SRIRAM's IAS

General Studies

INDIAN ECONOMY

2018

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ECONOMICS: AN INTRODUCTION

Definition

Economics as a word comes from the Greek: oikos means 'family, household, or estate', and nomos stands for 'custom, law' etc. As the management of household, so the management of national economy. The scale is different but the nature of the operation and the principles that underlie both are the same. The basic assumption that connects both is the scarcity of resources and the need to manage them judiciously as well as equitably. Rational management of scarce resources is the substance of economics. Since last century, rationality has come to include equity and sustainability as well as that adds the long term dimension to it.

Take for example, land. It is a scarce resource. India has 15% of global population but only 2.4% of the global land. Thus there is huge pressure on land. It is needed for agriculture (food and non-food); manufacturing; residential purposes and so on. There should be rational and judicious use of land for which economics can help to make public policy. The challenges associated with land use are being grappled with presently , for instance in the Land Acquisition and Rehabilitation and Resettlement Act 2013 where the land claims of farmers, industry and other sections are addressed.

Similarly, water is scarce and is becoming even more so. There are demands for agricultural, industrial, domestic and other uses. How to apportion the existing amount of water among all these users is a public policy challenge being considered by the Draft National Water Policy (NWP, 2012). Same is the purpose of the food security law and land acquisition law.

Broadly, economics is a social science that studies human activity aimed at satisfying needs and wants. It encompasses production, distribution, trade and consumption of goods and services

Initially, economics focused on wealth and later welfare. That is, initially, what mattered was creation of wealth at any cost. It did not interest economists to be sensitive to the human dimension- the misery that it produced. Later, by the late 19^{th} century, there was hue and cry about children being made to overwork and receive paltry payment for their work, to give one example. Then welfare became the focus of the discipline.

As a policy science, economics is always confronted with trade offs as scarcity of resources is the overriding assumption of the discipline. Tradeoffs involve making choices in policies wherein there is a compromise on one goal to achieve another goal. It is a way of balancing among desirable goals. Presently, the policy of Reserve Bank of India aims at moderating inflation that it is the overriding objective of its monetary policy (2015), even as some growth is eroded in the process. Thus, a bit of growth is traded off for price stability. Similarly, government wants to give subsidies to the poor and weak. It may mean more borrowings and thus some fiscal excess but poverty is addressed and thus political stability. Thus, fiscal prudence may be traded off to some extent in pursuit of welfare. The current state of public finance is an accurate description of this dilemma with fiscal deficit targeted at 3.2% of GDP (2017-18) even while 3% of GDP is the stated norm because public investment is urgently required in the given circumstances and thus fiscal discipline is relatively secondary in importance. In the land acquisition law, compensation for the land owners is increased to balance the interests of the industrialists and the farmers and others. Investment may moderate in the process, but social justice gets addressed. Land is to be acquired for manufacturing and consent of the land owner may be conditionally dispensed with in public interest- that is the tradeoff logic.

The focus on tradeoffs arises from the scarce resources that make it necessary to choose between competing alternatives. Choosing one benefit implies forgoing another alternative to a greater or lesser extent. Thus, there is an opportunity cost to the available resources and there is a continuous process of weighing alternatives and balancing them (opportunity cost of the opportunity foregone while choosing another).

Adam Smith, generally regarded as the Father of Economics, author of An Inquiry into the Nature and Causes of the Wealth of Nations (generally known as The Wealth of Nations) defines economics as "The science of wealth." Smith also offered another definition, "The Science relating to the laws of production, distribution and exchange."

Definitions in terms of wealth creation are limited in scope and favour the advantaged. Weak are left out, for example, women, children and old people. The belief is that non-productive activity is a cost on society. It meant that man was relegated to the secondary position and wealth was placed above life. In democratic times, it is not acceptable. There was a demand to balance wealth creation with focus on social and human welfare. Thus arose the shift in the focus to welfare economics- study of man and of human welfare, not of money and goods alone. A new dimension was added to the discipline of economics- one of welfare and equity.

As the production process evolved and as more problems cropped up, the discipline became wider while in search for new foci- sustainable development, green economy, well being, national happiness and so on.It went beyond wealth, welfare and trade offs,

Economics is usually divided into two main branches:

Microeconomics, which examines the economic behavior of individual actors such as consumers, businesses, households etc. to understand how decisions are made in the face of scarcity and what effects they have on larger economy.

Macroeconomics, on the other hand, studies the economy as a whole and its features like national income, employment, poverty, balance of payments and inflation.

The two are linked closely as the behaviour or a firm or consumer or household depends upon the state of the national and global economy and vice versa. For example, business and consumer confidence depends on the state of economy.

'Mesoeconomics' studies the intermediate level of economic organization in between the micro and the macroeconomics like institutional arrangements etc. Meso is relative. Study of a sector of economics like auto, infrastructure may be considered mesoeconomics while the study of each unit may fall under micro.

Division of Economics	Focus
Microeconomics	Is concerned with single factors and the effects of individual decisions. Deals with behavior of firms and consumers as to how they make their decisions.
Macroeconomics	National production/output, Gross domestic product, employment, Poverty, Inflation, BOP. Demonetisation, GST, IBC etc.

There are broadly the following approaches in the mainstream economics to boost national economic growth, the basis of all of them being the same: resources are scarce while wants are unlimited (often mentioned as the economic problem)

- During the Great Depression of the 1930s, there was no convincing economic theory either to explain why the economic crash happened or what was to be done to retrieve stability and growth. The entire focus on the discipline at that time was on free markets. British economist John Maynard Keynes changed the complexion by asserting that free markets have no self-balancing mechanisms that lead to full employment. Keynesian economists justify government intervention through public policies that aim to achieve full employment and price stability in times of slowdown and recession.Keynes argued that. An economy's output of goods and services is the sum of four components: consumption, investment, government purchases, and net exports (the difference between what a country sells to and buys from foreign countries) (Read ahead). Any increase in demand has to come from one of these four components. But during a recession, for a variety of reasons, demand slows down and may even turn negative when consumer confidence collapses causing them to reduce their spending. It in turn causes firms to either prune their operations or close down. It leads to more people out of work and the downward spiral. Under such recessionary conditions, it is the Government that has to lead by borrowing and investing. According to Keynesian theory, state intervention is necessary to moderate the booms and busts in economic activity, otherwise known as the business cycle. Intervene when there is bust and withdraw when there is boom. In normal times, it is the market that drives growth through the force of supply and demand though the respective roles of State and market are coming under critical scrutiny post-Lehman. Indian government stepped up expenditure with fiscal and monetary stimuli in the 2008-10 period to withstand the recessionary winds from the west. With growth spurting, the gradual and calibrated exit from the stimulus was begun in the 2010-11. When growth decelerated in 2017-18, the GOI launched Bharatmala as a Keynsian stimulus. It is the biggest ever highway project to develop and expand approximately 83,000 km of roads at an investment of Rs 6.9 lakh crore by 2022.It is the second largest highways construction project in the country after National Highway Development Programme connecting border areas, improving international, port and coastal connectivity and developing highway corridors connecting key economic and commercial hubs.

- Economics is about resource management and politics is about the redistributive side of resources through government power. Politics sets the larger framework in which economics operates. Thus, understanding the two as they interconnect is the substance of political economy studies. While politics sets the values, economists set the prices! In simple terms, political economy describes production, buying and selling, and their relations with law, custom, and government, as well as with the distribution of national income and wealth. It refers to examining how political forces affect the choice of economic policies. If we take the example of demonetization that took place in India in 2016 which is a millennial event, the entire process of choosing to embark on it was a political choice while the economy went through so many fundamental effects of it- banking, fiscal, industrial, agricultural etc. Similarly, unless one studies the connection between land reforms and the political context, its failure can not be fathomed in India. Political economy reveals that the landlords and the political leaders being the same, the policy had inherent limtations to success. In China, a political party, Communist Party of China, decided how the economy is to be structured. The priorities and policies of economy drastically altered according to the beliefs and biases of the political party and its leaders.

Thus, economics can be understood only when the politics that influences it, is made sense of.

