plan:

- Its duration was from **1969 to 1974**, under the leadership of Indira Gandhi.
- There were two main objectives of this plan i.e. **growth with stability and progressive achievement of self-reliance**.
- During this time, **14 major Indian banks were nationalized** and the Green Revolution was started. Indo-Pakistani War of 1971 and the Bangladesh Liberation War took place.
- Implementation of Family Planning Programmes was amongst major targets of the Plan
- This plan failed and could achieve a growth rate of **3.3% only against the target of 5.7%.**

Fifth Five Year Plan:

- Its duration was **1974 to 1978.**
- This plan focussed on **GaribiHatao, employment, justice,** agricultural production and defence.
- The Electricity Supply Act was amended in 1975, a Twenty-point program was launched in 1975,

the Minimum Needs Programme (MNP) and the Indian National Highway System was introduced.
- Overall this plan was successful which achieved a growth of **4.8% against the target of 4.4%.**
- This plan was terminated in 1978 by the newly elected Moraji Desai government.

Rolling Plan:

- After the termination of the fifth Five Year Plan, the Rolling Plan came into effect from **1978 to 1990**.
- In 1980, Congress rejected the **Rolling Plan and a new sixth Five Year Plan** was introduced.
- Three plans were introduced under the Rolling plan: **(1) For the budget of the present year (2) this plan was for a fixed number of years– 3,4 or 5 (3) Perspective plan for long terms– 10, 15 or 20 years**.

Sixth Five Year Plan:

- Its duration was from **1980 to 1985**, under the leadership of Indira Gandhi.
- The basic objective of this plan was **economic liberalization by eradicating poverty and achieving technological self-reliance.**
- It was based on **investment Yojna, infrastructural changing, and trend to the growth model.**
- Its growth target was **5.2% but it achieved a 5.7% growth.**

Seventh Five Year Plan:

- Its duration was from **1985 to 1990**, under the leadership of Rajiv Gandhi.
- The objectives of this plan **include the establishment of a self-sufficient economy, opportunities for productive employment, and up-gradation of technology.**
- The Plan aimed at accelerating food grain production, increasing employment opportunities & raising productivity with a focus on 'food, work & productivity
- For the first time, the private sector got priority over the public sector.
- Its **growth target was 5.0% but it achieved 6.01%.**

Annual Plans:

- Eighth Five Year Plan could not take place due to the volatile political situation at the centre.
- Two annual programmes were formed for the **year 1990-91& 1991-92.**

Eighth Five Year Plan:

- Its duration was from **1992 to 1997**, under the leadership of P.V. Narasimha Rao.
- In this plan, the top priority was given to the development of human resources i.e. **employment, education, and public health.**
- During this plan, Narasimha Rao Govt. launched the **New Economic Policy of India.**
- Some of the main economic outcomes during the eighth plan period were rapid economic growth **(highest annual growth rate so far – 6.8 %), high growth of agriculture and allied sector, and manufacturing sector, growth in exports and imports, improvement in trade and current account deficit**. A high growth rate was achieved even though the share of the public sector in total investment had declined considerably to about 34 %
- This plan was successful and got an annual **growth rate of 6.8% against the target of 5.6%.**

Ninth Five Year Plan:

- Its duration was from **1997 to 2002**, under the leadership of Atal Bihari Vajpayee.
- The main focus of this plan was **"Growth with Social Justice and Equality".**
- It was launched in the **50th year of independence of India.**
- This plan failed to achieve the growth **target of 6.5% and achieved a growth rate of 5.6%.**



Tenth Five Year Plan:

- Its duration was **from2002 to 2007**, under the leadership of Atal Bihari Vajpayee and Manmohan Singh.
- **This plan aimed to double the Per Capita Income of India in the next 10 years**.
- It also aimed to reduce the poverty ratio **to 15% by 2012.**
- Its growth target was 8.0% but it achieved **only 7.6%.**

Eleventh Five Year Plan:

- Its duration was from **2007 to 2012**, under the leadership of Manmohan Singh.
- It was prepared by the C. Rangarajan.
- Its main theme was **"rapid and more inclusive growth".**
- It achieved a growth rate of 8% against a **target of 9% growth**.

Twelfth Five Year Plan:

- Its duration is from 2012 to 2017, under the leadership of Manmohan Singh.
- Its main theme is **"Faster, More Inclusive and Sustainable Growth".**
- Its **growth rate target was 8%.**
- For a long time, there had been a feeling that for a country as diverse and big as India, centralised planning could not work beyond a point due to its one-size-fits-all approach. Therefore, the NDA government has dissolved **the Planning Commission which was replaced by the NITI AAYOG**. Thus, there was no thirteen Five Year Plan, however, the five-year defense plan was made. It is important to note that the documents of the **NITI Aayog have no financial role**. They are only policy guide maps for the government.

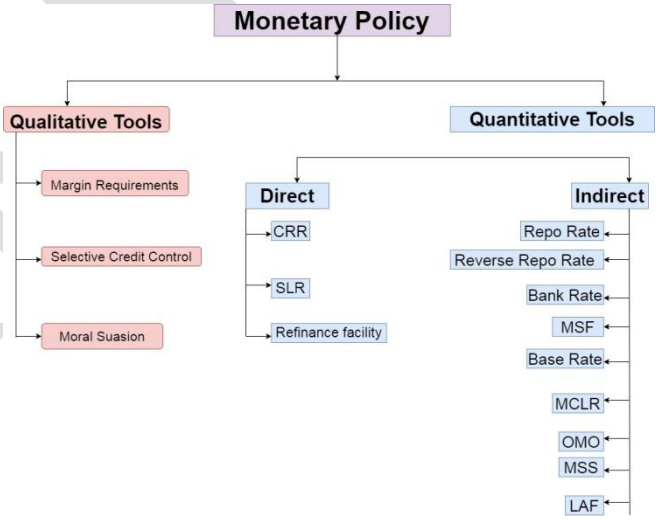
The three-year action plan only provides a broad roadmap to the government and does not outline any schemes or allocations as it has no financial powers. Since it doesn't require approval by the Union Cabinet, its recommendations are not binding on the government.

Monetary Policy

Laid down by the central bank, **it involves Management of money supply and interest rate and is used to achieve macroeconomic objectives like price Stability, consumption, growth and liquidity**.

Objectives of Monetary Policy

- **Price Stability** by **increasing or decreasing money Supply.** When the economy suffers from recession **Easy/cheap money policy'** is pursued whereas 'dear Money policy is pursued during inflationary Situations.
- **Rapid Economic Growth** by controlling real interest Rates and their **resultant impact on the investment.**
- For example, **a cheap or easy credit policy reduces Interest rates encouraging investment levels** in the Economy which in turn speeds up economic growth.
- **Equal Income Distribution** by making special provisions for **sectors such as agriculture, small-scale Industries, village industries**, etc. And providing cheaper credit.
- **Exchange Rate Stability** by altering foreign exchange Reserves and influencing demand for foreign Exchange.
- **Balance of Payments (BOP) Equilibrium**: The BOP has two aspects i.e. The **'BOP Surplus'** and the 'BOP Deficit'. The former reflects an excess money supply In the domestic economy, while the later stands for **Stringency of money**. If the monetary policy succeeds In maintaining monetary equilibrium, then the **BOP Equilibrium can be achieved.**



Instruments of Monetary Policy

Quantitative Measures

- **Quantitative Measures** are used **to regulate the Quantity or volume of money supply.** These tools are Indirect in nature.
- **Bank Rate**: Rate at which **RBI lends money to domestic banks,** often in the form of very short-term loans. If **RBI increases the bank rate, volume of commercial banks borrowing from the RBI decreases deterring banks from further credit expansion.** On the other hand, if RBI reduces the bank rate, borrowings by commercial banks will be easy and cheaper thereby indirectly boosting credit creation,
- **Open Market Operation (OMO)**: It is **purchase and/ or sale of short-term and long-term securities by the RBI.** Whenever RBI sells securities in an open market,

it reduces existing money supply as **commercial banks and private individuals buy these securities in return of money**. In contrast, when RBI buys the securities from commercial banks, commercial banks get back the money they had invested in them that increase stock of money in the economy.

- **Cash Reserve Ratio (CRR):** A **specified minimum fraction of the total deposits of customers, which commercial banks have to hold as reserves either in cash or as deposits with RBI. CRR is set by RBI**. Higher is the ratio, lower is the amount that banks will be able to use for lending and investment.
- **Statutory Liquidity Ratio (SLR):** A **stipulated proportion of net demand and time liabilities of a bank that they are required to maintain in the form of liquid assets like cash, gold and unencumbered securities with them**. This money is predominantly invested in government securities, which means banks earn interest on it.
- **Repo Rate**: Rate at **which central bank lends money to commercial banks**. Banks borrow from RBI against the pledge of government securities to meet their day-to-day obligations.
- **Reverse Repo Rate:** Rate at **which RBI borrows money from commercial banks.** It must be noted that reverse repo rate is always lower than the repo rate.

Qualitative Instruments

Directed towards the quality of credit or the use of the credit.

- **Fixing Margin Requirements:** Margin refers to that Part of a loan which a borrower has to raise in order to get finance for his purpose. It is the difference between the values that securities offer and actual credited. The margin can be either increased or decreased depending on necessary and non necessary sectors to **either encourage or discourage credit supply.**
- **Consumer Credit Regulation:** Rules regarding down payments and maximum maturities of installment credit for purchase of goods.
- **Credit Rationing:** Limiting the amount available for each commercial bank. For specific purposes, upper limit of credit is fixed and banks are generally asked to stick to the limit.
- **Moral Suasion:** RBI issue directives, guidelines and **suggestions for commercial banks regarding reducing credit supply for speculative purposes**.
- **Control through Directives:** RBI issues frequent directives to commercial banks to guide them in framing their lending policy.

Operation Twist

- 'Operation Twist' is the name given to a US Federal Reserve monetary policy operation, which **involves the purchase and sale of government securities to boost the economy by bringing down long-term interest rates**.
- The tool essentially **aims at changing the shape of the yield curve (hence the name - twist)** through simultaneous buying and selling of long- and short term government bonds
- In India, the RBI put through its version of **Operation Twist in December 2019 by buying 10,000 crores worth of 10-year government bonds** while selling four shorter-term government bonds adding up to the same value.
- The intent is to moderate high long-term interest rates in the market and bring them closer to the repo rate.

Currency Swap

- A currency swap between two economies is an **agreement to exchange currencies (of the two countries or any hard currency) with predetermined terms and conditions**.
- India has signed currency swap agreements with **several countries such as Japan, UAE**, etc.
- The chief objective of currency swap agreement is to get the foreign currency from the issuing foreign central bank at the predetermined conditions (like exchange rate and the volume of currency) for the swap.
- Besides supporting the domestic currency and foreign exchange market, another **main goal of currency swaps is to keep the value of the foreign exchange reserves kept with the central bank**.
- Currency swap agreements help in saving for a rainy day when the economy is not looking in good shape and also contributes towards **stabilizing the country's Balance of Payments (BOP) position**.

Long Term Repo Rate

- Reserve Bank of India (RBI) introduced Long Term Repo Operation (LTRO) to enable a **better monetary transmission.**
- Recently, RBI conducted Long Term Repo Operations (LTRO) of **one-year and three-year tenors of appropriate sizes for up to a total amount of * 1lakh crore at the policy repo rate**.
- LTRO is expected **to assure banks about the availability of durable liquidity at a reasonable cost relative to prevailing market conditions, and to further encourage banks to undertake maturity transformation smoothly and seamlessly so as to augment credit flows to productive sectors**.

Measures of Money Supply

Money supply, like money demand, is a stock variable. The total stock of money in circulation among the public at a particular point of time is called money supply. RBI

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publishes figures for four alternative measures of money supply, viz. M1, M2, M3 and M4.

They are defined as follows:

- **M1 = CU + DD**
- **M2 = M1 + Savings deposits with Post Office savings banks**
- **M3= M1 + Net time deposits of commercial banks M4=M3+ Total deposits with Post Office savings organizations (excluding National Savings Certificates).**
- Where CU is currency (notes plus coins) held by the public and DD is net demand deposits held by commercial banks. The word 'net' implies that only deposits of the public held by the banks are to be included in the money supply.
- The interbank deposits, which a commercial bank holds in other commercial banks, are not to be regarded as part of the money supply.
- **M1 and M2 are known as narrow money.**
- **M3 and M4 are known as broad money.**
- These measures are in decreasing order of liquidity. **M1 is most liquid and easiest for transaction Whereas M4 is the least liquid of all**.
- M3 is the most commonly used measure of the money supply. It is also known as aggregate monetary resources.

Liquidity Adjustment Facility (LAF): Introduced in 2000, **it allows banks to borrow money from RBI through repurchase agreement**. The borrowings under LAF are used by banks to meet **day-to-day mismatches in liquidity.** The two components of LAF are repo rate and reverse repo rate.
Marginal Standing facility (MSF): A window for **banks to borrow from RBI in an emergency** (overnight period) by pledging government securities at rates higher than the repo rate under LAF. The **MSF rate is pegged 100 basis points or one percentage point above the repo rate**. This came into effect in May 2011.

Monetary Policy Agreement

- The Government of India and RBI signed a **Monetary Policy Framework Agreement in 2015** to primarily maintain price stability, while keeping in mind the objective of growth.
- As per the agreement, RBI would set the policy interest rates and would **aim to bring inflation below 6% by January 2016 and within 4% with a band of (+/-) 2% for 2016-17 and all subsequent years.**
- While the agreement gives a free hand to the **RBI Governor to decide on the monetary policy measures to achieve the inflation target,** it also requires the RBI to give out to the Central Government a report in Case the target is missed.

Monetary Policy Committee - Entrusted with the Task of fixing the benchmark policy rate (repo rate) required to contain inflation within the specified target Level and to add value and transparency to monetary Policy decisions.

- It has **six members, with three appointed by RBI and the remaining nominated by an external selection Committee.**
- The RBI Governor will have the **casting vote in case of a tie.**
- Setting up of MPC also makes monetary policy Decision making more democratic as earlier only the **RBI Governor** decided key interest rates.
- The committee will take decision based on the **Majority vote**. Each member will have one vote.

Urjit Patel Committee

- Formed **to revise and strengthen monetary policy frame work in India**.
- Recommendations:
- **Target CPI:** Monetary policy should aim at controlling CPI and WPI (targeted till recently) is not true indicator of inflation.
- **Control Inflation**: The committee suggested to **do away with multiple Targeting of monetary policy and instead, it should be focused on one Issue at a time, the first of them being inflation.**

Define a target: The **committee defined the target for inflation as 4%With bandwidth of -/- 2%.**

Banking System in India

- **Bank:** A government authorized financial institution that deals with deposits, advances and other related Services. It **accepts money from depositors and lends in the form of loans**. A bank also provides easy Payment and withdrawal facility in form of cheques, Drafts, etc.
- **Non-Banking Financial Companies (NBFCS):** Do **not provide withdrawal or cheque facility to its depositors.** Characteristics of NBFCS in India:
- • They usually do not accept demand deposit.
- Since **they are not part of payment settlement**, they cannot issue cheques.
- **They do not provide deposit insurance facility**. In Other words, public deposit with them is Unsecured.