- Liberalism dominated economics in its early forms. Later it fell into disrepute as socialist and welfare perspectives came up and held sway. When the latter lost charm starting from the middle of last century and decisively by late last century, liberalism staged a comeback under the term Neoliberalism. As with the earlier version, it is associated with free-market economics: free trade, privatisation, price deregulation, a reduced size of government ("that government is the best which governs the least") and flexible labour markets ("hire and fire"). Neo-liberalism is the underlying philosophy of the Washington Consensus – the free market approach of the IMF and other institutions. Individualism, competition and efficiency are its core values. Neoliberals believe that there is so much rationality and end use in their beliefs that Francis Fukuyama ,the American political economist who wrote the book *The End of History and the Last Man* (1992) argued that the worldwide popularity of free markets after the demise of Soviet communism showed that free markets are the highest point of human evolution and can not be improved upon.Neoliberalism "proposes that human well-being can best be advanced by liberating individual entrepreneurial freedoms and skills within an institutional framework characterized by strong private property rights, free markets and free trade". India's economic reforms are largely centred around it. Critics of neoliberalism hold that leaving large role to the market forces can be detrimental to genuine human and sustainable growth. The risk is compounded by the notion of "invisible hand" used by Adam Smith. It says that all economic participants are rational and their self interest ensures order in the economy. That is the self interest all participants makes the economic system find its equilibrium. There is no government regulation required as the "invisible hand" of collective self interest provides stability. However, the 2018 great recession is the latest example when the belief in invisible hand was exposed as irrational.

- socialist economics believes that a large part of economic resources should be in giovernemnt hands so that inequality can be minimized and give the workers greater control of the means of production. It comes in many forms- Nehruvian socialism where there is public and private sector coexisting and complementing called mixed economy. An extreme form of socialit economics is communist control where the entire economy is held by State and there is no private property at all. For example, Soviet economy and China under Mao Zedong (1893 -1976).

- Nehruvian economics is a subset of socialist economics. It rests on state -ownership of basic parts of economy like infrastructure, higher education, metal and other industries etc.;socio economic planning because Soviet Russia showed that it could be an expeditious way of achieving equitable growth, India lacked any significant private sector when we became Independent and also because Nehru personally believed in the values of equity.Given the historical circumstances in which it emerged, Nehruvian economics supports self-reliance in economic growth. The modern foundations of it are revealed in its emphasis on capital goods industry, technical education and R&D- all being interconnected.

- Gandhian economics is the set of ideas that Mahatma Gandhi propounded. Mahatma Gandhi questioned the scarcity assumption when he said: 'Earth provides enough to satisfy every man's need but not for every man's greed.' The principle of Gandhian economic thought is small scale and locally oriented production, using local resources and meeting local needs, so that employment opportunities are made available everywhere, promoting the ideal of Sarvodaya: the welfare of all, in contrast to the rich dominating. Gandhian economy aims to boost employment which is very desirable for India where there is abundance of labour. It had no aversion to machinery and welcomes it where it avoids drudgery and reduces monotony, for example, sewing machine. It is opposed to labour-displacing technology. It is worth imagining whether Gandhi would support artificial intelligence and machine learning. It emphasises dignity of labour, and criticises the society's contemptuous attitude to manual labour. It insists on everybody doing some 'bread labour'. Another axiom of Gandhian economics is "trusteeship": while an individual or group of individuals is free not only to make a decent living through an economic enterprise but also to accumulate, their surplus wealth above what is necessary to meet basic needs and investment, should be held as a trust for the welfare of all, particularly of the poorest and most deprived. It thus combines economics of development with ethics of equity, self-reliance (with minimum wants), sustainability, trust and cooperation.

- Development economics. By the middle of last century the challenge of enabling economic growth of the poor countries to transition from low income to decent standard of living was the focus for a school of economic thought called the Development economics. The concern was the human challenge of promoting economic growth and structural change (from agriculture to industry) but also improving the well being of the population as a whole through focus on health , education and employment, whether through public or private channels. The most prominent contemporary development economists are Nobel laureates Amartya Sen and Joseph Stiglitz. Currently, Jean Dreze, Ejaz Ghani, Abhijit Banerjee, Jeffrey Sachs and Esther Duflo are some global names in the field.

- China model of economic growth: Beijing Consensus is the name given to the political economy of People's Republic of China under Deng Xiaoping since early eighties which continues till today under Xi Jinping (2012-). The term captures China's economic development model as an alternative to the Washington Consensus of market-friendly policies advocated by the Bretton Woods Twins- World Bank and International Monetary Fund; and the World Trade Organization (WTO). There is no clear set of implications of the term but is generally taken t mean pragmatic economic policy led by State but liberal use of private initiative: "stable, if repressive, politics and high-speed economic growth". It does not follow text book economics but sets out its own mix of State, market and redistribution. Its growing global reach is striking. Officially it called socialism with Chinese characteristics but critics call it capitalism with Chinese characteristics.

- Mercantilism wants Government to make policies for maximising net exports because the best way of ensuring a country's prosperity is to reduce imports and promote exports, thereby generating a net inflow of foreign exchange and maximising the country's gold stocks. Mercantalists believe that the country that has more gold is stronger. That belief however is outdated though the foundational mercantilist views are still influential. Import substitution means selective use of globalization for national prosperity which in the medium to long term is unworkable as national growth is premised at the expense of other countries. It is in contrast to the theory of free trade – which states that countries can have economic growth through the reduction of tariffs and fair free trade. While it dominated European thought between the 16th and 18th centuries, in the current world it is acquiring dominant importance under the US President Donald Trump who stands for "America First" and also Brexit. Brexit argued against import of human capital from the European Union as influx of immigrants from Eastern Europe deprived unskilled British workers of their jobs, lowered their wages and increased unemployment.

- Behavioural economics: Behavioral economics is a relatively new field that combines insights from various fields of study to generate a more accurate understanding of human behavior. Behavioral models integrate insights from psychology, neuroscience and microeconomic theory. Behavioral economics is concerned with the bounds of rationality of economic agents.Economics has long differed from other disciplines in its belief that most.if not all human behavior can be easily explained by relying on the assumption that our preferences are well-defined and stable across and are rational. Richard Thaler, the University of Chicago professor who won the Nobel Memorial Prize in Economic Sciences. In 2017 challenged that view by writing about anomalies in people's behavior that could not be explained by standard economic theory. Thaler inspired the creation of behavioral science teams, often call "nudge units," in public and private organizations around the globe. He suggests that there are many opportunities to "nudge" people's behavior by making subtle changes to the context in which they make decisions.Nudges can solve a variety of problems that governments and businesses alike consider important. (More in the classroom)

- Green Economics: When the growth of economy all over the world created environmental degradation, a school of thought emerged showing alternative paths to growth where there is sustainability of economic growth without damaging the growth rates. It is called green economics and focuses on and supports the harmonious interaction between humans and nature and attempts to reconcile the two. It is referred by many names like sustainable development, green economy. "A Green Economy promotes a triple bottom line: sustaining and advancing economic, environmental and social well-being." New indices of measuring growth have been built to promote green economy: Green GDP, *Social Progress Index and* Environmental Performance Index (EPI) are some examples. Millennium Development Goals and Sustainable Development Goals also advocate green economics.

Measuring Economic Growth

Economic growth is the change- increase or decrease, in the value of goods and services produced by an economy. Measures of national income and output are used in economics to estimate the value of goods and services produced in an economy. Common measures are Gross National Product (GNP) and Gross Domestic Product (GDP).

National Income Accounting

National income accounting refers to a set of rules and techniques that are used to measure the output of a country. It centres around basic concepts of Gross Domestic Product (GDP) and Gross National Product (GNP).

GDP is defined as the total market value of all final goods and services produced within the country in a given period of time- usually a calendar year or financial year or a fraction like quarter.

GDP can be real or nominal. Nominal GDP refers to the current year production of final goods and services valued at current year market prices. Real GDP refers to the current year production of goods and service valued at base year prices. Base year prices are constant prices. For the current national income series introduced in 2015, the base year is 2011-12.

In estimating GDP, only final marketable goods and services are considered. When it is compared to the base year figure, the real growth levels are seen.

In calculating GDP, certain transactions are excluded. For example, gains from resale are excluded but the services provided by the agents are counted. That is, when a used car or house is sold, no new goods are being produced. But the real estate or the auto agent makes some money though commission which adds to the service economy.