Types of Banks:

Central Bank

The Reserve Bank of India is the central bank of our country. Each country has a central bank that regulates all the other banks in that particular country.

The main function of the **central bank is to act as the Government's Bank and guide and regulate the other**

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banking institutions in the country. Given below are the functions of the central bank of a country:

- **Guiding other banks**
- **Issuing currency**
- **Implementing the monetary policies**
- **Supervisor of the financial system**

In other words, the central bank of the country may also be known as the **banker's bank** as it provides assistance to the other banks of the country and manages the financial system of the country, under the **supervision of the Government**.

Cooperative Banks

These banks are organised under the state government's act. They give short term loans to the **agriculture sector and other allied activities**.

The main goal of Cooperative Banks is to **promote social welfare by providing concessional loans**

They are organised in the 3 tier structure

- **Tier 1 (State Level) – State Cooperative Banks (regulated by RBI, State Govt, NABARD)**
  - **Funded by RBI, government, NABARD. Money is then distributed to the public**
  - **Concessional CRR, SLR applies to these banks. (CRR- 3%, SLR- 25%)**
  - **Owned by the state government and top management is elected by members**

Tier 2 (District Level) – Central/District Cooperative Banks

Tier 3 (Village Level) – Primary Agriculture Cooperative Banks

Commercial Banks

- Organised under the **Banking Companies Act, 1956**
- They operate on a **commercial basis** and its main objective is profit.
- They have a **unified structure and are owned by the government**, state, or any private entity.
- They tend to **all sectors ranging from rural to urban**
- These banks do not charge **concessional interest rates** unless instructed by the RBI
- Public deposits are the **main source of funds** for these banks

The commercial banks can be further divided into three categories:

1. **Public sector Banks** – A bank where the **majority stakes are owned by the Government** or the central bank of the country.
2. **Private sector Banks** – A bank where the **majority stakes are owned by a private organization** or an individual or a group of people
3. **Foreign Banks** – The banks with their **headquarters in foreign countries** and branches in our country, fall under this type of bank

Regional Rural Banks (RRB)

- These are special types of commercial Banks that provide concessional credit to agriculture and rural sector.
- **RRBs were established in 1975 and are registered under a Regional Rural Bank Act, 1976**.
- **RRBs are joint ventures between the Central government (50%), State government (15%), and a Commercial Bank (35%).**
- 196 RRBs have been established from 1987 to 2005.
- From 2005 onwards government started merger of RRBs thus reducing the number of RRBs to 82
- One RRB cannot open its branches in more than **3 geographically connected districts**.

Local Area Banks (LAB)

- Introduced in India in the **year 1996**
- These are organized by the **private sector**
- **Earning profit is the main objective of Local Area Banks**
- Local Area Banks are registered under **Companies Act, 1956**
- At present, there are only **4 Local Area Banks all which are located in South India**

Specialized Banks

Certain banks are introduced for specific purposes only. Such banks are called specialized banks. These include:

- **Small Industries Development Bank of India (SIDBI)** – Loan for a small scale industry or business can be taken from SIDBI. Financing small industries with modern technology and equipments is done with the help of this bank
- **EXIM BANK** – EXIM Bank stands for Export and Import Bank. To get loans or other financial assistance with exporting or importing goods by foreign countries can be done through this type of bank

- **National Bank for Agricultural & Rural Development (NABARD)** – To get any kind of financial assistance for rural, handicraft, village, and agricultural development, people can turn to NABARD.

There are various other **specialized banks** and each possesses a different role in helping develop the country financially.

Small Finance Banks

As the name suggests, this type of **bank looks after the micro industries, small farmers, and the unorganized sector of the society** by providing them loans and financial assistance. These banks are governed by the central bank of the country.

Digital Banking Units:

- A Digital Banking Unit is a **specialised fixed point business unit or hub, set up by scheduled commercial banks**, **housing certain minimum digital infrastructure for delivering digital banking products and services** as well as **servicing existing financial products and services digitally** in self-service mode at any time.
- The DBUs are being set up with the objective to **ensure the benefits of digital banking reach every nook and corner** of the country and will cover all the States and Union territories.

Payments Banks

A payments bank is like any other bank, **but operating on a smaller scale without involving any credit risk**. In simple words, it can carry out most banking operations but can't advance loans or issue credit cards. **It can accept demand deposits (up to Rs 1 lakh), offer remittance services, mobile payments/transfers/purchases and other banking services like ATM/debit cards, net banking and third party fund transfers.**

Nationalization of Banks

- The RBI was nationalized in 1949.
- With the enactment of SBI Act, 1955 three imperial Banks were merged and State Bank of India was formed.
- **In 1969, under the Banking Nationalization Act, 20 Private Banks were nationalized**.
- **The second phase of nationalization came in April 1980 when several other banks were nationalized.**

Benefits of Nationalization

- **Checking monopoly** of few private banks.
- **Ensure a smooth supply of credit** to socially desirable Sections.
- **Financial Accessibility by expanding banking network** (by opening new bank branches) in the un-banked Areas.
- **Financial Awareness** through geographical expansion to rural areas.
- **Priority Sector Lending (PSL)** to cater to the needs of the agriculture sector and its allied activities which were the largest contributor to the national income but were deprived of their due share in the credit.

Demerits

- **Banks profitability decreased** due to high Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR). Moreover, PSL targets left very little funds with Banks to make profits.
- **Opening of large number of bank branches** led to Overstaffing which became economically unviable
- **Number of bad loans and Non Profit Assets increased.**
- **Banks were used by political class** by announcing loan Waiver schemes.
- **Customer service degraded**.

Banking Sector Reforms

Narasimham Committee, 1991

Purpose: To recommend **measures to restore the financial health of commercial banks and make them Function efficiently and profitably**.

On the recommendations of Narasimham Committee, government undertook following measures:

- As **high SLR and CRR reduced the profits of the banks, Government reduced them so that banks have enough funds for allocation to agriculture, industry, Trade**, etc.
- **Prudential Norms by RBI to impart** professionalism in commercial banks. For example, classification of assets, proper disclosure of income and provision for bad debts which ensures that the books of commercial banks reflect the accurate and correct picture of their financial condition.
- **Capital Adequacy Ratio (CAR**) is the ratio of minimum capital to risk asset ratio. In April 1992 **RBI fixed CAR at 8%**
- As per current RBI norms, **Indian scheduled commercial banks are required to maintain a CAR of 9% while Indian Public Sector Banks are emphasized to maintain 12% CAR.**
- **Deregulation of interest rates** by linking them to the market forces. Also, Scheduled Commercial banks have freedom to set interest rates on their deposits subject to minimum floor rates and maximum ceiling rates.

Narasimham Committee, 1998

- Purpose: To review **the banking reform progress and design a programme to further strengthen the financial system of India**. The recommendations

were: Merger of major banks which will have 'multiplier effect on the industry.

- **Narrow Banking Concept'** for successful rehabilitation of banks with high NPAS; wherein weak banks will be allowed to place their funds only in short term and risk free assets.
- **To improve the strength of the Indian banking system**, the committee recommended to raise capital adequacy norms.
- **Review of functions of boards to adopt professional corporate strategy** to check the imbalance between Government control over the banks in the form of management and ownership, and bank autonomy.
- **Review and amend governing laws like RBI Act, Banking Regulation Act**, State Bank of India Act, Bank Nationalization Act, etc to line them up with present needs of the banking sector in India.
- **Faster computerization,** technology up gradation, training of staff, depoliticizing of banks, professionalism in banking, reviewing bank recruitment, etc.

NachiketMor Committee, 2013

- **Purpose: To study comprehensive financial services for small businesses and low-income households**. The recommendations:
- Providing a **universal bank account** to all Indians above the age of 18 years by January 1, 2016.
- To achieve this, a **vertically differentiated banking** system with payments banks for deposits and payments and wholesale banks for credit outreach must be developed.
- **Aadhaar will be the prime driver towards rapid expansion** in the number of bank accounts.
- Monitoring at the district level such as deposits and Advances as a percentage of GDP. Adjusted **50% priority sector lending target** with adjustments for sectors and regions based on difficulty in lending.
- **Universal Electronic Bank Account (UEBA**): Each Indian resident, above the age of eighteen years, would have an individual, full service, safe, and secure electronic bank account.

PJ Nayak Committee, 2014

Purpose: To review governance of Boards of Banks in India. The recommendations:

- Conversion of PSBS into companies as per the Companies Act.
- **Formation of a Bank Investment Company (BIC**) under the Companies Act and transfer of shares by the central government in **PSBS to the BIC**.
- BIC should be given controlling power of boards of PSBS.
- **Proportionate voting rights to all shareholders** and reduction of governmental shareholding to **40%**.
- Government to control earnings and returns on investment only.
- Fair return on investment to the Central government would be the responsibility of BIC.
- **Appointments of CEOs, Inside Directors and top Executives of PSBS would be the responsibility of the Bank Boards Bureau c**onstituting three serving or retired bank chairman.

Basel Norms

Basel Norms are the **set of agreements** which mainly focus on risks to banks and the financial system. The norm **ensures that financial institutions** have enough capital to meet unexpected losses and obligations. Up till now **Basel Accord has given us three Basel norms**.

- **BASEL-I** focused almost entirely on credit risk and defined capital and structure of risk weights for banks. The minimum capital requirement was **fixed at 8% of Risk Weighted Assets**. India adopted Basel I guidelines in 1999.
- **BASEL-II guidelines:**
  - Banks should maintain a minimum capital **adequacy requirement of 8% of risk assets.**
  - Banks were needed to develop and use better risk Management techniques in monitoring and managing all three risks namely **operational risk, Market risk, capital risk**. Banks are mandated to disclose their risk Exposure, etc., to the central bank.
  - Basel II norms in India and overseas are yet to be fully implemented.
- **BASEL-III norms were introduced in response to the 2008 financial crisis:**
  - Aim at making most banking activities more capital-intensive and promoting a more resilient banking system by focusing on four **vital banking parameters viz. Capital, leverage, funding and liquidity**.
  - **The RBI is in the process of implementing BASEL III norms in India.**

Capital Adequacy Ratio/Capital to Risk Weighted Asset Ratio (CAR/ CRAR) Total Capital/RWA 100 (Total Capital Tier1 - Tier2 capital)

- RWA: Risk Weighted Assets are assets with different risk profiles.
- **Tier 1 Capital is the core capital like paid up capital, statutory reserves, Other disclosed free reserves, capital reserves.**
- **Tier 2 Capital is the subordinate capital and include undisclosed reserves, revaluation reserves general provisions and loss reserves, debt capital instruments like bonds, long term unsecured loans, etc**.

Marginal Cost of Funds Based Lending Rate (MCLR)

- A system closely based on market rates, allowing quicker transmission of the monetary policy.
- **An internal benchmark lending rate where interest rate for different customers will be fixed in accordance with their risk. To be revised every month by considering factors like repo rate and other borrowing rates.**
- While calculating the lending rate, banks have to consider the costs for obtaining funds which is basically the interest rate given to the depositors.
- It is the minimum lending rate below which a bank is not permitted to lend,

Why MCLR Reforms?

- At present, banks are **slightly reluctant to change their interest rate** in accordance with repo rate change by the RBI. So, even if RBI reduced repo rates, the benefits were not transferred to the customers by banks.
- Hence, the **MCLR facilitates the so called monetary transmission as it is mandatory for banks to consider the repo rate while calculating their MCLP**

Money Market:

Major Terminologies – Financial Market

Treasury Bills: They are **promissory notes** issued by the RBI on behalf of the government as a short term liability and sold to banks and the public. The maturity period ranges from **14 to 364 days**. They are the negotiable instruments, i.e. **they are freely transferable**. No interest is paid on **such bills but they are issued at a discount on their face value**.

Commercial Bills: They are also called **Trade Bills or Bills of Exchange**. Commercial bills are drawn by one business firm to another in lieu of credit transactions. It is a written acknowledgment of the debt by the maker directing to pay a specified sum of money to a particular person. They are short-term instruments generally **issued for 90 days**. These are freely marketable. Banks provide working capital finance to firms by purchasing the commercial bills at a discount; this is called **'discounting of bills'**.

Commercial Paper (CP): The CP was introduced in **1990** on the recommendation of the **Vaghul Committee.** A commercial paper is an unsecured promissory note issued by a corporate with a net worth of at least **Rs 5 crore** to the banks for short term loans. These are issued at discount on face value for a period of **14 days to 12 months**. These are issued in multiples of Rs 1 lakh subject to a **minimum of Rs 25 lakh.**

Certificate of Deposit (CD): The CD was introduced in **1989 on the recommendation of the Vaghul Committee**. These are issued by banks against deposits kept by individuals and institutions for a period of **15 days to 3 years**. These are similar to Fixed Deposits but are negotiable and tradable. These are issued in multiples of **Rs. 1 lakh subject to a minimum of Rs 25 lakh**.

Discount and Finance House of India Ltd.: DFHI was set up as a subsidiary of RBI in 1988 on the recommendation of the **Vaghul Committee**. Its objective is to stimulate activity in the money market by providing liquidity to the money market instrument. It buys bills and short term securities from banks and financial institutions thereby developing a secondary market in them. DFHI was set up as a **subsidiary of RBI** in 1988 on the recommendation of the **Vaghul Committee**. It buys bills and short term securities from banks and financial institutions thereby developing a secondary market in them.

Gilt-Edged Market

The Gilt-edged market refers to the market for government and **semi-government securities**, backed by the RBI. The term gilt-edged means **'of the best quality'**. It is known so because the government securities do not suffer from the risk of default and are highly liquid. The **RBI is the sole supplier of such securities**. These are demanded by commercial banks, insurance companies, provident funds, and mutual funds.

The **gilt-edged market** may be divided into two parts- the Treasury bill market and the government bond market. Treasury bills are issued to meet short-term needs for funds of the government, while government bonds are issued to **finance long-term developmental expenditure**.



Capital Market

- An **institutional arrangement for borrowing medium and long-term funds**.
- In particular, there are two categories of financial instruments in which capital markets are involved - equity securities (often known as stocks) and debt securities (also known as bonds).
- **Capital markets** involve the issuing of stocks and bonds for medium-term and long-term durations.
- **Securities market** is place where securities are traded consisting of two segments:
- Primary market: It facilitates procurement of long term funds by companies by issuing fresh **shares and debentures.**
- Secondary market: It provides a place for **purchase and sale of existing securities and is often termed as stock market or stock exchange.**
- It is where these securities are encased.
- It facilitates the **growth of primary market** as the investors in the primary market are assured of a continuous market for liquidity of their holdings.

Important Functions

- **Mobilizing savings** for further investments in the productive channels of economy.
- **Capital formation** by making available mobilized savings to various segments such as agriculture, industry, etc.
- **Provision of Investment Avenue** for people who wish to invest resources for a long period of time.
- **Speed up development by making funds** available for a long period of time, so that the financial requirements of business houses are met by the capital market.
- **Continuous flow of funds** as capital market is highly liquid in nature because it makes fund easily available.

Difference Primary Market & Secondary Market		
Basis	Primary market (New issue market)	Secondary market (Stock exchange)
Securities traded	Sale of securities by new companies or new issues of securities by existing companies are sold to investors.	Trading of only existing securities takes place
Buying/selling	Only buying of Securities takes place in the primary market. Securities cannot be sold there.	Both buying and selling of securities can take place on the stock exchange.
Purpose	Securities are issued By the company directly for through an intermediary).	Ownership of existing securities is exchanged between investors. Company is not involved at all.
Capital Formation	The flow of funds is from savers to investors, primary market directly promotes capital formation.	Enhances liquidity of Securities, ie. The secondary market indirectly promotes capital formation.
Price determination	Prices of securities are determined by the management of the company.	Price are determined by demand and supply of the securities
Location	There is no fixed geographical location.	Located at specified place.

Stock Exchange

A term commonly used for secondary market, which provide a place where different types of existing securities such as shares, debentures and bonds, government securities can be bought and sold on a **regular basis**.

Functions of a Stock Exchange

- Provides ready and continuous market
- Provides information about prices and sales Provides safety to dealings and investment
- Helps in mobilization of savings and capital formation
- Barometer of economic and business conditions
- Better allocation of funds.

Stock Exchanges in India

The first organized stock exchange in India was started in Mumbai known as Bombay Stock Exchange, (BSE) in **1875**. It was followed by Ahmadabad Stock Exchange in **1894** and **Kolkata Stock Exchange in 1908**.

National Stock Exchange

- Based in Mumbai was incorporated in **1992** and commenced its **operations in 1994**.
- First exchange in the country to provide a modern, **fully automated screen-based electronic trading System.**
- Established with a diversified shareholding comprising domestic and global investors.

Nifty

- **The CNX Nifty is a well diversified 50 stock index accounting for 22 sectors of the economy**.
- Owned and managed by India Index Services and Products Ltd. (ISL), which is a **joint venture between NSE and CRISIL.**

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Shares vs Debentures		
Characteristics	Debentures	Shares
Capital/Loan	Part of loan of the Company.	Part of capital of the Company
Presentation	On liabilities side under Secured Loan.	On liabilities side under Share Capital
Creditor/Owner	Holders are the creditors	Holders are the owners
Participation in Management	Debenture holders do not participate in the management of the company because they do not have any threat to the existing control of the company.	Shareholders Participate in the management of the company and control the total affairs of the company
Voting Right	Do not have voting right	Have voting right
Interest/ Dividend	Interest is paid at Predetermined fixed rate whether there is any profit or not	Dividend on equity shares is paid at variable rate affected by the profits of the company
Security for Payment	Yes	No

Over The Counter Exchange of India (OTCEI)

- Provides for nationwide online ringlets trading with **20 plus representative offices in all major cities of the country.**
- Securities of those companies can be traded which are exclusively listed on **OTCEI only**.

Bombay Stock Exchange

- The Bombay Stock Exchange Ltd. (BSE), earlier a regional stock exchange, converted into a national one in **2002**.
- The biggest in India, **it accounts for almost 75% of total stocks traded in India and is the fifth largest in the world** (on the basis of market capitalization).

Securities and Exchange Board of India

- As part of economic reforms programme started in **June 1991**, the Government of India initiated several capital market reforms, which included the abolition of the office of the **Controller of Capital Issues (CCI)** and granting statutory recognition to Securities and Exchange Board of India (SEBI) in **1992** for:
- Protecting the **interest of investors in securities**;
- Promoting the **development of securities market**;
- **Regulating** the securities market; and
- Matters connected there with or incidental thereto. SEBI has been vested with necessary powers
- Concerning various aspects of capital market such as:
- **Regulating the business** in stock exchanges and any other securities market.
- **Registering and regulating** the working of various intermediaries and mutual funds.
- Promoting and regulating self-regulatory organisations
- Promoting investors education and training of Intermediaries.
- Prohibiting insider trading and unfair trade practices.
- Regulating substantial acquisition of shares and takeover of companies.

Financial Sector: Key Terms

- Stocks, or shares of stock, represent an **ownership interest in a corporation.**
- **Bonds are a form of long-term debt** in which the issuing corporation promises to pay the principal amount at a specific date.
- **Types of Bonds**:
- **Government bonds**: A debt security issued by the central bank on behalf of the government to support government spending.
- **Municipal bonds**: A debt security issued by a state, municipality or county to finance its capital expenditures, including the construction of highways, bridges or schools. Exempt from federal taxes and from most state and local taxes.
- **Corporate bonds**: A debt security issued by a corporation and sold to investors. The backing for the bond is usually the payment ability of the company, which is typically money to be earned from future operations. In some cases, the company's physical assets may be used as collateral for bonds.
- **Zero-coupon bonds**: Often sold at a discount and have a fixed interest rate that only pays out upon bond maturity. In other words, there are no periodic interest payments from these bonds; instead, the interest accrues, or builds up, over time.
- **Initial Public offering refers** to the process of offering shares of a private corporation to the public in a new stock issuance.
- Treasury Bills are issued when the government is in the need for a short-term finance. **These can be issued only by the central government** and the interest on them is determined by the market forces for issuance period of **91 days, 182 days, and 364 days.**

Inflation

- **The rate at which the general level of prices for goods and services is rising and, consequently, the purchasing power of currency is falling**. It is measured as an **annual percentage increase**.
- As inflation rises, every rupee you own buys a smaller percentage of a good or service. Thus, inflation results in loss of value of money.
- **Inflation is attributed to monetary growth relative to the output/availability of goods and services in the economy.**
- **Economists favor some inflation** for a growing economy - some amount of price rise is inevitable when there is economic growth.

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- If **inflation is slowing down quickly** and is not accompanied by a faster pace of growth in GDP, it might lead to a slowdown in economic growth.

Different Types of Inflation

Demand-Pull Inflation

- It results from strong consumer demand when many individuals purchasing the same good causes the price to increase.
- In other words at a macro scale, **when supply is not able to match the rising demand, there is a general rise in price level.**

Reasons that increase aggregate demand are the Following:

- Increase in the money supply.
- Increase in government purchases.
- **Depreciation of local exchange rates**, which raises the price of imports and, for foreigners, reduces the price of exports. As a result, the purchasing of imports decreases while the buying of exports by foreigners increases, thereby raising the overall level of aggregate demand.
- **Rapid overseas growth** can also ignite an increase in demand as there is an increase in demand of the exports consumed by foreigners.
- **If government reduces taxes**, households have more disposable income leading to increased consumer spending.

Cost-Push Inflation

- It is caused by an **increase in prices of inputs like labour, raw material, etc. Which leads to a decreased supply of goods**
- The two main sources of decrease in aggregate supply are:
- An increase in **wage rates**
- An increase in the **price of raw materials**
- Other things remaining the same, higher the cost of production leads to **smaller amount of production**. For example, rising wage rates or rising prices of raw materials such as oil lead firms to decrease the **quantity of labor employed and to cut production.**

Deflation

- While inflation refers to the rise in price levels in an economy, **deflation refers to the fall in price levels,** it moves hand in hand with economic slowdown and loss of jobs.
- **A positive aspect of deflation** is increased export competitiveness as most other economies are in an inflationary trend.

Disinflation

- It refers to a **slower rate of inflation**.
- Unlike deflation, **it is considered a positive sign**
- However, disinflation without economic growth can be a cause for worry.

Stagflation

- It is a condition of slow **economic growth and rising prices (inflation).**
- Stagflation occurs when the economy isn't growing but prices are going up.

Structural Inflation

- Persistent inflation caused **by deficiencies in certain conditions of the economy such as backward agricultural sector that is unable to respond to people's increased demand for food, inefficient distribution and storage facilities, and production of some goods controlled by a small group of people.**
- **Food inflation witnessed in India since 2008 has been structural** as the preference for protein foods is far ahead of its supplies and it is a phenomenon driven by income rise.

Hyperinflation

- It refers to a situation where the **price increases are too sharp.**
- It occurs when there is a large **increase in the money supply**, though not supported by growth in GDP resulting in an imbalance in the supply and demand for the money,
- If unchecked, it results in sharp increase in prices and **depreciation of the domestic currency**.

Headline Inflation

- It is a measure of the **total inflation within an economy, including commodities such as food and energy prices (e.g., oil and gas), which tend to be much more volatile and prone to inflationary spikes.**
- **Headline inflation** may not present an accurate picture of an economy's inflationary trend since **sector-specific inflationary spikes** are unlikely to persist.

NOTE: **Core Inflation or non-food-manufacturing or underlying inflation is calculated from a price index minus the volatile food and fuel components**.

Indices of Inflation

- The changes in the price level at the retail and wholesale level are tracked by two price indices **Wholesale Price Index (WPI) and Consumer Price Index (CPI).**
- The price indices uses a particular year as a base year ,Meaning that rises and falls in prices are measured with reference to the price in that year.
- The base year for **both WPI and CPI is 2011-12**.

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Measurement of Inflation in India

WPI

- The most widely used inflation indicator in India.
- Published by the **Office of Economic Adviser, Ministry of Commerce and Industry**.
- All transactions at first point of bulk sale in the domestic market are included
- Major criticism for this index is that the general public **does not buy products at wholesale price**.
- Hence, **WPI does not give actual picture of the amount of pressure borne by the general public.** However, the increase in wholesale prices does affect the retail prices.

CPI

- Measures price changes from the **perspective of a retail buyer.**
- Measures changes over time at the level of retailer
- **Prices of selected goods and services on which consumers** of a defined group spend their incomes.
- Four types of consumer price index are as follows:
  - **CPI for Industrial Workers (IW)**
  - **CPI for Agricultural Laborer (AL)**
  - **CPI for Rural Laborer (RL)**
  - **CPI (Rural/Urban/Combined)**
- Of these the first three are compiled by the **Labour Bureau** in the **Ministry of Labour and Employment,** while fourth is compiled by **Central Statistical Organization (CSO)** in the Ministry of Statistics and Programme Implementation.

Producer Price Index (PPI)

- Measures the average change over a period of time in **selling prices by producers of goods and services.**
- It measures price change from the point of view of the seller.
- Majority of **Organization for Economic Co-operation and Development (OECD) countries measure inflation based on PPI** while others use Wholesale Price Index (WPI).

Remedial Measures to Control Inflation

- By addressing **supply side bottlenecks** such as infrastructure, marketing, etc.
- By directly affecting the **demand pull inflation** changing the amount of liquidity circulating in the Economy.
- **Fiscal measures** include reduced import duties on food items, raised import duties on gold, etc., to contain Current Account Deficit (CAD).
- **Monetary measure** is when RBI changes liquidity in market by its various tools viz. CRR, Bank Rate, Repo and Reverse Repo Rate, SLR, etc.

Public Finance

- The study of **government's role in resource mobilization and utilization in an economy** constitutes public finance.
- **It comprises government revenue and government expenditure** by public authorities to enable it to spend money in accordance with the national priorities.

Budget

- The Union Budget of India is also referred to as the Annual Financial Statement in **Article 112 of the Constitution of India**
- It is a statement of income and expenditure of the government. General budget has three set of figures actual **figure of the previous year, budget & revised estimates for the current year and budget estimates for the upcoming year**.
- The Government presents the Budget on the first day of February so that it could be materialized before the beginning of the new financial year beginning April.
- The first Indian Budget was presented by Mr. **James Wilson on February 18, 1860**. The first Union budget of independent India was presented by **R.K. Shanmukham Chetty** on 26 November 1947.
- **Till 1955, the Budget was only printed in English language**. After that, it started getting printed in both languages, Hindi and English.

Revenue Budget

- Shows **current receipts of the government and the expenditure** that can be met from these receipts. They a generally recurring in nature.
- **Revenue Receipts:** Considered As non-redeemable As Budget They are divided into:
- **Tax revenues: Proceeds of taxes and other duties levied by the central government**. Further, tax revenues comprise of direct taxes (personal income tax, corporation tax), and indirect taxes like excise taxes, customs duties and service tax.
- **Non-tax revenues**: Mainly consist of **interest proceeds of loans** provided by the central government, dividends and profits on investments made by the government. Also, cash grants-in-aid from foreign countries and international organisations are also included as part of revenue receipts.
- **Revenue Expenditure:** Expenditure incurred for s other than the creation of physical or financial purposes of assets constitute revenue expenditures.
- **It includes:**

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Departures in Budget 2017-18

- **Budget was presented a month in advance on 1 February as against the traditional practice of presenting it on last day of February to accelerate implementation of public projects.**
- **The Rail Budget was merged with the Union Budget and a single Comprehensive Budget was presented.**
- **Did away with the distinction of plan and non-plan expenditure replacing by capital expenditure and revenue expenditure classification, as suggested by Rangarajan Committee (2011).**

Capital Budget

Gives an account of central government's assets as well as liabilities.

- **Capital Receipts: Either create liability or reduce financial assets**. Major components:
- Loans raised by the government from the public as well as from foreign governments and international organisations, borrowing from RBI, commercial banks and other financial institutions through the **sale of treasury bills, and recoveries of loans granted.**
- **Small savings accounts like Post Office Savings** Accounts, National Savings Certificates etc, provident funds and net receipts obtained from the sale of shares in Public Sector Undertakings (PSU disinvestment).
- Capital Expenditure**: Results in creation of physical or financial assets or reduction in financial liabilities**. These include acquisition of land, building, machinery, equipment, investment in shares, and loans and advances by the central government to state and union territory governments, PSUs and other parties.

Measures of Government Deficit

When expenditure exceeds revenue, a deficit Is incurred.

Revenue Deficit

- **Excess of government's revenue expenditure over government's revenue receipts.**
- **Revenue deficit= Revenue expenditure - Revenue receipts**.
- Implies disserving on government account and that it is using savings from other sectors of economy to finance a part of its consumption expenditure.

Fiscal Deficit

- **The difference between the government's total expenditure and its total receipts excluding borrowing.** In short, fiscal deficit indicates the total borrowing requirements of the government.
- **Fiscal Deficit = Total Expenditure-(Revenue Receipts + Non-debt Capital Receipts), Net Fiscal Deficit = Fiscal deficit net interest payments (Net interest payment is interest paid minus interest receipt).**
- Also called as Gross Fiscal Deficit (GFD) which measures that portion of government expenditure, which is financed by borrowing and drawing down of cash balances.
- **Gross Fiscal Deficit = Net borrowing at home + Borrowing from RBI + Borrowing from abroad**
- Demerits of Fiscal Deficit
  - High fiscal deficit leaves **little room for the private sector investment.**
  - Rise in fiscal deficit leads to macroeconomic instability that may influence the growth rates.
  - While financing fiscal deficit through domestic borrowing can lead to rise in interest rates, **too much of foreign borrowings can culminate into an external debt crisis.** Printing of money also fuels inflationary pressures.
  - It also **reduces the capacity of the state to lend any support to the economy.**

Primary Deficit

- **Fiscal deficit minus interest payments.**
- Measured to focus on present fiscal imbalances and obtain an estimate of borrowing on account of current expenditures exceeding revenues, **Gross primary deficit = Gross fiscal deficit – Net Interest liabilities**
- Net primary deficit is obtained by subtracting **'Loans and Advances from net fiscal deficit**.

Effective Revenue Deficit

It is the difference between revenue expenditure and grants that create assets.

- Generally, revenue expenditure indicates expenditure to finance day-to-day functions of the government which are not productive.
- Hence, effective revenue deficit includes revenue expenditures that are productive and create assets.