Final goods are goods that are ultimately consumed rather than used in the production of another good. For example, a car sold to a consumer is a final good; the components such as tyres sold to the car manufacturer are not; they are intermediate goods used to make the final goods. The same tyres, if sold to a consumer, would be a final goods. Only final goods are included when measuring national income. If intermediate goods were included too, this would lead to double counting; for example, the value of tyres would be counted once when they are sold to the car manufacturer, and again when the car is sold to the consumer.

Only newly produced goods are counted. Transactions in existing goods, such as second-hand cars, are not included, as these do not involve the production of new goods. (mentioned earlier)

GDP considers only marketed goods. If a cleaner is hired, his pay is included in GDP. If one does the work himself, it does not add to the GDP. Thus, much of the work done by women at home-taking care of the children, aged; chores etc. which is called 'care economy' is outside the GDP. Even what the elder sibling teaches the younger one is outside the scope of national accounts.

The value of intermediate goods is a part of the final goods and services and so are not counted separately as it amounts to double counting and exaggerates the value of the output.

Not all goods and services from productive activities enter into market transactions. Imputations are made for some of these non-marketed but productive activities: for example, imputed rental for owner-occupied housing.

Market Price and Factor Cost

Market price refers to the actual transacted price and it includes indirect taxes- custom duty, excise duty, sales tax, service tax etc.

Factor cost refers to the actual cost of the various factors of production and it includes government grants and subsidies but it excludes indirect taxes.

Factors of Production

Factors of production, which are also called resource or inputs are what we use used in the production process to produce output—that is, finished goods and services. There are three factors of production: land, labor and capital. All three of these are required in combination at a time to produce a commodity.

There are two types of factors: *primary* and *secondary*. Primary factors are land, labor (the capacity to work), and capital goods. Materials and energy (fuel) are considered secondary factors in classical economics because they are obtained from land, labor and capital. The primary factors facilitate production but neither become part of the product (as with raw materials) nor become significantly transformed by the production process (as with fuel used to power machinery). Land includes not only the site of production but natural resources above or below the soil. Some scholars distinguish human capital (skills, talent and knowledge in the labor force) from labor. Capital can have other forms also intellectual capital, social capital (networks of relationships necessary for cooperative work for production of value) and even civic capital (citizens working together for facilitating social and political order based on constitutional values).

Some scholars list Entrepreneurship as a factor of production.

Factor Costs

Factor costs are the actual production costs at which goods and services are produced by the firms and industries in an economy. They are the costs of all the factors of production such as land, labor, capital, energy, raw materials like steel etc. that are used to produce a given quantity of output in an economy. They are also called factor gate costs (farm gate, firm gate and factory gate) since all the costs that are incurred to produce a given quantity of goods and services take place behind the factory gate i.e., within the walls of the firms, plants etc. in an economy.

Relationship Between Market Price And Factor Cost:

GNP at factor cost = GNP at market price – indirect taxes + subsidies

GDP at factor cost = GDP at market price – indirect taxes + subsidies

Transfer Payments

Transfer payments are made by the government as 'one-way' payment of money for which no money, good, or service is received in exchange. Governments use such payments as means of income redistribution (universal basic income) under social welfare programs such as social security, old age or disability pensions, student grants, unemployment compensation, etc. There is a need to differentiate them from subsidies. Transfer payments are a part of personal income. Subsidies paid to exporters, farmers, manufacturers are not considered transfer payments because they are linked to an economic transaction.

Transfer payments may be conditional cash transfers or unconditional cash transfers (universal basic income). IGMSY is a transfer payment. It is a conditional cash transfer. Under Indira Gandhi Matritva Sahyog Yojana (IGMSY) GOI provides financial aid of Rs 6,000 to pregnant woman who undergo institutional delivery for hospital admission. The sum is also meant to help with their child's vaccination, as well as nutritional food.The money will be directly transferred to the bank accounts of pregnant women. The scheme is aimed at encouraging institutional deliveries n order to reduce maternal as well as infant mortality.

)irect Benefit transfer of LPG (DBT) scheme PAHAL (Pratyaksh Hanstantrit Labh) is a part of GDP and thus is not a transfer payment.

'ransfer payments are excluded in computing gross national product.

stimating GDP/GNP

'here are three different ways of calculating GDP. The expenditure approach adds consumption, ivestment, government expenditure and net exports (exports minus imports). The income pproach adds what factors earn: wages, profits, rents etc. Output approach adds the market value final goods and services .The three methods must yield the same results because the total penditures on goods and services (GNE) must by definition be equal to the value of the goods id services produced (GNP) which must be equal to the total income paid to the factors that oduced these goods and services.

In reality, there will be minor differences in the results obtained from the various methods due to changes in inventory levels. This is because goods in inventory have been produced (and therefore included in GDP), but not yet sold. Similar timing issues can also cause a slight discrepancy between the value of goods produced (GDP) and the payments to the factors that produced the goods, particularly if inputs are purchased on credit. Inventory is a detailed list of all the items in stock

Gross GDP means depreciation (wear and tear of machinery in their use) of capital stock is not subtracted. If depreciation is subtracted, it becomes net domestic product.

Calculating the real GDP growth-inflation adjusted GDP growth-allows us to determine if production increased or decreased, regardless of changes in the inflation and purchasing power of the currency.

Output expressed as GDP at factor cost at constant prices makes more genuine sense as inflation/deflation is factored out and the distortions of subsidies and indirect taxes are also deducted. Thus, quantitative levels of production changes are expressed.

The data from the current prices is adjusted to the constant prices by using deflator- it helps take out the contribution of inflation to the value of the output. GDP deflator is a price index.

GDP and GNP

The two are related. The difference is that GNP includes net foreign income- what foreigners produce in the country is subtracted from what Indians produce abroad or vice versa. That is meant by net foreign income. GNP adds net foreign income compared to GDP. GDP shows how much is produced within the boundaries of the country by both the citizens and the foreigners. GDP focuses on where the output is produced rather than who produced it- it is a geographical concept. GDP measures all domestic production, disregarding the producing entities' nationalities.

In contrast, GNP is a measure of the value of the output produced by the "nationals" of a country- both within the geographical boundaries and outside. That is, all the output that the Indian citizens produce in a given year – both within India and all other countries makes up the GNP of India. For example, there are Indian and foreign firms operating in India. Together what they produce within the Indian geography is the GDP of India. The profits of foreign firms earned within India are included in India's GDP, but not in India's GNP.

In other words, income is counted as part of GNP according to who owns the factors of production rather than where the production takes place. For example, in the case of a German-owned car factory operating in the US, the profits from the factory would be counted as part of German GNP rather than US GNP because the capital used in production (the factory, machinery, etc.) is German owned. They are a part of US GDP.

GDP is essentially about where production takes place. GNP is about who produces. If it is an open economy with great levels of foreign investment (FDI) and lesser levels of outbound FDI, its GDP is likely to be larger than GNP.

If it is an open economy but more of its nationals tend to move economic activity abroad or earn more from investing abroad compared with non-nationals doing business and earning incomes within its borders, its GNP will be larger than GDP.

If it is a closed economy where nobody leaves its shores, nobody invests abroad, nobody comes in and nobody invests in the country, its GDP will be equal to GNP.

For most countries, GDP and GNP have more or less the same values.

However, for East Timor, GNP is 3 times or so more than GDP. East Timor which gained Independence in 2002 has low level of production of goods and services on Timorese soil—the country's GDP. It receives foreign aid which is counted as remittance from abroad thus enlarging the GNP value. Whether foreign aid is to be so counted is a separate matter of methodology.

Take the case of Ireland. Its GDP is much larger than its GNP. In Ireland, Google, Apple, Microsoft, Accenture and such other multinational corporations are headquartered due to the tax advantage they get as corporate tax rates are very low. They only have registered offices in Ireland without any production activity. These MNCs contribute to its GDP through exports. Here, the difference between GDP and GNP can be significant. This is due to the fact that such exports far outweigh the Irish imports. The higher GDP value however is illusory.

India's GDP is a little more than its GNP.

Analysts tend to say that GDP is a better measure than GNP. The reason is that GDP is domestic production where employment is created; inflation is moderated; tax revenues are more, exports can be made for foreign exchange reserve build up and so on. GNP also has its advantages and India is a big beneficiary of it-remittances from aborad; acquisition of foreign companies; invest abroad to tap on foreign opportunities etc. But the consensus is that former is of greater value than the latter for the reasons cited.

There are other related concepts too.