Deficit Financing

- **Method of meeting government deficits through generating new money is termed as deficit financing.**
- Generating new money to meet government deficit had been in use for a long time. But the practice has now been given up.
- A new scheme **called Ways and Means Advances (WMAS)** has been started instead. Under this system, the government gets temporary loans from RBI for an average period of three months to overcome the mismatch between its receipts and expenditures.

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Disadvantages of Deficit Financing

- It results in **inflationary rise** of prices of goods and services in the country.
- **Inflationary forces impact investment as credit availability** decreases due to increased credit rationing by banks.

Fiscal Policy

- The government through changes in its expenditure and taxes can attempt to increase output and income and stabilize the economy.
- A fiscal policy is **one that affects the government's actions to influence an economy** using taxation and spending.

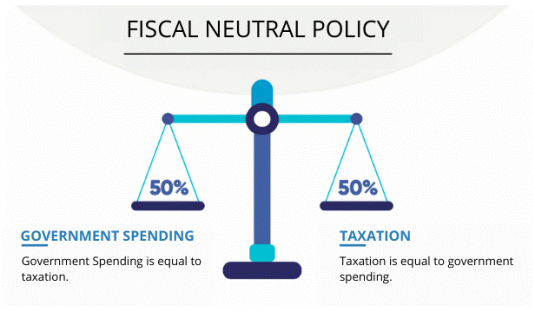
Fiscal Policy	Monetary Policy
Change in government spending and tax rates	Change in interest rates / money supply.
Set by the Government	Set by a Central bank
No specific target	Target inflation
Side effect on government budget / borrowing	Side effect on exchange rate and housing market
Strong political dimension to changing tax rates	Mostly independent from the political process

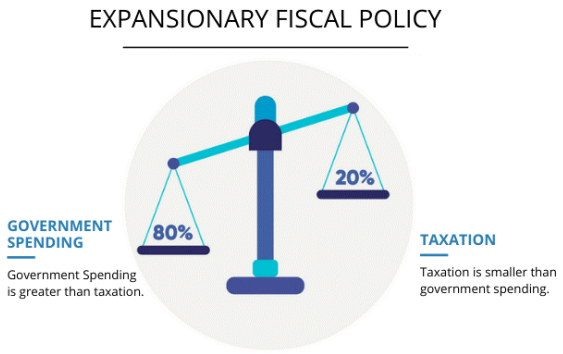
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Objectives

- **Ensure expenditure boosts growth** and welfare of the economy.
- **Ensure efficiency in resource usage and their equal distribution**. Avoid uneconomical expenditure in the economy that May result in price rise.

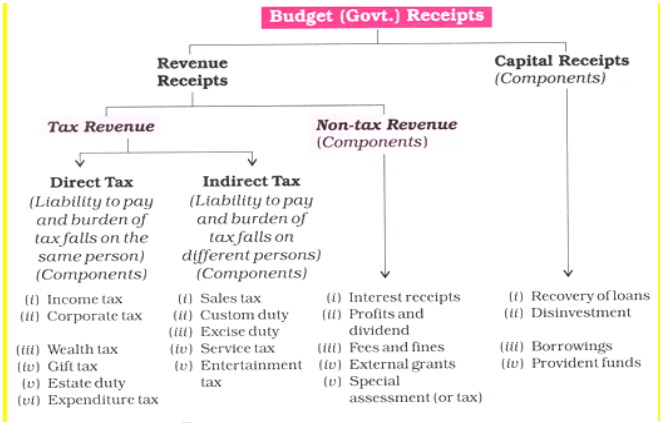
Types of Fiscal Policy:

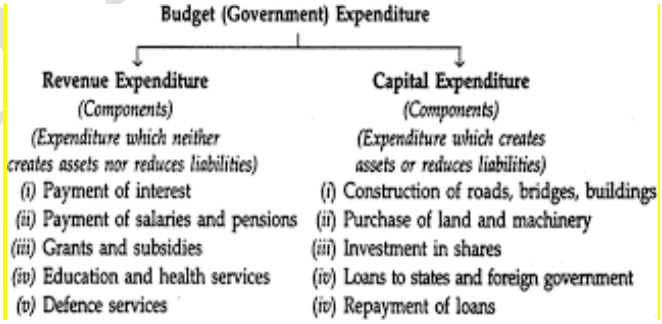






Components of Fiscal Policy:





Effects of Fiscal Policy on Economy

- **Higher government expenditure stimulates aggregate demand** (by pumping money in consumer's hand), which in turn increases output, growth and employment in the economy.
- On the other hand, if the government decreases its spending, aggregate demand decreases and slows the growth of the economy.
- As per **Keynesian economics**, a government must spend specifically during times of economic downturns to fend off recessions and depressions. This is to offset the drop in private sector spending by consumers and businesses to stimulate growth.
- **Government through tax collection leaves less money in pockets of the common citizenry to spend, save and invest**. This means that government can

directly influence spending in an economy through taxes.

- **During recession**, governments generally decrease taxes to boost the income and spending by individuals. More spending ensures that demand is sustained in the economy. However, governments do the opposite during boom when economy faces Inflationary situations.

Criticism of Fiscal Policy

- **Time lags:** Government decisions can take several months to filter through into the economy and actually affect aggregate demand.
- **Crowding out:** Whenever government resorts to public borrowings, it crowds out the private sector with lower availability of funds for private investment
- **High borrowing costs:** Expansionary fiscal policy, at times, result in higher bond yields under certain conditions. This increases the cost of debt repayments.

Taxation

Tax is compulsory levy that an economic unit has to pay to the taxing authority of the country.

Incidence of Tax

- **Final point of contact that bears the real burden of payment is termed as incidence of tax**
- For direct taxes like income tax, incidence and impact of the tax are same, while they are different for indirect taxes like sales tax.

Tax Buoyancy

- **Reflects responsiveness of tax revenue growth to changes in GDP**
- It seeks to establish a positive connection between **The government's revenue earnings and economic growth** (as the economy grows at faster rates, tax revenue of the government also goes up).

Tax Elasticity

Refers to changes in tax revenue in response to tax rate change.

Cess and Surcharge

- **Charge on an already charged tax is termed as surcharge**. It goes to the Consolidated Fund of India allowing government to spend it on any sectors it deems necessary.
- Cess is an additional tax that is levied for particular sectors say education, irrigation, etc.
- Thus, **the major difference is that while surcharge can be used for any purpose, a cess is levied for a particular purpose only**.
- It must be noted that both of them are not shareable with the state governments and belong exclusively to the central government.
- In recent years**, the share of cess and surcharge as a percentage of tax revenue has increased**.
- The **increase in levy has been criticized for misbalancing the vertical fiscal equilibrium**, a situation where revenues do not correspond with the expenditures of different levels of government.
- This is because while the centre gets the larger share of revenues, the states are deprived of shareable revenue.

Classification of Tax

- **Direct Taxes:** Taxes that are **directly paid by the taxpayer to the government**. It includes taxes like income tax, corporation tax, wealth tax etc.
- **Indirect Taxes:** Taxes whose point of impact is **different from its point of incidence, Such taxes are generally applied on the manufacture or sale of goods and services**. Examples of these are goods and services tax, excise duty, etc. Since these taxes put equal burden on unequal's, they are considered regressive in nature.
- **Progressive Tax:** in this case, **tax rate increases with the increase in tax base** (income, wealth or any other object). The principle underlying a progressive tax is that greater the tax base, the higher the tax rate. Though it is the most popular taxation method, this method is criticized for discouraging more earnings by individuals.



Merits and Demerits of Direct and Indirect taxes		
Direct Taxation	• Equitable in that it falls on those who can afford to pay • Give the government direct control over people's spending.	• Discourage hard work and enterprise • Increases the time and resources spent on tax avoidance • The tax on company profits tends to reduce investment • Can be difficult and costly to collect
Indirect Taxation	• Does not discourage effort. • Can be used for specific social policies such as reducing smoking or gambling. • People have a degree of choice in whether they will Pay the tax • Relatively cheap and easy to collect	• Indirect taxes are regressive as a proportion of income they fall more heavily on the poor • The amount of revenue to be raised by excise duty or sales tax cannot easily be predicted

- Regressive Tax: In this case, **the rate is lowered as the income rises**. Thus, tax burden lays relatively more on the poor than rich.
- Proportional Tax: In this case, **tax rate remains same irrespective of the magnitude of the base on which it is levied.** Such taxes are neutral for poor or the rich.

Direct Taxes in India

Income Tax

- **Levied on one's earning** in a financial year, i.e. Between 1 April and 31 March.
- **Tax slabs** are the brackets that determine the tax to be paid based on the annual income of an individual.
- **Tax Deducted at Source (TDS) aims at collecting tax from the very source of income**.

Wealth Tax

- Levied on net wealth of an individual, or a company.
- **The Budget 2015-16 abolished the tax and replaced it with a surcharge on individuals that earn more than 21 crore per annum**. Companies with revenue of over *10 crores per annum are also covered under the new surcharge rates.
- **Currently, people earning 2 crore and 5 crore pay 25% surcharge on the tax amount, whereas, those earning above 5 crore pay 37% as surcharge on tax amount.**

Capital Gains Tax

- **Charged on profits made by an investor through sale of its capital assets**.
- A capital asset **excludes stock-in-trade, agricultural land and certain specified bonds.**
- **Jewellery, archaeological collections, drawings, paintings, sculptures or any work of art are however covered under the definition of 'capital asset'**. It is of two types:
- **Short term capital gains tax** that is charged when investment is held for less than 36 months and is calculated on the basis of income bracket one falls in.
- **Long term capital gains tax** that is charged when investments is held for longer period which is **more than 36 months**.

Securities Transaction Tax

- **Levied on value of securities traded in stock market.**
- This means that every time one buys or sells shares, a tax is charged on them.
- It was **introduced in 2004-05**.

Corporate Tax

Imposed on net income of a company registered in India under the **Companies Act, 1956.**

Minimum Alternate Tax (MAT)

- **Aimed at bringing those companies under tax net which try to escape corporate tax or pay very low tax by using provisions of the tax laws.**
- It states that if total income of a company calculated after availing all eligible deductions is less than **30%** Of its book profit, the company shall be charged a minimum tax as a percentage of its total income.

Alternative Minimum Tax (AMT)

- Introduced for non-corporate tax payers, works on the principles similar to Minimum Alternate tax.
- Hence, **AMT is a minimum tax that is levied alternative to normal tax on adjusted total income in a Financial Year**.

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Goods and Services Tax (GST)

What is GST?

- GST is an Indirect Tax levied on every value addition, it was introduced through 101st Constitutional **Amendment Act, 2017. GST became applicable from 1 July 2017**
- GST is a comprehensive tax as it subsumes almost all the indirect taxes under it; multi-stage because it is applied at every stage of production process and destination-based because it is collected at the point of sale rather than the point of origin.
- Components of GST
- For **intra-State transactions (i.e. Sale within the State), the GST is divided into two components. Central GST (CGST) and State GST (SGST). Revenue is shared equally between the Centre and the State-CGST goes to Central government and SGST goes to the State government.**
- For **inter-State transactions** (i.e. Sale to another State), there is only one type of **tax Integrated GST (IGST).** It is collected by the Central government. The Centre then shares the IGST revenue based on the destination of goods.
- **GST Council was established under Article 279A:**
- **Chairperson - Union Finance Minister**
- **Members - Union Minister of State in-charge of Revenue; Minister in-charge of Finance or Taxation or any other Minister nominated by each State Government.**
- **The Council decides tax rates, CESS, model GST laws and other issues related to GST.**
- The GST regime brought with it some new provisions schemes and bodies like Compensation CESS, Input Tax Credit (ITC), Composition Scheme, Reverse Charge Mechanism, E-way Bill, Goods and Services Tax Network (GSTN) and National Anti-Profiteering Authority (NAA).

Compensation CESS

- **The Compensation CESS is a CESS that is collected on the supply of selected goods and/or services. It seeks to compensate the States for their loss of revenues arising from the implementation of GST**.
- **The States were guaranteed a 14% GST revenue per annum (Base year 2015-16)**. Any shortfall from this revenue path is to be compensated by the Centre.
- For this purpose, a CESS was imposed on selected luxury and sin goods, from which compensation would be paid to the relevant States in bi-monthly Installments. This is effective for five years from the implementation of GST i.e. **Till 1 July 2022.**
- **The CESS is applicable on certain notified goods and in addition to regular GST. For example, SUV vehicles are charged 50% GST, of which the GST tax rate is 28% and the compensation CESS is 22%.**
- The collected compensation CESS flows into the Consolidated Fund of India, and then transferred to the Public Account of India, where a GST compensation CESS account has been created.
- States are compensated **bi-monthly** from the accumulated funds in this account.

Input Tax Credit (ITC)

- For a producer/manufacturer, input tax credit helps partially reduce GST liability by only paying the difference between the tax already paid on the raw materials of a particular good and that on the final product.
- In other words, **the taxes paid on purchase (input tax) can be subtracted from the taxes paid on final product (output tax) to reduce the final GST liability.**
- For example, you are a manufacturer
- Tax payable on output (final product) is **450**
- Tax paid on input (purchases) is **300**
- You can claim Input Credit of **300** and you only need to deposit **150** in taxes.
- ITC can be claimed only for business purposes. ITC will not be available for goods or services exclusively used for personal use, exempt supplies, supplies for which ITC is specifically not available.

Composition Scheme

- **The composition scheme is an alternative method of tax levy under GST designed to simplify compliance for small taxpayers and prevent them from the tedious GST formalities.**
- It is optional and the eligible business or person opting to pay tax under this scheme can pay tax at a flat percentage of turnovers every quarter, instead of paying tax at normal rate every month.
- **The scheme is applicable to manufacturers or traders whose taxable business turnover is up to 1.5 crore (75 lakh in case of North-Eastern States). A service provider can opt for the scheme if his taxable turnover is up to 50 lakh.**
- However, the following cannot opt for the scheme:
- Businesses with inter-State supplies.
- Manufacturers of **ice cream, pan masala, or tobacco.**
- Businesses which supply goods through an **E-commerce operator.**
- A casual taxable person or a **non-resident taxable person.**
- The following conditions must be satisfied in order to opt for composition scheme:
- **No Input Tax Credit** can be claimed by a dealer opting for composition scheme.
- The taxpayer has to pay tax at normal rates for transactions under the **Reverse Charge Mechanism.**
- The dealer cannot supply **GST exempted go**ods, etc.

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Reverse Charge Mechanism

- Generally, the supplier of goods or services is liable to pay GST. However, in specified conditions the liability may be cast on the recipient.
- Reverse Charge means **the liability to pay tax is on the recipient of goods or services instead of the supplier of such goods or services in respect of notified categories of supply.**
- **Reverse charge mechanism** in GST is basically applicable in three scenarios:
- Supply of certain goods and services
- **Services through e-commerce** to registered Dealers
- Supply from **unregistered dealers**
- For example, if a vendor who is not registered under GST, supplies goods to a person who is registered under GST, then Reverse Charge would apply. This means that the GST will have to be paid directly by the receiver to the Government instead of the supplier.

E-way bill

- E-way bill is a document required to be carried by a person in charge of the conveyance carrying any consignment of goods**. It is applicable to goods of value exceeding 50,000**
- It is a common and **shared Information Technology (IT) infrastructure** between the Centre and States, and acts as evidence for movement of goods.
- **E-way bill regime** is not applicable on some goods, for example postal package, petrol, diesel, natural gas etc.

Goods and Services Tax Network (GSTN)

- GSTN is a not for profit, non-government private limited company.
- The Company has been set up primarily to provide **IT infrastructure and services to the Central and State Governments, tax payers and other stakeholders for Implementation of the Goods and Services Tax (GST)**.

National Anti-Profiteering Authority (NAA)

- The NAA was established under the Central Goods and Services Tax (CGST) Act, 2017.
- The Authority monitors whether any reduction in the rate of tax or benefit of input tax credit is passed to the recipient by way of appropriate reduction in prices. **The action of not passing of such benefits to the recipient amounts to "profiteering".**
- NAA has the authority to deregister an entity or business if it fails to pass on the benefit of lower taxes under GST to the customer.
- NAA has the authority to penalise businesses.

Basis for Comparison	Tax Avoidance	Tax Evasion
Meaning	Minimization of tax liability through means that do not violate the tax rules.	Reducing tax liability by using illegal means.
Concept	Taking unfair advantage of the shortcomings in the tax laws	Deliberate account manipulation resulting In fraud
Type of act	Legal	Criminal
Consequences	Deferment of tax liability	Penalty or imprisonment

FRBM Act

- Enacted by Parliament in **2003**, the Fiscal Responsibility and Budget Management (FRBM) Act **seeks to bring in fiscal discipline by imposing limits on central government's fiscal and revenue deficit.**
- The act empowers **RBI to take essential measures** to control inflation. Some of its provisions are:
- It targeted to eliminate revenue deficit by 2008 (**0.5% annually**) and thereafter build up adequate revenue surplus.
- **It mandated Central government to take appropriate measures to reduce fiscal deficit to 3% of GDP by 2008-09, annual targeting 0.3% reduction.**
- It stated that Fiscal Deficit and Revenue Deficit targets can be exceeded only on **grounds of national security, calamity or on exceptional grounds.**
- The Rules had **mid-year targets** for fiscal and revenue deficits and mandated to restrict fiscal and revenue deficit of the government to 45% of budget estimates at first half of the financial year
- In case of **non-compliance, the Finance Minister was required to explain reasons to the Parliament**, advice corrective steps, and make the proposals for funding the additional deficit.
- However, its implementation was put on hold in **year 2007-08** due to global financial crisis and the need for fiscal stimulus.
- **It was amended in 2012 to target effective revenue deficit in place of revenue deficit**.

Fiscal Consolidation and FRBM Act

- **Reduction in the fiscal deficit of a government indicating improved fiscal health of the economy is termed as fiscal consolidation**.
- It can be done through various means like cutting down subsidies, stopping leakages in subsidies, reforming tax structures, improving the performance of PSUS, recovering black money, etc.

- Thus, improved tax **revenue realization** and better aligned expenditure are major components of fiscal consolidation.
- In India, the **FRBM Act provided** the fiscal roadmap for the center that gave revenue and fiscal deficit targets for fiscal consolidation in India.
- The government to achieve fiscal consolidation has envisaged following measures:
- **To realize improved tax revenue, increasing efficiency of tax administration by reducing tax avoidance, eliminating tax evasion, enhancing tax compliance etc. Are to be done.**
- **Widening the tax base to enhance tax GDP ratio and minimizing tax concessions and exemptions also help in improving tax revenues.**
- **Better targeting of Government subsidies is needed. It can be done by extending Direct Benefit Transfer for more subsidies.**

N.K. Singh Committee

A Committee under former Revenue Secretary**, N.K. Singh was constituted by the government in May 2016** for reviewing the Fiscal Responsibility and Budget Management (FRBM) Act, 2003.

Recommendations

- The Committee suggested using debt as the primary target for fiscal policy.
- **A debt to GDP ratio of 60% should be targeted with a 40% limit for the Centre and 20%** limit for the States. The targeted debt to GDP ratio should be achieved by 2023.
- **To achieve the targeted debt to GDP ratio, it proposed yearly targets to progressively reduce the fiscal and revenue deficits till 2023.**
- The Committee suggested that grounds on which the government can deviate from the targets should be clearly specified, and the government should not be allowed to notify other circumstances.
- Further, the government may be allowed to deviate from the specified targets upon the advice of the **Fiscal Council** in the following

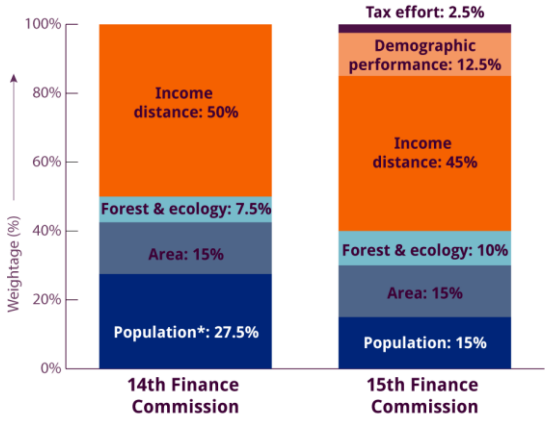
Circumstances:

- Considerations of national security, war, national calamities and collapse of agriculture affecting output and incomes,
- structural reforms in the economy resulting in fiscal implications, or
- **Decline in real output growth of at least 3% below the average of the previous four quarters.**
- **These deviations cannot be more than 0.5% of GDP in a year.**

15th Finance Commission Report for 2020-2021

- The first report of the **15th Finance Commission** (FC) for the **financial year 2020-21**, was tabled in Parliament on **February 1, 2020**. The final report for the **2021-26** period will be submitted by **October 2020**,

Revenue-sharing formulas in the 14th and 15th Finance Commissions



Key recommendations

- **Devolution of Taxes to States:** The share of states in the centre's taxes is recommended to be decreased **from 42% during the 2015-20 period to 41% for 2020 21**. This 1% of the divisible pool is necessary to meet the security and other special needs of the Union Territories of Jammu and Kashmir and Ladakh
- **Grants in Aid:** The Commission has also proposed a framework for sector-specific and performance-based grants. State-specific grants will be provided in the final report.
- **Sector-specific grants:** The Commission has recommended a grant of **around 27,400 crores for nutrition in 2020-21**. Other sector-specific grants for health, railways, etc. Will be provided in the final report.
- **Grants to local bodies: FC has recommended an amount of 290,000 crore as grant to local bodies for 2020-21, which is 4.31% of the estimated divisible pool.** The grants will be divided between states based on population and area in the ratio 90:10 and will be made available to all three tiers of Panchayat-village, block, and district.
- **Disaster risk management: The Commission recommended setting up National and State Disaster Management Funds (NDMF and SDMF) for the promotion of local-level mitigation activities**. The Commission has recommended retaining the existing cost-sharing patterns between the centre and states to fund the new SDMF and the existing State Disaster Response Fund (SDRF). **The cost-sharing pattern between centre and states is 75:25 for all states, and 90:10 for north-eastern and Himalayan states.**

- **Statutory framework for public financial management:** The Commission recommended forming an expert group to draft legislation to provide for a statutory framework for a sound public financial management system.

Contemporary Committees related to Public Finance

Tax Administration Reforms Commission (TARC) - chaired by **Dr Parthasarathi Shome**, submitted its report on May 30, 2014. The Committee made following observations:

- There exists an artificial separation between direct and indirect tax administration, and a lack of cooperation between **CBDT and CBIC**.
- One of the highest numbers of **disputes between tax administration and taxpayers exists in India with lowest proportion of recovery of tax arrears**.
- Research-based policy analysis and impact assessment studies are absent. Neither the benefits of **Information and Communication Technology (ICT) systems** have been reaped.

Recommendations

Consumer Focus:

- Ombudsman's decision with regard to redressing taxpayer grievances should be binding on tax officers.
- A **minimum of 10% of the tax administration's** budget must be spent on taxpayer services.

Structure and Governance:

- Full integration of **CBDT and CBIC in 10 years** as a unified management structure under the Central Board of Direct and Indirect Taxes.
- Ending the post of **Revenue Secretary** and its
- Functions should be assigned to the two Boards, setting up a **Governing Council** to oversee the working of Boards and a Tax Council to suggest policy and legislation.

Human Resource Development:

- **Indian Revenue Service (IRS) officers** should be specialized in specific tax administration areas.
- **Central Vigilance Commission** should have al member who has been an IRS officer.

Dispute Resolution and Management:

- **Retrospective legislation** should be avoided.
- **A special drive for review** and liquidation of cases presently clogging the system should be run by setting up dedicated task forces.

Kelkar Committee on **Fiscal Consolidation**-under the chairmanship of **Dr. Vijay Kelkar a committee** was constituted in **2012** to outline roadmap for fiscal consolidation.

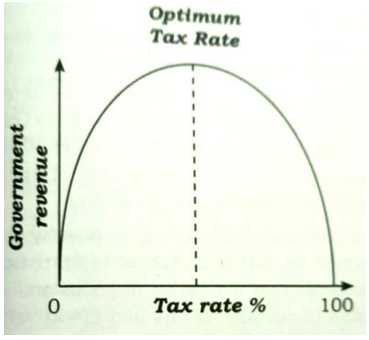
Recent Committees Relate to Finance

Committee	Head	Purpose
High-Level Advisory Group on Elephant Bonds	Surjit S Bhalla	To identify and pursue opportunities and address challenges in the current global trade scenario.
Committee on MSME	UK Sinha	To propose long term solutions for the economic and financial sustainability of MSME's
Committee to Strengthen Core Investment Companies (CIC) Framework	Tapan Ray	The MSME (Micro, Small and Medium Enterprises).
Committee on Deepening of Digital Payments	Nandan Nilekani	To strengthen the supervisory framework applicable to cics.
Expert Committee on Economic Capital Framework	Dr. Bimal Jalan	To establish a seamless digital payments system which is accessible, affordable and available.
Committee for Sub-National Accounts	Ravindra H Dholakia	To review the current Economic Capital Framework under which the RBI is required to pay the balance of its profits to the central government.
Committee on fintech	Subhash Chandra Garg	To suggest measures to improve State Domestic Product (SDP) and District Domestic Product (DDP).
Committee on bad loans, rising cases of frauds and auditing	YH Malegam	To look into the development and regulation of the Financial Technology (fintech) sector in India.
Task Force on off-Shore rupee market	UshaThorat	To look into reasons for high divergence observed in asset classification and provisioning by banks vis-à-vis RBI's supervisory assessment.

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Laffer's Curve

- Graphic representation of the relationship between possible **rates of taxation and the resulting levels of government revenue**.
- The relationship suggests that **revenues decline beyond a tax rate,** suggesting that government revenue will increase with tax rate only up to certain point of time.
- Arthur Laffer plotted the curve on a graph with revenue displayed on the vertical axis and the tax rates on the horizontal axis.



- The shape of the Laffer curve suggests that at **take rates approaching 100%,** taxpayers will become reluctant to not work at all or will work less as they have **no incentive to work**.
- Hence, a government wanting **to maximize its tax revenues** must ascertain its optimal tax rate.

Fiscal Drag

- A condition under which tax payers are pushed towards higher tax brackets due to inflation and increasing earnings growth results in fiscal drag
- Hence, **fiscal drag implicitly raises government's tax revenue without explicitly raising tax rates**.
- Fiscal drag tends to reduce aggregate demand in the economy and **exhibits deflationary fiscal policy.**
- Other school of thought sees it as an automatic fiscal stabilizer because higher earnings growth results in higher taxes and therefore moderates **inflationary pressure in the economy**.

Poverty

A situation when people are deprived of basic necessities of life often characterized by inadequacy of food, shelter and clothes. In other words, poverty refers to a state of deprivation where there is a lack of essential needs for subsistence.

Key Terms: Poverty Line

Absolute Poverty

- A yardstick for measuring poverty in precise terms helps establish a fixed level of poverty, known as "**poverty line**" below which poverty begins and above which it ends.
- Such a yardstick is believed to be universal in character and would be applicable to all the societies. This concept of poverty is known as "**absolute poverty**".
- Absolute poverty is often known as "**subsistence poverty for it is based on assessments of minimum subsistence requirements or basic "physical needs" such as food, clothing, shelter, health requirements etc. Some concepts of absolute poverty would even include the idea of "basic cultural needs".**

Criticisms:

- The concept of absolute poverty has been widely criticized since it is based on the assumption that there are **minimum basic needs for all people in all societies.**
- This is a difficult argument to defend even with regard to subsistence poverty measured in terms of food, clothing and shelter. **Such needs vary both between and within societies**.

Relative Poverty

- In place of absolute standards, researchers developed the idea of relative standards that is, standards which are relative to particular time and place.
- It is measured in terms **of judgments by members of a particular society of what is considered as reasonable and acceptable standard of living and styles of life** according to the conventions of the day.
- Just as conventions change from time to time, and place to place, so will definitions of poverty in a rapidly changing world, definitions of poverty based on relative standards will be constantly changing Hence, it has been **suggested that any definition of poverty must be related to the needs and demands of a changing society.**

Criticism of Poverty Line Concept

- Even though based on calorie approach, the **poverty line is not a true indicator of malnourishment** Because of interpersonal variations in good habits.
- The notion of **absolute poverty is inadequate because Relative poverty is also equally important.**
- The poverty line, **quantified as a number is reductionist.** It does not capture important aspects of poverty-ill health, low educational attainments. Geographical isolation, Ineffective access to law, powerlessness in civil society, caste and/or gender based disadvantages, etc.
- The poverty line provides the **conceptual rationalization** for looking at the poor as a "category" to be taken care of through targeted ameliorative programmes, ignoring structural inequalities and other factors which generate, sustain, and reproduce poverty.

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- Poverty line derived from **personal consumption patterns** and levels do not take into account items of social consumption such as basic education and health, drinking water supply, sanitation, environmental standards, etc. In terms of normative requirements or effective access.
- The **head-count ratio based on the poverty line does not capture the severity of poverty in terms of the poverty deficit** (total shortfall from the poverty line) or additionally the distribution of consumption expenditure among the poor.
- It is **insensitive to mobility within the below poverty line group**. It is also invariant to upward and downward mobility across the poverty line so long as such mobility takes place in equal measure.
- In a country of **India's continental size and diversity, poverty line based on aggregation** at all-India level ignores State-specific variations in consumption patterns and/or prices.

Committees on Poverty in India

- In **1962**, **Planning Commission** constituted a working group to estimate poverty nationally, and it formulated **poverty lines for rural and urban areas Separate poverty lines for rural and urban areas.**
- **VM Dandekar and N Rath** made the first systematic assessment of poverty in India in 1971, based on **National Sample Survey (NSS) data from 1960-61**. They argued that the poverty line must be derived from the expenditure that was **adequate to provide 2250 calories per day in both rural and urban areas.**
- **Alagh Committee (1979):** Constructed a poverty line for rural and urban areas on the basis of nutritional requirements and **related consumption expenditure based on 1973-74 price levels.** Poverty estimates for subsequent years were to be calculated by adjusting the price level for inflation.
- **Lakdawala Committee (1993):** Constituted to review methodology for poverty estimation and made following suggestions:
- **Consumption expenditure should be calculated based on calorie consumption**,
- State specific poverty lines should be constructed and these should be updated using the Consumer **Price Index of Industrial Workers (CPI-IW) in urban areas and Consumer Price Index of Agricultural Labor (CPI-AL) in rural areas**; and
- Discontinuation of **'scaling'** of poverty estimates based on National Accounts Statistics. This assumes that the basket of goods and services used to calculate **CPI-IW and CPI-AL** reflect the consumption patterns of the poor.
- **Tendulkar Committee (2009):** Constituted by the Planning Commission to address the following three shortcomings of the previous methods:
- Consumption patterns were linked to the 1973-74 **Poverty Line Baskets (PLBS) of goods and services, whereas there were significant changes in the consumption patterns of the poor since that time, which were not reflected in the poverty estimates.**
- There were issues with the adjustment of prices for inflation, both **spatially (across regions) and temporally (across time).**
- Earlier poverty lines assumed that health and education would be provided by the State and formulated poverty lines accordingly.