Gross National Product and Net National Product

We have seen GDP and GNP above.

Net National Product

In the production process a country uses machines and equipment. When there is depreciation, we have to repair or replace the machinery. The expenses incurred for this are called the depreciation expenditure. Net National Product is calculated by deducting depreciation expense from gross national product.

NNP = GNP - Depreciation

National Income is calculated by deducting indirect taxes from Net National Product and adding subsidies. National Income (NI) is the NNP at factor cost.

NI = NNP - Indirect Taxes + Subsidies

Per Capita Income is per capita GDP: GDP divided by mid year population of the corresponding year. Similarly, per capita GNP can also be calculated.

The real GDP per capita of an economy is often used as an indicator of the average standard of living of individuals in that country, and economic growth is therefore often seen as indicating an increase in the average standard of living.

Base Year

Base year is a specific year from which the economic growth is measured. It is allocated the value of 100 in an index. The estimates at the prevailing prices of the current year are termed as "at current prices", while those prepared at base year prices are termed "at constant prices". The comparison of the two estimates gives the measure of real growth. It means the production of the current year is valued at base year prices so that the real growth is worked out by deducting the impact of inflation or deflation. That is, the increase in the value of the GDP due to inflation is excluded and the `real increase' of goods and services is found out.

The base year of the national accounts is changed periodically to take into account the new goods and services in the economy and thus to depict a true picture of the economic growth. For example, software, digital hardware etc are of recent origin and if the base year remained in the 1990's, the same would be not tracked. Thus, we are blind to growth in its statistical measurement. Similarly, when we continue to measure the goods and services that are no longer in production as they were- jute, type writers etc, we see the decline as fall of growth while in reality they are replaced by new products. Therefore, base year needs to be brought closer to the current year. The National Statistical Commission wants that the base year should be revised every five years.

The first official estimates of national income were prepared by the Central Statistical Office (CSO) with base year 1948-49 for the estimates at constant prices. These estimates were published in the publication, "Estimates of National Income" in 1956. With the gradual improvement in the availability of basic data over the years, a comprehensive review of methodology for national accounts statistics has constantly been undertaken with a view to updating the database and shifting the base year to a more recent year. As a result, base years of the National Accounts Statistics series have been shifted and 2011-12 is the base year for the new series of national accounts being followed from 2015.

Normally, when the base year of national accounts statistics is changed, there is some change in the levels of GDP estimates. This happens due to widening the coverage and counting the actual production.

A base year has to be a normal year without large fluctuations in production, trade and prices of commodities in general. Reliable price data should be available for it. It should be as recent as possible.

GDP Deflator

GDP Deflator is a measure of inflation that tracks the price changes in the entire economy and not a specific limited basket of goods and services as in the price indices of Whole-sale price index (WPI) and Consumer price index (CPI). It is implicitly derived from national accounts data as a ratio of GDP at current prices to constant prices. It encompasses the entire spectrum of domestic economic activities including services, and is available on a quarterly basis with a lag of two months since 1996. At present, the GDP deflator is available only annually with a long lag of over one year and hence has very limited use for the conduct of policy.

A change in prices can distort perception of actual gross domestic product even without an increase or decrease in the quantity of goods and services produced by an economy. In 2015, in India, the goods and services produced were higher than their market prices indicated. That was an exception. Normally, it is the opposite- market value of the production is higher than the actual goods produced. In both cases, there is distortion that can misguide public policy. Therefore, the impact of prices has to be removed to arrive at a true measure of economic growth. A deflator is used to restate output estimates at current prices into what they would be if calculated with reference to prices in an earlier year- be it the immediately preceding year or the base year or any year in between. This will give an idea of the real growth in the economy, minus the price effect. The ratio between the GDP at current prices and GDP at constant prices gives an idea of the increase in prices of all goods and services with reference to the base year. However, the deflator comes with a lag, which limits its usefulness.

When the GDP deflator is in the negative as mentioned above, nominal GDP is less than real GDP. It means there is deflation in the country.

Seasonality

Estimates of GDP should be seasonally adjusted to factor for fluctuations that normally occur at about the same time and the same magnitude each year. Seasonal adjustment ensures that the movements in GDP, or any other economic series, more accurately reflect true patterns in economic activity. Examples of factors that may influence seasonal patterns include weather, agricultural production, holidays and production schedules. Take the case of India. When we say that India's economic growth was 5.7% in the April-June quarter of the 2017-18 fiscal year, it means that it grew that much over the base value in the same quarter of the previous fiscal year. Its accuracy will be lost if it is a comparison with the previous quarter that is January-March as the seasonal factors of the two quarters are different. Southwest monsoons begin in June and continue for 2-3 months which impacts of construction activity. Similarly, October-December quarter should be compared with the same quarter in the earlier years as it has festivals in it that are relatively absent in other quarters.

Potential GDP

Potential gross domestic product (GDP) is the level of output that an economy can produce without inflating the economy. It is the highest level of real gross domestic product (output) that can be sustained over the long term. Sustainability is in terms of prices, fiscal deficit, current account deficit (exports can not be boosted by devaluing the exchange rate as it can be dysfunctional), financial sector not accumulating non-performing assets etc. Potential output depends on ta variety of factors like infrastructure, human capital and skills, potential labour force (which depends on demographic factors), level of technological development and labour productivity. These limits thus pertain natural and institutional factors.

If actual GDP rises and stays above potential output, it is inflationary as demand for factors of production exceeds supply. In the opposite set of conditions, if GDP is below potential GDP, inflation will come down. Ideally, potential GDP is not to be exceeded for the reasons given above. Towards this objective, government's fiscal policy and Reserve Bank of India (RBI) monetary policy is suitably used. The difference between potential output and actual output is referred to as the output or GDP gap.

Hard And Soft Landing

The Hard Landing of the economy means a sudden fall in the growth rate of economy that is otherwise growing well for any reason. The fall is so steep that a rapidly growing economy may slip into recession. It can be internal or external reason. When the economy is gorwing too fast and for long- when there is inflation along with growth, government wil slow it down by monetary tightening to make the growth sustainable. If such slowdown lands the economy all the way into recession, it hard landing otherwise it is soft landing

India's National Income Statistics

The Central Statistical Office (CSO) in the Ministry of Statistics and Programme Implementation (MoSP & I) is responsible for the compilation of NAS. At the State level, State Directorates of Economics and Statistics (DESs) have the responsibility of compiling there State Domestic Product and other aggregates.

The statistics that are released by the CSO and the State DESs relate to various macro-economic aggregates of the Indian economy. The aggregates compiled and released (at current and constant prices) at annual periodicity by the CSO include gross and net domestic product by economic activity, consumption, saving, capital formation and capital stock, public sector transactions and dis-aggregated statements, as well as the consolidated accounts of the nation namely like Gross Domestic Product. The CSO also releases the quarterly GDP estimates.

The CSO revises the base year of the NAS series periodically. The CSO releases the current series of NAS with 2011-12 as Base Year. The first estimates for a reference year are released by the CSO, about two months before the close of the year, in the form of Advance Estimates (AE) of National Income. These estimates present at both current and constant prices and at factor cost, the Gross National Product (GNP), Net National Product (NNP), Gross Domestic Product (GDP), Net Domestic Product (NDP), and Per Capita Income. These estimates are subsequently revised and released as updates of advance estimates. Quick Estimates of NAS and the Revised Estimates of the earlier years are released by the CSO utilising the available data of various sectors provided by the statistical system, in the month of January or February of the following year (with a 10-month lag). Along with the Quick Estimates for the previous financial year, estimates for the earlier years are also revised using the detailed data supplied by various source agencies and final figures released.

"New GDP Series" 2015

The Central Statistics Office (CSO) came out with a new series of national accounts with 2011-12 as base year for computing size of the economy and economic growth rate. It has the effect of broadening the coverage across segments including farm, corporate and unorganised sectors - a move that will likely expand the size the economy's size. The base year of the national accounts is changed periodically to factor in structural changes in the economy. The new series includes data on unorganised manufacturing and services. Under the new series, the data for corporate income is collated from the corporate affairs ministry's MCA21 records, a comprehensive compendium that allows collecting granular information even from the level of the small firms.In the earlier series such data was taken primarily from the Reserve Bank of India's study on companies and finances. The series also incorporates results of recent National Sample Surveys such as those on enterprises, unemployment, debt and investment, situation assessment of farmers and survey of land livestock holdings.The National Statistical Commission suggested that the base year for computing national account should be revised every five years.