Recommendations:

- A shift away from calorie **Consumption based poverty estimation.**
- A **uniform Poverty Line Basket (PLB)** across rural and urban India.
- A change in the price adjustment procedure to correct **spatial and temporal issues with price adjustment.**
- Incorporation of private expenditure on health and education while estimating poverty.
- Using **Mixed Reference Period (MRP) based estimates, as opposed to Uniform Reference Period (URP)** based estimates that were used in earlier methods for estimating poverty.
- a new method of updating poverty lines, adjusting for changes in prices and patterns of consumption, using the consumption basket of people close to the poverty line. Thus, the estimates released in **2009-10 and 2011-12** use this method instead of using indices derived from the **CPI-AL for rural areas and CPI-IW for urban areas as was done earlier**.
- **Rangarajan Committee:** Set up in **2012** in the backdrop of national outrage over the Planning Commission's suggested **poverty line of *22 a day for rural areas.**
- The **Rangarajan committee** estimation is based on an independent large survey of households by **Center for Monitoring Indian Economy (CMIE),**
- It considered average requirements of calories, protein and fats based on **Indian Council of Medical Research (ICMR)** norms differentiated by **age and gender**.
- Based on this methodology, **Rangarajan committee Estimated the number of poor were 19% higher in Rural areas and 41% more in urban areas than what was estimated using Tendulkar committee formula**
- Taskforce on elimination of poverty was set up by **NITI Aayog**, under **Arvind Panagariya** to come out With recommendations for a realistic poverty line.

Uniform Reference Period (URP)

- **El 1993-94** consumption information collected by the **NSSO** was based an the Uniform Reference Period (URP), which measured **consumption is a 30-day recall period**. That is, survey respondents

were asked and their consumption in the previous 30 days.

Mind Reference Period (MRP)

- Uniform 1999-2000 onwards, the NSSO switched to a method known as the Mixed Reference Period (MRP). **The MRP measures consumption of five frequently items (clothing, footwear, durables, education and institutional health expenditure) over the previous year, and all other items over the prior 30 days**. That is to say, for the five items, survey respondents are asked about consumption in the previous one year. For the remaining they are asked about consumption in the **previous 30 days**.

Modified Mixed Reference Period

- In this method, for some food items, instead of a 30-day recall, only a day recall is collected. Also, for some low-frequency items, **instead of 30-day recall, a 1-year recall is collected**. This is believed to provide a more accurate reflection of consumption expenditures. According to the Modified Mixed Reference Period (MMRP) concept proposed by **World Bank in 2015**, India's poverty rate for period **2011-12** stood at **12.45** of the total population, or about **172 million people**; taking the revised poverty line **as $1,90 day**.

Conclusion

- The **poverty challenge** in India remains broad. Even though there is an emerging middle class, many people who have escaped poverty are not yet economically secure, living precariously close to the **poverty line**.
- When the definition of **poverty is expanded beyond what people consume to include other dimensions** of well-being such as access to education, health care and basic infrastructure, poverty has a grip on a much **larger proportion of India's population.**
- When compared to other countries, there is **massive scope for improvement**. For example, even though India has grown rapidly, its growth has been less effective at reducing poverty than in some of **India's middle-income peers such as China, Vietnam, Brazil and Turkey**.
- India's performance on key non-monetary indicators of well-being such as child nutrition and improved sanitation facilities lags behind countries at similar stages of development.

Unemployment

Unemployment is a situation when a capable and willing to do job workforce does not get work.

Types of Unemployment

- **Disguised Unemployment**: **Situation in which more people are working than actually required**. If some are withdrawn, production does not suffer. It refers to a situation of employment with surplus manpower in which some workers have zero marginal productivity. For example, Overcrowding in agriculture due to rapid growth of population and lack of alternative job opportunities.
- **Seasonal Unemployment**: **Occurs during certain seasons of the year particularly in some industries and occupations like in agriculture where production activities take place only in some seasons**. So, it offers employment for only a certain period of time in a year. People engaged in such type of activities may remain unemployed during the off-season.
- **Cyclical Unemployment**: A result of business cycles at regular intervals particularly in **capitalist economies which are subject to trade cycles**. The downward trend in business activities results in unemployment. Cyclical unemployment is normally a short run phenomenon.
- **Structural Unemployment**: **Arises due to changes in the economic structure of a country**. Structural unemployment is a natural outcome of economic development and technological advancement and innovation that are taking place rapidly all over the world in every sphere.
- **Casual Unemployment**: **When a person is employed on a day-to-day basis, casual unemployment may occur** due to short-term contracts, shortage of raw Materials, fall in demand, change of ownership, etc.
- **Chronic Unemployment**: **If unemployment continues to be a long term feature of a country, it is called chronic unemployment**. Rapid growth of population and inadequate level of economic development on account of vicious circle of poverty are the main causes for chronic unemployment.
- **Frictional Unemployment**: **It is a temporary Joblessness during the period of shifting from one job to another**. This type of unemployment is due to immobility of labour, lack of correct and timely information, seasonal nature of work, etc.

Causes of Unemployment in India

- **Population explosion**, lack of vocational and technical education, slow economic growth are the leading causes of the unemployment in India.
- People from rural areas have **developed a tendency to migrate** to the cities for office jobs. They find little interest in self-employment schemes.
- **Due to the lack of practical knowledge**, thousands of graduates, post graduates, qualified engineers remain idle after completing their education.
- Though India has made good progress in the sphere of industrialization, it has **not been equally distributed across diverse geographical locations** of

India. Under industrialized regions cannot absorb many people.

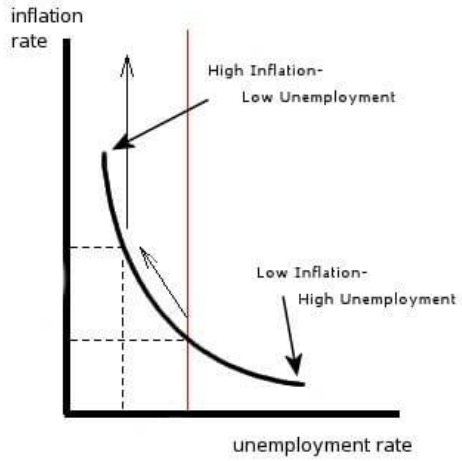
Key terms Related to Employment

Working Population refers to the number of people who are willing and eligible to work. In India those who are **above 15 years of age and those Who are below 60 years of age** comprises the working population.

Labour Force Participation Rate (LFPR): Persons who are either working (or employed) or seeking or available for work but unemployed) during the reference period together constitute the labour force. **LFPR is defined as the number of persons in the labour force per 1000 persons.**

- There are few technical schools for vocational education. Therefore, the young men without specialized training cannot get jobs that require technical skill.

Phillip's Curve



- It describes inverse relationship **between rates of unemployment and the corresponding rates of inflation** that result within an economy.
- Stated simply, **decreased unemployment**, (i.e. increased levels of employment) in an economy will correlate with **higher rates of inflation**.
- **Price stability** has a trade off against employment, as certain level of inflation is considered **desirable in order to minimize unemployment**.
- **Stagflation** is counter to **Phillips's curve** which refer to high inflation corresponded by high unemployment.

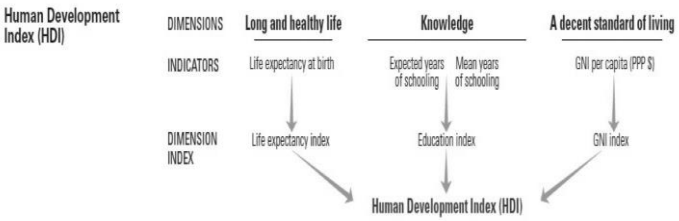
Schemes to Generate Employment in India

- **Pradhan Mantri Gramodaya Yojana** to provide sustainable human development, primary education rural drinking water, rural shelter, nutrition along wit rural electrification as an additional component.
- **Swarna Jayanti Shahari Rozgar Yojana** strives to provide gainful employment to the urban unemployed youth and underemployed poor, through encouraging the setting up of **self-employment ventures by the urban poor living below the poverty line.**
- **National Rural Livelihood Mission Scheme:** Rechristened version of SwarnaJayanti Gram SwarorgarYojna. It is a programme of Ministry of Rural Development. It **aims to reduce poverty by enabling the poor household to access gainful self-employment and skilled wage employment opportunity resulting in a sustainable livelihood**.
- **Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA):** Latest and one of most efficient and popular among all policies for unemployed is MGNERGA, guaranteeing the job **for hundred days in a year with certain minimum wage per day**. According to Mahatma Gandhi National Rural Employment Guarantee Act a job card will be issued for adult unemployed of rural family. If someone applies for job through this unemployment card one has to be provided with a job, if it is not then he will be eligible to have unemployment allowance.
- **Startup India scheme**: It is a flagship initiative of the Government aimed to promote entrepreneurship.
- **Prime Minister's Employment Generation Programme (PMEGP):** It is a major credit-linked subsidy programme being implemented by the Ministry of Micro, Small & Medium Enterprises since 2008-09. The Scheme is aimed at **generating self-employment opportunities through establishment of micro-enterprises in the non-farm sector by helping traditional artisans and unemployed youth in rural as well as urban areas**.
- **Stand up India:** It is a scheme to **promote entrepreneurship among SC/ST and women entrepreneurs**. It is intended to facilitate at least two such projects per bank branch, on an average one for each category of entrepreneur.
- **Make in India:** It was launched in 2014 with an intent to **boost the domestic manufacturing sector and also augment investment in the country**.
- The long-term vision is to gradually develop India into a global manufacturing hub, and also boost employment opportunities the country.
- The Government also intends to **encourage businesses from abroad into investing in the country** and also manufacture here, by improving the country's Ease of Doing Business index.
- **National Skill Development Mission:** The National Skill Development Mission, launched by the Ministry of Skill Development and Entrepreneurship in 2015, aims to create convergence across sectors and States in terms of skill training activities.
- Besides consolidating and coordinating skilling efforts, it also aims to expedite decision making across sectors to achieve skilling at scale with speed and standards.

- The mission aims to create an **end-to-end implementation framework for skill development**, which provides opportunities for life-long learning and provides opportunities for gainful employment
- **Pradhan Mantri Kaushal Vikas Yojana:** It is a skill development initiative for recognition and standardisation of skills.
- The **aim of the PMKVY is to encourage aptitude towards employable skills** and to increase the working efficiency of probable and existing daily wage earners, by giving monetary awards and rewards and by providing quality training to them with an overall aim of providing gainful employment.
- **Pradhan Mantri Rojgar Protsahan Yojana:** PMRPY is a scheme to **incentivise employers registered with the Employees' Provident Fund Organisation (EPFO) for job creation by the Government** paying the full contribution of employers to the **Employee Pension Scheme (EPS) and Employees' Provident Fund (EPF)** in respect of new employees having a new **Universal Account Number (UAN).**
- It is proposed to be made applicable for unemployed persons that are semi-skilled and unskilled.
- The scheme is being implemented by the **Ministry of Labour and Employment and is operational since August, 2016.**

SOCIAL AND ECONOMIC DEVELOPMENT

Human Development Index (HDI)



- Created by Pakistani economist Mahbubul Haq in 1990, the HDI is a statistical tool used by the **United Nations Development Program (UNDP)** to measure a country's overall development.

Method of Calculating HDI

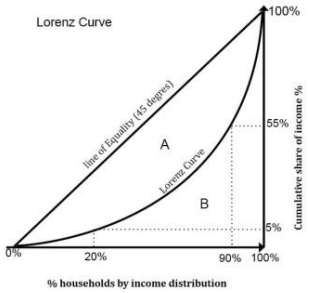
- **HDI** is a summary measure of average achievement in key dimensions of human development: **a long and healthy life, being knowledgeable and have a decent standard of living.**
- It is the geometric mean of normalized indices for Each of the three dimensions:
- **Life Expectancy Index:** It is calculated at life Expectancy (number of years a person is expected to live) at birth. Minimum value for life expectancy is fixed at 20 years and maximum value at 83 years.
- **Education Index:** Education Index (EI) assessment is composite of two indices.
- **Mean Years of Schooling Index (MYSI):** It is the Simple arithmetic mean of number of days of Schooling received by adults of the population,
- **Expected Years of Schooling Index (EYSI):** It is the number of years a child is expected to Attend school given the current enrolment rate
- **Income Index:** It is estimated using Gross National Income per capita. Minimum income is set **as $163 And maximum income is set as $108,211.**

Inequality Adjusted Human Development Index (IHDI)

- Introduced in **2010, IHDI combines a country's average achievements in health, education and income with how those achievements are distributed among the Country's population**
- Thus, the IHDI is distribution-sensitive average level of human development.
- The difference between the IHDI and HDI is the human development cost of inequality, also termed as the loss to human development due to inequality.

Gini Coefficient

- The Gini index or Gini coefficient is a statistical measure of distribution. It is often **used as a gauge of economic inequality, measuring income distribution or, less commonly, wealth distribution among a population**.
- The coefficient ranges **from 0 to** 1, with **0** representing **perfect equality and 1 representing perfect inequality.**
- A country in which every resident has the same income would have a Gini coefficient of **0**. A country where one resident earned all the income, while everyone else earned nothing, would have an **Gini coefficient of 1**.

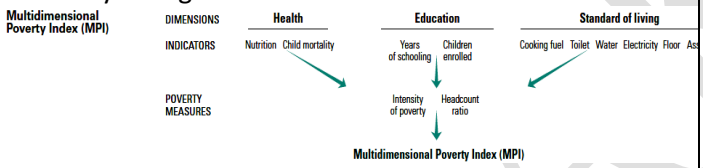


Graphical Representation of the Gini Index

- **The Gini index is often represented graphically through the Lorenz curve**, which shows income (or wealth) distribution by plotting the population percentile by income on the horizontal axis and cumulative income on the vertical axis.
- The **Gini Coefficient is equal to the area below the line of perfect equality minus the area below the lorenz curve, divided by the area below the line of perfect equality.**

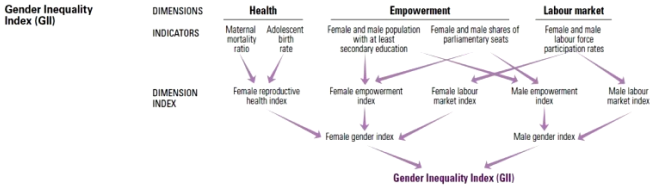
Multi-dimensional Poverty Index (MPI)

- It was first published in **2010 by UNDP**.
- It was first MPI which complements monetary measures of poverty and considers overlapping deprivations suffered at the same time.
- The index identifies deprivations across the same three dimensions of HDI and depicts the number of people who are multi-dimensionally poor
- According to it, a **person suffers from multi-dimensional poverty if he is deprived in 33% or more of weighted indicators.**
- MPI has two aspects related to it:
- **incidence of poverty** - measured on the basis of 10 indicators of health, education and standard of living (**nutrition, child mortality, years of schooling, children enrolment, cooking fuel, water, electricity, toilet, floor and assets**)
- Intensity of poverty captures the number of households that face deprivations.
- It is said that the MPI can help effectively allocate resources by targeting the population with greatest **Intensity of poverty.**
- Since, **MPI** can be adapted to the national level using indicators and weights that are suitable to the region or the country, it can also be adopted for national poverty eradication programs and can be used to study changes over time.



Gender Inequality Index (GII)

- An inequality index that measures gender inequalities in three important aspects of **human development, namely reproductive health, empowerment and economic status.**
- Reproductive health is measured by **maternal mortality ratio (MMR)** and adolescent birth rates, while empowerment is measured by proportion of parliamentary seats occupied by females and proportion of **adult females and males aged 25 years and older with at least some secondary education.**
- Economic status is expressed through labour market participation and is measured by labour force participation rate of female and male populations **aged 15 years and older**.
- Built on the same framework as the IHDI, GII better exposes differences in the distribution of achievements between women and men.
- It measures the human development costs of gender inequality, indicating that **higher the GII value the more disparities between females and males and the more loss to human development**.
- The GII gives insights into gender gaps in major areas of human development.



Gross National Happiness (GNH) Index

- Gross National Happiness was coined in Bhutan in the **1970s** and implies that development should be holistic and give equal importance to non-**economic Aspects of wellbeing**.
- The four pillars on which the concept of GNH has often been explained include:
- **good governance**
- **sustainable socio-economic development**
- **cultural preservation**
- **Environmental conservation**
- Lately, the four pillars have been further classified into nine domains that represent each of the components of wellbeing of the Bhutanese people, and the term 'wellbeing here refers to fulfilling conditions of a 'good life' as per the values and principles laid down by the concept of **Gross National Happiness**.

Green GDP

- Green GDP reflects the economist's attempt to measure the **economic growth of a country when compared to the harm done to the environment by production activities**.
- It is done by **subtracting the costs of environmental and ecological damage done in a specific period of time from the GDP of a country**.
- Unfortunately, **loss done to the environment and consequent Green GDP is difficult to measure** because of the inherent problems while calculating the **costs of ecological and environmental damage.**

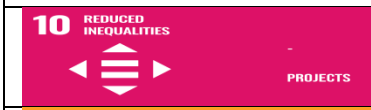
Sustainable Development Goals (SDGs)

- **SDGS** also known as the **Global Goals are a universal call to action to end poverty**, protect the planet and ensure global peace and prosperity. The concept of sustainable development goals was born at the United Nations Conference on Sustainable Development in **Rio de Janeiro in 2012.**
- **SDGS replace the MDGs**, which established measurable and universally agreed objectives for tackling extreme poverty and hunger, preventing deadly diseases, and expanding primary education to all children, among other development priorities.
- Built on the successes of the Millennium Development Goals (MDGs), the **17 SDGs include areas such as climate change, economic inequality,**

innovation, sustainable consumption, peace and justice, among other priorities.

- These goals are interconnected and work in the spirit of partnership and pragmatism to achieve **sustainable way of life**.

Sustainable Development Goals (SDGs) 2016-2030

	**End poverty** in all its forms everywhere
	**End hunger**, achieve food security and improved nutrition and promote sustainable agriculture
	**Ensure healthy lives** and promote well-being for all at all ages
	**Ensure inclusive and equitable quality education** and promote lifelong learning opportunities for all
	**Achieve gender equality** and empower all women and girls
	**Ensure availability and sustainable management** of water and sanitation for all
	Ensure **access to affordable, reliable, sustainable and modern energy for all**
	Promote sustained, **inclusive & sustainable economic growth**, full and productive employment and decent work for all
	Build **resilient infrastructure, promote inclusive and sustainable industrialization** and foster innovation
	**Reduce inequality** within and among countries
	**Make cities and human settlements inclusive**, safe, resilient and sustainable
	Ensure **sustainable consumption** and production patterns
	Take urgent action to **combat climate change** and its impacts
	**Conserve and sustainably use the oceans** seas and marine resources for sustainable development
	**Protect, restore and promote sustainable use of terrestrial ecosystems, combat desertification, and halt and reverse land** degradation and halt biodiversity loss
	**Promote peaceful and inclusive societies** provide access to justice for all and build effective, accountable and inclusive institutions at all levels
	Strengthen **the means of implementation and revitalize the Global Partnership for Sustainable Development**

International Economic Organizations

World Bank Group

- It is one of the **Bretton Woods twins** (International Monetary Fund and former International Bank for Reconstruction and Development ((BRD)) established in 1944 and is headquartered in **Washington, DC, USA.**
- The **World Bank Group (WBG) consists** of five international organizations and is the largest development bank in the world.
- Its five organizations are:
- **International Bank for Reconstruction and Development (IBRD),**
- **International Development Association (IDA),**
- **International Finance Corporation (IFC),**
- **Multilateral Investment Guarantee Agency (MIGA) and**
- **International Centre for Settlement of Investment Disputes (ICSID).**
- It was established to tackle the problem of **international investment** and to provide long-term investment loans on reasonable terms.
- Some of its functions are:
- Assist in the reconstruction and development of the member countries by **facilitating the Investment** of capital for productive purposes.
- Promote private foreign investment by means of guarantee of participation in loans and other

investments, to make loans for productive purposes out of its own resources or from funds borrowed by it.

- **Promote long-term balanced growth** of international trade and maintain equilibrium in balance of payments.
- **Arrange loans made or guaranteed** by it in relation to international loans through other channels so that more useful and urgent projects can be dealt.

International Development Association (IDA)

- Set up in 1960, it is the world's largest multilateral source of financing for the poorest countries.
- **Provides concessional development credits, grants, and guarantees in support of these countries' efforts to increase economic growth, reduce poverty, and improve the living conditions of the poor.**
- India has been the biggest beneficiary of IDA concessional funding.

International Finance Corporation (IFC)

- It was established in **1956** to promote private sector's growth in developing countries
- **Provides loans and equity financing, advice, and Technical services to the private sector**
- Additionally, it creates suitable environment that Stimulates flow of both domestic and foreign investment.

Multilateral Investment Guarantee Agency (MIGA)

- Established in **1988**, **MIGA** offers political risk insurance and credit enhancement guarantees to promote foreign investment in developing countries.
- **It is like an investment insurance facility to encourage investment.**
- It generally targets such projects that seek to create new jobs, develop infrastructure or generate tax revenues.
- It also provides technical assistance to help disseminate investment information.

International Centre for Settlement of Investment Dispute (ICSID)

- Established in 1966, **ICSID is an independent, depoliticized and effective dispute-settlement institution that settles investment disputes arising between foreign and host companies**.
- India is not a member of ICSID.

Criticism of World Bank

- The **financial help provided by the Bank** is at times found insufficient as compared to the requirement for various development projects.
- The group is also criticized for **neglecting social and Environmental implications** of infrastructure projects it finances.

International Monetary Fund (IMF)

IMF was conceived at a **UN Conference** in **Bretton Woods, United States**, in **1944**.

- It sought to build a framework for economic cooperation to avoid repetition of the competitive devaluations that had contributed to the **Great Depression of the 1930s.**
- **The IMF's prime responsibility is to ensure the stability of the international monetary system-the System of exchange rates and international payments that enables countries to transact with each other**
- The Fund's mandate was updated in **2012** to include All macroeconomic and financial sector issues that bear on global financial stability.

IMF performs following functions:

- **Providing short term credit to member countries** for **meeting temporary difficulties** due to adverse balance of payments.
- **Reconciling conflicting** claims of member countries.
- **Providing a reservoir of currencies of member**. Countries and enabling members to borrow on another's currency.
- **Promoting orderly adjustment of exchange rates**
- Advising member countries on economic, monetary and technical matters.

IMF Quotas

- IMF is a quota-based institution which acts like building blocks of IMF's financial and governance structure.
- **An individual member country's quota broadly reflects its relative position in the world economy**.



- Quotas are denominated in **Special Drawing Rights**, the IMF's unit of account.
- The **IMF's Board of Governors** conducts general quota reviews at regular intervals (no more than five years).
- **Any changes in quotas must be approved by an 85% majority of the total voting power, and a member's own quota cannot be changed without its consent.**

Role Played by Quotas:

- **Resource Contributions**: Quotas determine the maximum amount of financial resources a member is obliged to provide to the IMF.
- **Voting Power**: **Quotas are a key determinant of the voting power in IMF decisions. Votes comprise one vote per SDR100,000 of quota plus basic votes (same for all members).**
- **Access to Financing**: The maximum amount of financing a member can obtain from the IMF under normal access is based on its quota.
- **SDR Allocations**: Quotas determine a member's share in a general allocation of SDRs.

Special Drawing Rights (SDR)

- Created by IMF in **1969**, SDRs or Special Supplementary international reserve asset that can be exchanged as Drawing **Rights For Freely usable currencies.**
- The value of the SDR is based on a basket of five major currencies-**the Chinese Renminbi (RMB), the Japanese Yen US Dollar Euro, the And Pound Sterling**
- A country participating in this system needs official reserves Government or central bank holdings of gold and widely accepted foreign Currencies that could be used to purchase its domestic currency in exchange markets, as **required to maintain its exchange rate**

Arrangements to Borrow

General Agreement to borrow (GAB):

- The General Agreements to Borrow (GAB) allows **IMF borrowing from a more limited number of countries and institutions in circumstances where** the NAB cannot be activated.
- Through the **New Arrangements to Borrow (NAB**) the number of Member countries and institutions stand ready to lend additional Resources to the IMF
- The **NAB constitutes** the **second line** of defense to supplement IMF Sources to forestall or cope with an impairment of the international monetary system. **The first line being the Quotas**

Criticism

- Conditions imposed on borrower countries that do Not give due regard to the countries' individual Circumstances. Also, IMF is said to have failed in Resolving economic problems within the countries.
- There are also criticisms against the governance Structures of IMF which are dominated by Industrialized countries.
- Issues of representation at the institution especially of **developing countries** that still hold little voting Power is another criticism.
- Further, **IMF packages** have also been associated with Negative social outcomes such as reduced investment in public health and education.

Asian Development Bank (ADB)

- Conceived in the early 1960s as a financial institution that would be Asian in character and foster economic Growth and cooperation in one of the poorest regions in the world.
- It was then established in 1966 at **Manila, Philippines** the bank aims for poverty-free Asia-Pacific It works in partnership with member countries,
- Independent specialists and other financial Institutions to focus on delivering projects that create Economic and development impact.
- It provides loans, technical assistance and grants to Member countries.
- **Areas of focus for ADB include infrastructure, environment, regional cooperation and integration, Finance sector development and education.**
- Currently, the **ADB has 68 members** of which **49 are from Asia and the Pacific.**
- India is the **largest grants receiver** from ADB followed By China.
- **Japan and the US have the highest shareholding of 15.6% each, followed by China (6.4%) and India (6.3%).**

New Development Bank (NDB)

- The idea for creation of the NDB was first mooted in the **fourth BRICS summit at New Delhi in 2012** to meet development funding requirements of the five founding countries namely **Brazil, Russia, India, China and South Africa (BRICS).**
- It was finally established at the sixth summit in Fortaleza, **Brazil with an authorized capital of $100 billion in 2014**.
- **The bank is headquartered in Shanghai, China and has been established with the purpose of mobilizing resources for infrastructure and sustainable development projects in BRICS and other emerging economies**
- It seeks to complement existing efforts of multilateral and regional financial institutions for global growth and development.

AKS

- It shall also cooperate with international organizations and other financial entities, and provide technical Assistance for projects to be supported by the Bank.
- All the BRICS members are the equal shareholders with **equal voting rights of 20% each**.

Asian Infrastructure Investment Bank

- The Asian Infrastructure Investment Bank (AIIB) is a multilateral development bank that **aims to support the building of infrastructure in the Asia-Pacific region.**
- It was entered into force on **25 December 2015** and opened for business on **16 January 2016**. It is headquartered in **Beijing**, **China**.
- The initiative of **AIIB development** was officially launched by China in **2013** as China was frustrated by the slow pace of reforms and governance issues in global established institutions like IMF, World Bank and ADB. **China claimed that these institutions were dominated by American, European and Japanese interests.**
- **AIIB offers finance for project in energy and power, transportation and telecommunications, rural infrastructure and agriculture development, water supply and sanitation, environmental protection, and urban development and logistics**.

India & AIIB

- **India is one of the founding members of AIIB**
- **India is the second-largest shareholder in the AIIB**

World Trade Organization (WTO)

- Established in **1995**, **WTO replaced General Agreement on Trade and Tariffs (GATT**) that has been in existence since **1946** to promote international trade after World War II.

Functions:

- Administering **WTO trade agreements**
- Forum for trade negotiations
- Handling trade disputes
- Monitoring national trade policies
- Technical assistance and training for developing Countries
- Cooperation with other international organizations
- The bulk of the WTO's current work comes from **1986-94 negotiations** called the Uruguay Round under the General Agreement on Tariffs and Trade (GATT).
- WTO is currently the host to new negotiations, under the **'Doha Development Agenda'** launched in 2001.
- Decisions at WTO are taken by consensus of the entire Membership. The **highest institutional body is the Ministerial Conference**, which meets roughly every two years.
- The WTO currently has **164 members**.
- The WTO founding and guiding principles remain the pursuit of **open borders, the guarantee of most favored and non-discriminatory treatment by and among members with a commitment to transparency.**

Principle of Trade without Discrimination at WTO

- **Most Favored Nation (MFN): Treating other nations equally.** Under the WTO principle of trading system, countries normally are not allowed to discriminate between their trading partners. Even if they grant some favor to one over the other, they will have to do the same for all other WTO members. However, some exceptions are allowed:
- Countries can set up a free trade agreement that applies only to goods traded within a group (region or interest-based)
- Giving access to markets for developing countries.
- Raising barriers against products that may be unfairly traded from specific countries.

General Agreement on Tariffs and Trade (GATT)

- Set of multilateral trade agreements aimed at abolition of quotas and
- **Reduction of tariff duties among the contracting nations. When GATT was concluded in Geneva in 1947, it was considered an interim arrangement pending the formation of a United Nations**
- Agency to supersede it. When such an agency failed to emerge, GATT was further enlarged at several succeeding negotiations.
- It subsequently proved to be the most effective instrument of world trade liberalization, playing a major role in the massive expansion of world trade in the second half of the 20th century.
- One of the most important principles of GATT was **trade without discrimination**.
- It also included a schedule of specific tariff concessions for each country.
- Contracting nation, representing tariff rates that each country had agreed to extend to others.
- Another principle of **GATT was protection through tariffs rather than through import quotas or other quantitative trade restrictions**. However, due to certain limitations of GATT, it was replaced by WTO in **1995**. Some of the limitations were:
- Lack of institutional structure

- **Non-coverage of trade in services**
- Intellectual Property Rights etc.
- Absence of a **strong dispute resolution mechanism.**
- Mostly its representatives consisted of western countries with no or low participation of developing countries
- It also failed **to curb quantitative trade restrictions**
- The eighth round of multilateral negotiations under GATT, called **Uruguay Round**, continued **for 1986-1994**.
- It prescribed for further tariff reduction and removal of quantitative restrictions, progressive liberalization of trade in agricultural goods.