The 2004-05 GDP data was under-estimating industrial growth as the coverage was low and the weights were wrong. New GDP series has captured the changing structure of the Indian economy. The share of manufacturing has increased to 15.8% from 11.9% in the 2004-05 series. The share of agriculture has increased marginally in the new series to 17.2% from 16.8%.

The base year was last revised in 2010.

Real GDP or GDP at constant (2011-12) prices for the year 2016-17 is estimated at `121.90 lakh crore showing a growth rate of 7.1 percent over the year 2015-16 of `113.81 lakh crore.

Nominal GDP or GDP at current prices in the year 2016-17 is projected at Rs. 152.51 lakh crore, with growth rate of 11.5 percent against Rs. 136.75 lakh crore for 2015-16.

The GNI at current prices is estimated at 150 lakh crore during 2016-17, as compared to 135 lakh crore during 2015-16, showing a rise of almost 11% percent. The Gross National Income (GNI) at 2011-12 prices is estimated at 120.35 lakh crore during 2016-17.

The per capita income at current prices during 2016-17 is estimated to have attained a level of Rs.103219 as compared to the estimates for the year 2015-16 of Rs.94130 showing a rise of 9.7 percent.

India is behind by only $237 and $399 billion from 6th and 5th ranked France and United Kingdom, respectively. It is projected that India will be 6th largest economy of world in 2019 by overtaking France and will become 5th largest in 2019 by overtaking United Kingdom.

Per Capita

India's per capita income grew was Rs1,03,219 in 2016-17 compared to the estimates for the year 2015-16 of Rs94,130 showing a rise of 9.7%. In real terms (at 2011-12 prices), per capita income in 2016-17 rose 5.7% to Rs.82,269.

The Need To Measure Economic Growth

The following aims can be attributed to the study of economic growth:

- when growth is quantified, we can understand whether it is adequate or not for the given goals of the economy. When we can understand its potential and accordingly set targets
- we can adjust growth rates for their sustainability
- we can prevent inflation or deflation to some extent if we see the performance of the economy in quantitative terms
- we can balance the contributions of the three sectors of the economy and steer the direction of growth towards national goals- away from agriculture to manufacturing as in the case of India in recent years
- target appropriate levels of employment creation and poverty alleviation
- forecast tax revenues for governmental objectives
- corporates can plan their business investments

Economic Growth: Its Benefits And Side Effects

The first benefit of economic growth is wealth creation. It helps create jobs and increase incomes. It ensures an increase in the standard of living, even if it is not evenly distributed. Government has more tax revenues: fiscal dividend. Economic growth boosts tax revenues and provides the government with extra money to finance spending projects. For example, the flagship programmes of the government like Mantri Awaas Yojana-Gramin (PMAY-G), Pradhan Mantri Ujjwala Yojana (PMUY), Deen Dayal Upadhyaya Gram Jyoti Yojana (DDUGJY), Pradhan Mantri Gram Sadak Yojana (PMGSY) are a direct result of the tax buoyancy of growth . It sets up the positive spiral: rising demand encourages investment in new capital machinery which helps accelerate economic growth and to create more employment.

Economic growth can also have a self-defeating effect: violate the principles of fairness and equity thus setting off social conflicts. Environmental costs are another risk.

Problems in Calculating National Income

The measurement of national income encounters many problems.

Black Money Illegal activities like smuggling ind unreported incomes due to tax evasion and corruption are outside the GDP estimates. Thus, parallel economy poses a serious hurdle to accurate GDP estimates. GDP does not take into account the 'parallel economy' as the transactions of black money are not registered.

Non-Monetization In most of the rural economy, considerable portion of transactions occurs informally and they are called as non-monetized economy- the barter economy. The presence of such non-monetary economy in developing countries keeps the GDP estimates at lower level than the actual.

Household Services The national income accounts do not include the 'care economy'- domestic work and housekeeping. Most of such valuable work rendered by our women at home does not enter our national accounting.

Social Services It ignores voluntary and charitable work as it is unpaid.

Environmental Cost National income estimation does not account for the environmental costs incurred in the production of goods. For example, the land and water degradation accompanying the Green revolution in India. Similarly, the climate change that is caused by the use of fossil fuels. However, in recent years, green GDP is being calculated where the environmental costs are deducted from the GDP value and the Green GDP is arrived at.

Reliability of GDP As a Measure of Progress

Economic growth is generally taken as the measure of advancement in the standard of living of the country. Countries with higher GDP often score highly on measures of welfare, such as life expectancy. However, there are limitations to the usefulness of GNP as a measure of welfare:

- GDP does not value intangibles like leisure, quality of life etc. Quality of life is determined by many other things than economic goods.

- the impact of economic activity on the environment may be harmful-pollution, climate change, unsustainable growth, ecological refugees, life style diseases etc.
- It only gives average figures that hide stratification. Economic inequality is not revealed by GDP figures
- Condition of poor is not indicated
- Gender disparities are not revealed
- It does not matter how the increase in wealth takes place- whether by civilian demand or war
- GDP does not measure the sustainability of growth. A country may achieve a temporarily high GDP by over-exploiting natural resources

The major advantages to using GDP per capita as an indicator of standard of living are that it is measured frequently, widely and consistently. Frequently in that most countries provide information on GDP on a quarterly basis, which allows a user to spot trends more quickly. Widely in that some measure of GDP is available for practically every country in the world, which allows crude comparisons between the standard of living in different countries. And consistently in that the technical definitions used within GDP are relatively consistent between countries, and so there can be confidence that the same thing is being measured in each country.

The major disadvantage of using GDP as an indicator of standard of living is that it is not, strictly speaking, a measure of standard of living. For instance, in an extreme example, a country which exported 100 per cent of its production would still have a high GDP, but a very poor standard of living. The argument in favour of using GDP is not that it is a good indicator of standard of living, but that , in general, standard of living tends to increase when GDP per capita increases. This makes GDP a proxy for standard of living, rather than a direct measure of it. Because of the limitations in the GDP concept, other measures of welfare such as the Human Development Index (HDI), Genuine Progress Indicator (GPI) , Gross National Happiness (GNH), Green GDP, natural resource accounting have been suggested.

They are proposed in an attempt to give a more complete picture of the level of well-being and the position with reference to natural resource depletion, but there is no consensus as to which is a better measure than GDP. Some of the above defy quantification. GDP still remains by far the most often-used measure.

Alternatives to GDP

Robert F. Kennedy once said that a country's gross domestic product (GDP) measures "everything except that which makes life worthwhile". The metric was developed in the 1930s and 1940s amid the upheaval of the Great Depression and global war. Even before the United Nations began requiring countries to collect data to report national GDP, Simon Kuznets, the metric's chief architect, had warned against equating its growth with well-being.

Economic activity has depleted natural resources. The philosopher John Stuart Mill noted more than 200 years ago that, once decent living standards were assured, human efforts should be directed to the pursuit of social and moral progress and the increase of leisure, not the competitive struggle for material wealth. Economist John Kenneth Galbraith once observed: "To furnish a barren room is one thing. To continue to crowd in furniture until the foundation buckles is quite another."

How GDP number misguide about the general welfare GDP is now clear. Increased crime rates do not raise living standards, but they can lift GDP by raising expenditures on security systems. Despite the destruction wrought by the oil spills and environmental disasters like in Uttarakhand in 2013, J&K in 2014 and Chennai in 2015, they boosted GDP because they stimulated rebuilding. Despite the devastation for Houston (USA) and surrounding areas, there could be a pickup in GDP due to rebuilding from the storm, Hurricane Harvey in mid-2017. It could boost GDP when rebuilding results in a national shortage of construction workers or puts pressure on building materials prices.Competition for construction workers could raise wages. Following the massacre in Las Vegas in 2017 October, firearm manufacturers saw their stock prices go up as more guns were expected to be sold.

As Kuznets noted in 1934, "the welfare of a nation can scarcely be inferred from a measure of national income."

Commercial agricultural production in a country might expand, for example, leading to a rise in GDP; but if the increase is made possible by displacing women from land they farm to feed their family, or through practices that degrade the environment, like deforestation or the use of chemical fertilizers, pesticides and herbicides, misery will increase.

Accordingly, other measures of human well-being in a nation-state have been developed, such as the Human Development Index, Bhutan's Gross National Happiness etc. These approaches assess specific indicators of human welfare like longevity, literacy, and maternal and infant mortality, and are not exclusively economic in orientation.

Human Development Index (HDI)

The UN Human Development Index (HDI) is a standard means of measuring well-being. The index was developed in 1990 by the Pakistani economist Mahbub ul Haq, and has been used since 1993 by the United Nations Development Programme in its annual report.

The HDI measures the average achievements in a country in three basic dimensions of human development:

- A long and healthy life, as measured by life expectancy at birth.
- Knowledge, as measured by the adult literacy rate (with two-thirds weight) and the combined primary, secondary, and tertiary gross enrolment ratio (with one-third weight).
- A decent standard of living, as measured by gross domestic product (GDP) per capita at purchasing power parity (PPP) in US Dollars.

Each year, UN member states are listed and ranked according to these measures. The HDI goes beyond a nation's gross domestic product (GDP) to measure the general well-being of people under a host of parameters, such as poverty levels, literacy and gender-related issues.

The 2010 Human Development Report came up for the first time with an Inequality-adjusted Human Development Index (IHDI), which factors in inequalities in the three basic dimensions of human development (income, life expectancy, and education) and adjusts the HDI.

In the Human Development Report 2017, India has been placed at 131th position in the Human Development Index (HDI) among the 188 countries. India's human development index (HDI) value of 0.624 puts it in the "medium human development" category, alongside countries such as Congo, Namibia and Pakistan. It is ranked third among the SAARC countries, behind Sri Lanka (73) and the Maldives (105), both of which figure in the "high human development" category.

Human Poverty Index (HPI)

The Human Poverty Index (HPI) is an indication of the standard of living in a country, developed by the United Nations (UN) to complement the Human Development Index (HDI). In 2010 it was supplanted by the UN's Multidimensional Poverty Index.

Genuine Progress Indicator (GPI)

Genuine progress indicator (GPI) is a metric that is designed to take fuller account of the well-being of a nation, only a part of which pertains to the size of the nation's economy, by incorporating environmental and social factors which are not measured by GDP. For instance, some models of GPI decrease in value when the poverty rate increases. The GPI separates the concept of societal progress fromeconomic growth.

The GPI is deducts environmental costs of economic activity like biodiversity loss, resource depletion, pollution, loss of farmland and wetlands, and ozone depletion, and social costs like increase in crime and family breakdown.

For example, in coastal mangrove regions of India, shrimp farming generated substantial profits for those involved in the export market. Once the environmental costs of biodiversity loss through destruction of mangroves, ecosystem damage as well as social costs are factored in, however, the economic gains of shrimp farming no longer look like genuine progress, sustainable development, or poverty alleviation.

GPI incorporates sustainability by looking at losses and gains in "natural capital" like resources, biodiversity and ecosystem health.
In a world increasingly dominated by pursuit of "growth at any cost", the GPI provides economic perspectives in support of social justice, poverty alleviation and sustainable development even as the economic growth is maintained.

Some of the he "costs" of economic activity include the following potential harmful effects:

- Cost of resource depletion
- Cost of crime
- Cost of ozone depletion
- Cost of family breakdown
- Cost of air, water, and noise pollution
- Loss of farmland
- Loss of wetlands

Social Progress Index

The *Social Progress Index* measures the extent to which countries provide for the social and environmental needs of their citizens. Fifty-four indicators in the areas of basic human needs, foundations of well-being, and opportunity to progress show the relative performance of nations. The index is published by the nonprofit Social Progress Imperative, and is based on the writings of Amartya Sen and Joseph Stiglitz.The social and environmental factors include wellness (including health, shelter and sanitation), equality, inclusion, sustainability and personal freedom and safety. India has ranked 93rd among 128 countries on 2017 Social Progress Index report released by Social progress Imperative (SPI).

The index defines social progress as *the capacity of a society to meet the basic human needs of its citizens, establish the building blocks that allow citizens and communities to enhance and sustain the quality of their lives, and create the conditions for all individuals to reach their full potential.*

The index is prepared based on indicators like health, sanitation, personal safety, ecosystem sustainability, shelter, access to knowledge, personal rights, and tolerance and inclusion. India faces challenges across many dimensions. The country scores particularly low on shelter in the basic human needs dimension, access to information in the foundations of well-being dimension, and tolerance and inclusion in the opportunity dimension.

GNH

Gross National Happiness (GNH) is an attempt to define quality of life in more holistic and psychological terms than Gross National Product.

The term was coined by Bhutan's former King Jigme Singye Wangchuck in 1972 to indicate his commitment to building an economy that would serve Bhutan's unique culture based on Buddhist spiritual values. While conventional development models stress economic growth as the ultimate objective, the concept of GNH is based on the premise that true development takes place when material and spiritual development occur side by side to complement and reinforce each other. The four dimensions of GNH are the promotion of equitable and sustainable socio-economic development, preservation and promotion of cultural values, conservation of the natural environment, and establishment of good governance.

Natural Resources Accounting and Green GDP

Natural resources are essential for production and consumption, maintenance of life-support systems, as well as having intrinsic value in existence for intergenerational and other reasons. It can be argued that natural capital should be treated in a similar manner to man-made capital in accounting terms, so that the ability to generate income in the future is sustained by using the stock of natural capital judiciously. By failing to account for reductions in the stock of natural resources, standard measures of national income do not represent economic growth genuinely. Soil, water and biodiversity are the three basic natural resources.

National Biodiversity Action Plan published by Government of India, Ministry of Environment and Forests in 2008 highlights as an action point the valuation of goods and services provided by biodiversity. More specifically, the Action Plan states: to assign appropriate market value to the goods and services provided by various ecosystems and strive to incorporate these costs into national accounting.

In the Nagoya (Japan) meet in 2010 on biodiversity protection, India declared that it will adopt natural resource accounting. The 2010 UN biodiversity summit decided to respect the link between economic policy, natural capital and human wellbeing. There should be global partnership is to mainstream natural resources accounting into economic planning. India, Colombia and Mexico accepted it. This will plug deficiencies in traditional accounting systems. As mentioned above, India's national biodiversity action plan has already incorporated some of these concepts.

Green GDP

Green Gross Domestic Product (Green GDP) is an index of economic growth with the environmental consequences of that growth factored in. From the final value of goods and services produced, the cost of ecological degradation is deducted to arrive at Green GDP.

In 2004, China announced that the green GDP index would replace the Chinese GDP index. But the effort was dropped as green GDP figures shrank the size of the GDP to unimpressive levels. An Expert Group was convened in 2011 to examine the prospects of developing green national accounts in India, chaired Shri Partha Dasgupta and submitted its report in 2013.

Sarkozy's Alternative

The Commission on the measurement of economic performance and social progress was set up in 2008 on French government's initiative.

Increasing concerns have been raised since a long time about the adequacy of current measures of economic performance, in particular those based on GDP figures. Moreover, there are broader concerns about the relevance of these figures as measures of social well-being, as well as measures of economic, environmental, and social sustainability.

Reflecting these concerns, President Sarkozy decided to establish this Commission, to look at the entire range of issues. Its aim was to identify the limits of GDP as an indicator of economic performance and social progress, to consider additional information required for the production of a more relevant picture etc. The Commission was chaired by Professor Joseph E. Stiglitz. Amartya Sen and Bina Agarwal are also associated with it. The commission gave its report in 2009.

The Stiglitz report recommends that economic indicators should stress well-being instead of production, and for non-market activities, such as domestic and charity work, to be taken into account. Indexes should integrate complex realities, such as crime, the environment and the efficiency of the health system, as well as income inequality. The report brings examples, such as traffic jams, to show that more production doesn't necessarily correspond with greater well-being.

Stiglitz explains: The big question concerns whether GDP provides a good measure of living standards. In many cases, GDP statistics seem to suggest that the economy is doing far better than most citizens' own perceptions. Moreover, the focus on GDP creates conflicts: political leaders are told to maximise it, but citizens also demand that attention be paid to enhancing security, reducing air, water, and noise pollution, and so forth – all of which might lower GDP growth. The fact that

Happiness Index

The World Happiness Report is a measure of happiness published by the United Nations Sustainable Development Solutions Network. In 2011, the UN General Assembly passed a resolution inviting member countries to measure the happiness of their people and to use this to help guide their public policies. In 2012, this was followed by the first UN High Level Meeting called "Happiness and Well-Being: Defining a New Economic Paradigm," which was chaired by Prime Minister Jigme Thinley of Bhutan, the first and so far only country to have officially adopted gross national happiness instead of gross domestic product as their main development indicator.