It also sought to establish a new body called **World Trade Organization** to facilitate implementation of multilateral trade agreements.

- **National Treatment**: Treating foreigners and locals **equally under this principle**, foreign goods are given same treatment as one's own. It must be noted that national treatment applies only after product service rate has entered the market. Therefore, charging custom duty on an import is not a violation of national treatment principle.
- **Free Trade: Lowering trade barriers** is one of the most obvious means of encouraging trade. However, opening markets requires adjustment. The WTO agreements allow countries to introduce these changes casually through **"progressive liberalization** for which developing countries are **usually given longer time**.
- **Predictability:** With stability, predictability and binding commitments, WTO principle seeks to **encourage investment, create jobs and to accrue the benefits of competition to consumers in the form of choice, quality and lower prices.**
- **Promoting Fair Competition:** WTO agreements also aim to support fair competition in trade in agriculture, intellectual property, services etc.
- **Encouraging Development and Economic Reforms:** Developing countries that need flexibility to implement the system's agreements are given special assistance and trade concessions under WTO rules. This promotes economic reforms and development in these countries.
- **Major Agreements of WTO** Concluded during Uruguay Round Agreement on Subsidies and **Countervailing Measures (SCM**): It addresses two separates but closely related issues: multilateral disciplines regulating the provision of subsidies, and the use of countervailing measures **to offset injury caused by subsidized imports.**
- **Multilateral disciplines** are the rules regarding whether or not a subsidy be provided by a member country. They are enforced through invocation of the **WTO dispute settlement mechanism.**
- **Countervailing duties** are a unilateral instrument, which may be applied by a member after an investigation by that member and a determination that the criteria set forth in the **SCM Agreement** are satisfied.
- **For a subsidy to be actionable, three conditions should be present:**
- Injury to **domestic industry** due to subsidized imports.
- There is serious prejudice arising out of adverse effects like export displacement in the market of the subsidizing member.
- **Nullification or impair**ment of benefits accruing under the **GATT 1994** due to the subsidy

General Agreement on Trade and Tariff in Services (GATTS): From **1947 to 1994**, GATT was the forum for negotiating lower customs duty rates and other trade barriers, the text of the **General Agreement** spelt out important rules, particularly non-discrimination. Since **1995**, the updated GATT has become the **WTO'S umbrella agreement for trade in goods**.

It has annexes dealing with **specific sectors** such as agriculture and textiles, and with specific issues such as state trading, product standards, subsidies and actions taken **against dumping**.

Aggregate Measurement of Support (AMS)

- AMS represent annual level of support (subsides) expressed in monetary terms, **provided for an agricultural product in favor of the producers (product specific) of the basic agricultural product and non product specific support provided in favor of agricultural producers in general.**
- As per the WTO provision, AMS is a trade distorting subsidy. Since it distorts trade by directly influencing production and price in an economy, the AMS is categorized as a 'reducible, non permissible or non-exempted subsidy.
- It does not include subsidies in the Blue Box, Green Box and de minimum **De-Minimis provision: Under this provision developed countries are allowed to maintain trade distorting subsidies or Amber box subsidies to level of 5% of total value of agricultural output. For developing countries this figure is**

10%.

- **Special Safeguard Mechanism:** It is a protection measure allowed for developing countries to take contingency restrictions **against agricultural imports that are causing injuries to domestic farmers.** The contingency measure is imposition of tariff if the import surge causes welfare loss to the domestic poor farmers.
- **Special Products:** At the 2005 WTO Ministerial Conference in Hong Kong, members agreed to allow developing countries to **"designate an appropriate number of tariff lines as Special Products" (SPS) based on "food security, livelihood security and rural development".**

Countervailing Duty: It is **imposed on imported goods to counterbalance subsidy** provided by the exporter country.

Anti-Dumping Duty: An anti-dumping duty is a **protectionist tariff that a domestic government imposes on foreign imports that it believes are priced below fair market value.**

- **Dumping** is a process where a company exports a product at a price lower than the price it normally charges in its own home market.
- To **protect local businesses** and **markets**, many countries **impose stiff duties** on products that they believe are being dumped in their national market.

Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS): The WTO's intellectual property agreement amounts to rules for trade and investment in ideas and creativity.

- **The rules state how copyrights, patents, trademarks, geographical names used to identify products, industrial designs, integrated circuit layout-designs And undisclosed information such as trade secrets -"intellectual property"-should be protected when trade is involved.**
- It remains a contentious issue between developed and developing countries.

Agreement on Trade-Related Investment Measures (TRIMS): It recognizes that certain investment measures can restrict and distort trade.

- **It states that WTO members may not apply any measure that discriminates against foreign products or that leads to quantitative restrictions, both of which violate basic WTO principles.**
- A **list of prohibited TRIMS**, such as local content requirements, is part of the Agreement.
- The **TRIMS Committee** monitors the operation and implementation of the Agreement and allows member countries the opportunity to consult on any relevant matters.

Agreement on Agriculture: It is aimed to remove trade barriers and to promote transparent market access and integration of global markets. Agreement on agriculture stands on three pillars:

- **Domestic Support:** It calls for reduction in domestic subsidies that distort free trade and fair price. Under this provision, the Aggregate **Measurement of Support (AMS) is to be reduced by 20% over a period of 6 years by developed countries and 13% over a period of 10 years by developing countries**. Under this, subsidies are categorized into:
- **Green Box: Subsidies that do not distort trade**, or at most cause minimal distortion.
- They are **government-funded** and must not involve price support.
- They tend to be programmes that are not targeted at particular products, and include direct income supports for farmers that are not related to (are "**decoupled**" from) current production levels or prices.
- They also include **environmental protection** and **regional development** programmes. "**Green box**" subsidies are therefore allowed without limits, provided they comply with the **Policy-specific criteria**
- **Amber Box:** All domestic support measures **considered to distort production and trade (with some exceptions) fall into the amber box.** These include measures to support prices, or subsidies directly related to production quantities.
- **Blue Box:** This is the "**amber box with conditions**". Such conditions are designed to reduce distortion. Any support that would normally be in the amber box is placed in the blue box if the support **also requires farmers to limit production.**
- **At present, there are no limits on spending on blue box subsidies**. Some countries want to keep

the blue box because they see it as a crucial means of moving **away from distorting amber box subsidies** without causing too much **hardship**.

- Others want to set limits or reduction commitments, some advocate moving these supports into the amber box.
- **Market Access: Market access for goods** in the WTO means the conditions, tariff and non-tariff measures, agreed by members for the entry of specific goods into their markets. **The market access requires that tariffs fixed (like custom duties) by individual countries be cut progressively to allow free trade.** It also required countries to remove non-tariff barriers and convert them to tariff duties.
- **Export Subsidy:** Subsidy on inputs of agriculture, making export cheaper or other incentives for exports such as import duty remission, etc. are included under export subsidies. These can result in dumping of **highly subsidized** (and cheap) products in other country and damage domestic agriculture sector of other country.

Doha Development Round

- **Its aim is to achieve major reform of the international trading system through the introduction of lower trade barriers and revised trade rules**.
- The **Doha Ministerial Declaration** provided for the negotiations, including on **agriculture, services and intellectual property.**
- Doha, decision on how to address the problems developing countries face in implementing the comment WTO agreements was also approved.
- Main negotiating issues of **Doha Development Round**

Agriculture

- Substantial and effective reductions in Overall **Trade-Distorting Domestic Support (OTDS)** by **developed countries**
- **Self designation of an appropriate number of Special Products** (sps)
- An operational and effective **Special Safeguard Mechanism (SSM)**
- Tariff simplification and tariff capping of developed country tariffs
- **Non-Agricultural Market Access (NAMA**) for manufacturing products, fuels and mining products, fish products and forestry products as they are not covered under the Agreement on Agriculture or the negotiations on services.

Services

- **Qualitative improvement** in the revised offers especially on **cross border supply and movement of persons,**
- Establishing a clear linkage between the TRIPS Agreement and the **Convention on Bio diversity (CBD)** by incorporating specific disclosure norms for patent applications.
- Enhanced protection for **geographical Indications (GIs)** other **than wines and spirits.**

Ninth Ministerial Conference 2013 and Ball Package

- The topmost **decision-making** body of the WTO is the Ministerial Conference, which usually meets **every two years**.
- The key issues discussed at **Ball meet included trade facilitation, agriculture negotiations, cotton, least developed countries, monitoring mechanism, small and vulnerable economies, non-violation in intellectual property,** etc.
- The outcomes of this WTO meet have been termed as Bali Package and are as follows:
- Developing countries were allowed to provide subsidy on food crops without any punitive action under Peace Clause that offered four years of Immunity against penalties imposed for breaching the **farm subsidy cap of 10% under the WTO Agreement on Agriculture (ADA),**
- Trade facilitation agreement was designed to cut down the red tape in customs clearance. It spells out a framework for trade facilitation related technical assistance and transparency procedures to monitor the implementation.
- The Bali package also entails decisions on cotton, preferential rules-of-origin for LDCS, preferential treatment for services from ldcs, and **duty-free and quota-free (DFQF)** market access for LDCS. These further advance special and differential **(S&D) treatment provisions for LDCS**.

Nairobi Ministerial Meet, 2015

- It was a huge disappointment for the developing and under developed world as the **Doha Development Agenda (DDA)** was termed as a dead, outdated and undesirable course.
- In the run-up to the **Nairobi meeting**, a majority of developing countries led by India, China, South Africa, Indonesia, Ecuador, and Venezuela prepared the ground to ensure that the Doha Round of negotiations are not closed by **trans-Atlantic trade giants.**
- They also tabled detailed proposals for a permanent solution for public stockholding programmes for food security and a **special safeguard mechanism (SSM)** to **protect millions of**

poor and low-income farmers from the import surges from industrialized countries.

- Again, the two proposals were actively opposed by the US. The meet ended without any firm outcome on continuing DDA negotiations or a deal on **SSM and public stockholdings for food security.**

Highlights of Nairobi outcomes:

- **There was a commitment to completely eliminate subsidies for farm exports with developed members committing to remove export subsidies immediately** (except for a handful of agriculture products) and developing countries to do so by 2018. Additionally, developing members will keep the flexibility to cover marketing and transport costs for agriculture exports until the end of 2023.
- **Ministers also adopted a Ministerial Decision on Public Stockholding** for Food Security Purposes that commits members to engage in finding a permanent solution to the **issue of public stockholding.**
- **A Ministerial Decision on SSM for Developing Countries recognizing developing members right to temporarily increase tariffs in face of import surges by using an SSM was also discussed**. However, negotiations could not reach any final agreement.
- There was affirmation that **Regional Trade Agreements (RTAS) remain complementary to, not a substitute fo**r, the multilateral trading system.

Ministerial Conference at Buenos Aires, 2017

- In the run-up to it, decisions were expected on a **permanent solution on food security and other agriculture issues.** Unfortunately, the strong position of one member against agricultural reform based on **current WTO mandates** and **rules**, led to a deadlock without any outcome on agriculture or even a work programme for the **next two years**.
- However, the existing mandates and decisions ensure that work will go forward and members will continue to work on issues such as the permanent solution on **public stockholding for food security purposes**, agricultural Special **Safeguard Mechanism and agricultural domestic support**.
- Some of the other decisions that were taken included a **Work Programme** on Disciplines on Fisheries Subsidies with a view to arriving at a decision by **12th Ministerial Conference, 2019**.
- It was also decided to continue with the non negotiating mandate of the existing Work Programme on E-**commerce**.
- Ministerial Decisions on new issues like Investment Facilitation, **Micro, Small & Medium Enterprises (MSMES),** gender and trade, which lacked a mandate or consensus, were not taken forward.
- **Due to divergences** among members, and a few members not supporting acknowledgment and reiteration of key underlying principles guiding the WTO and various agreed mandates, Ministers could not arrive at an **agreed Ministerial Declaration.**
- **During Ministerial Conference 11**, India stood firm on its stand on the fundamental principles of the WTO, including multilateralism, rule-based consensual decision-making, an independent and credible dispute resolution and appellate process, the centrality of development, which underlies the **Doha Development Agenda**, and special and differential treatment for all developing countries.
- Therefore, the **Ministerial Conference** ended without a **Ministerial Declaration or any substantive outcome**.

Related Information Rules of Origin

- Rules of origin are the **criteria needed to determine the national source of a product.**
- They are used for implementing other trade policy measures, including **trade preferences (preferential rules of origin)**, quotas, anti-dumping measures and **countervailing duties (non-preferential rules of origin).**
- Rules of Origin are also used to determine whether imported products shall receive **Most-Favoured-Nation (MFN) treatment or preferential treatment**

Technical Barriers to Trade

- The Technical Barriers to Trade (TBT) Agreement **aims to ensure that technical regulations, standards, and conformity assessment procedures are non-discriminatory and do not create unnecessary obstacles to trade.**
- At the same time, it recognizes **WTO members' right to implement**
- Measures to achieve legitimate policy objectives, such as the protection of **human health and safety, or protection of the environment The** TBT **Agreement** strongly encourages members to base their Measures on international standards as a means to facilitate trade.

Sanitary and Phytosanitary Measures

- The **Agreement on the Application of Sanitary and Phytosanitary Measures** (the "**SPS Agreement**") entered into force with the establishment of the **World Trade Organization**

on 1 January 1995. It concerns the application of food safety and animal and plant health regulations.

- It was finalized in the **Uruguay Round** of Multilateral Trade Negotiations, signed in **Marrakesh on 15 April 1994**.
- It applies to **all sanitary (relating to animals) and phytosanitary (relating to plants) (SPS) measures that may have a direct or indirect impact on international trade.**

It allows countries to set their own standards. But it also says regulations must be based on science. They should be applied only to the extent necessary to protect human, animal or plant life or health.

Agreement on Fisheries Subsidies

- The **Agreement on Fisheries Subsidies (Agreement)** agreed at the recently concluded WTO Ministerial meeting **will prohibit subsidies from being provided for Illegal, Unreported and Unregulated (IUU)** fishing and overfished stocks.
- Under the **Special and Differential Treatment** (S&DT), **Developing Countries and Least Developed Countries (LDCs) have been allowed a transition period of two years** from the date of entry into force of this Agreement.
- The Agreement also **prohibits providing subsidies for fishing on high seas,** which are outside the jurisdiction of coastal countries **and Regional Fisheries Management Organizations/ Arrangements** (RFMO/As).
- As per the Agreement, **no prohibition has been imposed on a WTO Member regarding granting or maintaining subsidy to its vessel or operator as long as it is not carrying out IUU.**
- Similarly, **no prohibition on providing subsidies has been imposed for fishing** regarding **overfished stocks as long as such subsidies are implemented to rebuild the stock to a biologically sustainable level**.