The first World Happiness Report was released in 2012. It drew international attention as the world's first global happiness survey. The report outlined the state of world happiness, causes of happiness and misery, and policy implications highlighted by case studies. In September 2013 the second World Happiness Report offered the first annual follow-up and reports are now issued every year.The report primarily uses data from the Gallup World Poll.

In the reports, leading experts in fields including economics, psychology, survey analysis, and national statistics, describe how measurements of well-being can be used effectively to assess the progress of nations. Reports delve deep into issues relating to happiness, including mental illness, the objective benefits of happiness, the importance of ethics, policy implications, and links with subjective well-being and the Human Development Report.

India ranked at 122 out of 155 countries in the World Happiness Report 2017.

Norway is the happiest country based on the index compiled from data which combine economic, health and polling data compiled by economists that are averaged over three years from 2014 to 2016. It is recommended that statistics and surveys, which normally deal with income, spending, health and housing, include a few extra questions on happiness because it would lead to better policy that affects people's lives. The entire top ten were wealthier developed nations. Yet money is not the only ingredient in the recipe for happiness. In fact, among the wealthier countries the differences in happiness levels had a lot to do with differences in mental health, physical health and personal relationships: the biggest single source of misery is mental illness.China, has made major economic strides in recent years. But its people are not happier than 25 years ago, it found.

The United States meanwhile slipped to the number 14 spot due to less social support and greater corruption; those very factors play into why Nordic countries fare better on this scale of smiles.What works in the Nordic countries is a sense of community and understanding in the common good. The rankings are based on gross domestic product per person, healthy life expectancy with four factors from global surveys. In those surveys, people give scores from 1 to 10 on how much social support they feel they have if something goes wrong, their freedom to make their own life choices, their sense of how corrupt their society is and how generous they are.

Madhya Pradesh's Department of Happiness

In 2016, Madhya Pradesh became the first state to announce its happiness department. Madhya Pradesh said that the department would ensure happiness in the lives of people and stop them from taking extreme steps, such as suicide. MP joined hands with the Indian Institute of Technology (IIT) Kharagpur to develop a happiness index for "measuring the well-being of the people".IIT KGP will develop the Index and analyze data collected by the Government of Madhya Pradesh in order to assess the level of happiness and develop recommendations that can be used to enhance happiness. The institute will also develop online courses on happiness.

Andhra Pradesh

Andhra Pradesh is the second state in the country after Madhya Pradesh to start a Happiness Index Department. Chief Minister heads the newly formed departmentas in Madhya Pradesh. The State had recently launched an "achieving happiness" programme under which civic bodies organised song and dance events.The Andhra Pradesh government's 'Sunrise AP Vision 2029' has taken Bhutan as a model to focus on matters including psychological well-being, health, time use, education, etc.

Maharashtra

The state of Maharashtra plans to set up a "happiness department" in the government and has set up a seven-member committee to plan the formation of a happiness department under the state department of relief and rehabilitation in mid-2017.

Environmental Performance Index (EPI)

It is a method of quantifying and numerically marking the environmental performance of a state's policies. The 2016 Environmental Performance Index is a project lead by the Yale Center for Environmental Law & Policy (YCELP), Columbia University, in collaboration with World Economic Forum.

The 2016 Environmental Performance Index provides a global view of environmental performance and country by country metrics to inform decision-making. Launched at the World Economic Forum, the EPI is in its 15th year and more relevant than ever to achieving the United Nations' Sustainable Development Goals and carrying out the recent international climate change agreement. The Environmental Performance Index (EPI) ranks countries' performance on high-priority environmental issues in two areas: protection of human health and protection of ecosystems but factors taken into consideration also include tree cover and reduction in carbon intensity.2016 report ranked India 141st among 180 countries worldwide. The ten best performers in EPI are Finland, Iceland, Sweden, Denmark, Slovenia, Spain, Portugal, Estonia, Malta, and France. United Kingdom ranks 12th and the United States ranks 26th.The report stresses, there is no relationship between countries' EPI performance and economic development. "For instance, countries located in Europe tend to have higher EPI scores in relation to their Gross Domestic Product (GDP) per capita", while "China and India both have "high GDP per capita but receive low scores on the overall EPI."

Referring to unsafe water, unsafe sanitation, ambient particulate matter pollution, household air pollution from solid fuels, and ambient ozone pollution, the report states, **"Some countries, like India, perform poorly across all five environmental risk factors"**.The report is titled "Global Metrics for the Environment".

Purchasing Power Parity: PPP

Purchasing power parity is defined as the number of units of a country's currency required to buy the same amount of goods and services in the domestic market as one dollar would buy in the US. The concept of purchasing power parity allows us to estimate what exchange rate between two currencies is needed to express the accurate purchasing power of a currency in relation to another

The PPP system allows GDP comparisons to be made by asking how much money would be needed to purchase the same goods and services in two countries and using that to calculate an implicit foreign exchange rate. Purchasing power parity exchange rates are useful for comparing living standards between countries. Actual exchange rates can give a very misleading picture of living standards. For example, if the value of Indian rupee falls by half compared to the dollar, the Gross Domestic Product measured in dollars will also halve.

However, this doesn't necessarily mean that Indians are any poorer. Measuring income in different countries using purchasing power parity exchange rates helps to avoid this problem. PPP has been developed to remove the distortions in the exchange rate in the forex market. Market exchange rate doesn't reflect the purchasing power of a currency. PPP removes distortions that come with market exchange rates, which are often volatile, affected by political and financial factors that do not lead to immediate changes in income and tend to understate the standard of living in poor countries.

Let us assume that the market exchange rate between Dollar and Rupee is 66. One Dollar in the US fetches one liter of milk in the US. Rs 66 can buy three liters of milk in India. Assume that India's GDP is Rs 660. It is worth $10 by nominal exchange rate in the forex market. If milk is all that the world produces, one concludes that India's GDP is 10 liters of milk, if we use the market exchange rate. Actually, India produces 30 liters of milk. Thus, GDP calculated at market rates of foreign exchange tends to distort GDP. Remedy lies in the World Bank concept of Purchasing Power Parity (a type of exchange rate).Under PPP, we measure the GDP of India by measuring how much milk that Rupees 66 can purchase in India and One Dollar can purchase in the US. Here, one dollar in the US can purchase one liter of milk whereas Rs 22 can purchase one liter of milk in India.

$ 1 = Rs 22

Using this PPP exchange rate instead of market rate, we can calculate that India's GDP of Rs 660 becomes $30. Thus, in terms of PPP, India's GDP is $30 and not $10 which is the value that we arrive at by using market exchange rate. Big Mac Index says the same as can be seen below:

Big Mac Index

The Big Mac index was developed by The Economist magazine in 1986 as a lighthearted guide to whether currencies are at their "correct" level. It is based on the theory of purchasing-power parity (PPP). For example, the average price of a Big Mac in America in January 2017 was $6.6. In India, it was about Rs.120. It means, under PPP, the equation is Rs.18.18 per dollar. Thus, rupee is seen to be grossly undervalued.

How PPP is more reliable than market exchange rate is as follows: Firstly, market exchange rates can quickly change, which artificially changes the value of GDP. Secondly, market exchange rates are determined by demand and supply of currencies that includes speculation and expectations and confidence. The Gross Domestic Product per capita in India was at 6092.60 US dollars in 2016, when adjusted by purchasing power parity (PPP).

Business Cycles

Alternating periods of expansion and decline in economic activity is called business cycle. That is, the ups and downs of the economy. There are four stages in the business cycle: expansion, growth, slowdown and recession. Recession may not follow every time.

Recession

A recession is economic contraction (de-growth) which results in a general slowdown in economic activity. Macroeconomic indicators such as GDP (gross domestic product), investment, capacity utilization, household income, business profits, and inflation fall, while the unemployment rate rises. In the United Kingdom, it is defined as a negative economic growth for two consecutive quarters. This may be triggered by various events, such as a financial crisis (2008), an external trade shock, an adverse supply shock or the bursting of an economic bubble. Governments usually respond to recessions by adopting expansionary macroeconomic policies, such as increasing money supply, increasing government spending and decreasing taxation. Recession may end with the corrective measures taken by the government and the market. If it does not end and relapses for any reason, due to external or internal shocks, it is called double dip recession. In 2012, UK was in double dip recession. When recession worsens, with de-growth becoming stubborn and deeper and more and more people lose jobs, it is called depression- statistical markers may differ- whether 10% GDP is lost or more or less.

Great Recession 2008-9

The Great Recession was a period of steep economic decline observed in world economies, particularly the developed world during the late 2000s and early 2010s. The scale and timing of the recession varied from country to country. In terms of overall impact, the International Monetary Fund concluded that it was the worst global recession since the 1930s (the Great Depression). The causes of the recession largely originated in the United States, particularly related to the real-estate market. It began in December 2007 and ended in June 2009, thus extending over 19 months. The Great Recession was related to the financial crisis of 2007–08 and U.S. subprime mortgage crisis of 2007–09. It resulted in the collapse of the financial sector in USA. The banks were then bailed out by the U.S. government.

The recession was not felt evenly around the world. Whereas most of the world's developed economies, particularly in North America and Europe (including Russia), fell into a definitive recession, many of the newer developed economies suffered far less impact, particularly India and China whose economies grew substantially during this period.

2008 Subprime Crisis

The financial crisis is linked to reckless lending practices by financial institutions in the United States. The US mortgage-backed securitieswere marketed around the world. When these securities lost value and were considered toxic, the financial institutions that bought them either went into heavy losses or went bankrupt fully. These companies being listed on the stock market, equities collapsed in their value as a result. Indian banks had negligible exposure to them.

Credit boom fed a global speculative bubble in real estate and equities, which served to aggravate the risky lending practices. The emergence of Sub-prime loan losses in 2007 began the crisis and exposed other risky loans and over-inflated asset prices. With loan losses mounting and the fall of Lehman Brothers on September 15, 2008, a major panic broke out in the global financial transactions. As share and housing prices melted, many large and well established investment and commercial banks in the United States and Europe suffered huge losses and even faced bankruptcy, resulting in massive public financial assistance.A global recession resulted in a sharp drop in international trade, rising unemployment and slumping commodity prices.The conditions leading up to the crisis, characterized by an exorbitant rise in asset prices and associated boom in economic demand, are considered a result of the extended period of easily available credit, inadequate regulation and oversight etc.Some trace the genesis to the Chinese buying US treasuries with their export earnings thus supplying the US cheap money that they could lend recklessly.

The recession renewed interest in Keynesian economic ideas on how to combat recessionary conditions. Fiscal and monetary policies have been significantly eased to stem the recession and financial risks.

(The best authors on the meltdown are Arun Kumar (JNU); Joseph Stiglitz, Paul Krugman and Dr.C.Rangarajan)

Depression

A depression is a more severe economic downturn than a recession, which is a slowdown in economic activity over the course of a normal business cycle. Technically, recession is negative growth in two successive quarters.

A depression is an unusual and extreme form of recession. Depressions are characterized by their length, by abnormally large increases in unemployment, falls in the availability of credit (often due to some form of banking or financial crisis), shrinking output as buyers are not there and producers cut back on production and investment, large number of bankruptcies including sovereign debt defaults, significantly reduced amounts of trade and commerce (especially international trade), as well as highly volatile relative currency value (often due to currency devaluations). Price deflation, financial crises and bank failures are also common elements of a depression that do not normally occur during a recession.Greece was in depression in 2012 with 50% of the young people out of work.According to the International Monetary Fund, Venezuela's GDP in 2017 is 35% below 2013 levels. That is a significantly sharper contraction than during the 1929-1933 Great Depression in the United States, when US GDP is estimated to have fallen 28%.

Structural Composition of The Economy

Economies can be classified into three sectors by activity: extraction of raw materials (primary), manufacturing (secondary), and services (tertiary). As the economy develops, there is a progression from primary to secondary to tertiary sector. The development of technology, improvement in quality of life, social security, growth of education and culture are the benefits of such transition.

The primary sector of the economy involves changing natural resources into primary products. Most products from this sector are considered raw materials for other industries. This sector includes agriculture, fishing, forestry and all mining and quarrying industries. Primary sector is a larger sector in developing countries; for instance, animal husbandry is more common in Africa than in Japan.

The secondary sector of the economy includes those economic sectors that create a finished, usable product: manufacturing and construction. This sector generally takes the output of the primary sector and manufactures finished goods or where they are suitable for use by other businesses, for export, or sale to domestic consumers. This sector is often divided into light industry and heavy industry.

Light industry is that part of an economy's secondary sector which is less capital-intensive and more labor-intensive operations. They are argely consumer goods. Consumer electronics, clothes, shoes, furniture and household items like consumer electronics are the examples. Heavy industry is capital intensive and produces goods for businesses: auto, steel, cement, petroleum etc producing large quantities. The tertiary sector of economy (service sector) produces "intangible or invisible goods". The tertiary sector of economy involves the provision of services to businesses as well as final consumers. Services may involve the transport, distribution and sale of goods from producer to a consumer, entertainment. The service sector consists of the "soft" parts of the economy such as insurance, government, tourism, banking, retail, education, retail, insurance, and government.

The quaternary sector includes activities which provide information services (information generation, information sharing and research and development); computing, ICT (information and communication technologies), consultancy (offering advice to businesses) and R&D (research and development). The quaternary sector is sometimes included with the tertiary sector, as they are both service sectors but many argue that intellectual services are distinct enough to warrant a separate sector. To many industries, such as the pharmaceutical industry, the sector is the most valuable because it creates future branded products which the company will profit from. This sector evolves in well developed countries and requires a highly educated workforce.

Quinary sector is not clearly conceptualized like the preceding four sectors. Some include the highest levels of decision making in an economy in it: CEOs of firms; HODs in government, science, universities, nonprofit, healthcare, culture and the media. Some include police and fire departments which are public services and not for-profit enterprises.Some economists include care economy in it. Structural change of an economy refers to a long-term and broad based change of the fundamental structure, rather than microscale or short-term change. Originally it meant the way the economy is evolving impacting on the respective contributions of the three sectors of economy (agriculture, industry and services) to Gross Domestic Product (GDP). It may also mean other changes. For example, a subsistence economy is transformed into commercial economy or a regulated economy is liberalized. An insulated and protectionist economy becomes open and globalized. India has been structurally reorienting its economy since the early 1990s under which there is more room for markets; privatization of the public sector; greater flow of foreign investment and foreign goods etc.

Indian Economy: Sectoral Classificaion and Components
I. Agriculture, forestry & fishing
Crops
Livestock
Forestry & logging
Fishing and aquaculture
II. Industry Sector
Mining & quarrying
Manufacturing
Food Products, Beverages and Tobacco
Textiles, Apparel and Leather Products

Metal Products
Machinery and Equipment
Other Manufactured Goods
Electricity, gas, water supply & other utility services
Construction
III. Services Sector
Trade, repair, hotels and restaurants
Trade & repair services
Hotels & restaurants
Transport, storage, communication & services related to broadcasting
Railways
Road transport
Water transport
Air transport
Services incidental to transport
Storage
Communication & services related to broadcasting
Financial, real estate & prof. servs
Financial services
Real estate, ownership of dwelling & professional services
Community, social & pers. Servs
Public administration & defence
Other services

Indian economy is classified in three sectors — Agriculture and allied, Industry and Services. Agriculture sector includes Agriculture (Agriculture proper & Livestock), Forestry & Logging, Fishing and related activities. Industry includes 'Mining & quarrying', Manufacturing (Registered & Unregistered), Electricity, Gas, Water supply, and Construction. Services sector includes 'Trade, hotels, transport, communication and services related to broadcasting', 'Financial, real estate & prof servs', 'Public Administration, defence and other services'. Services sector is the largest sector of India. Services sector accounts for 53.66% of GDP. Industry sector contributes 29.02%. While, Agriculture and allied sector share is 17.32%.

Some Terms

A developed country or industrialized country has advanced technological infrastructure. Most commonly, the criteria for evaluating the degree of economic development are gross domestic product (GDP), level of industrialization, amount of widespread infrastructure and general standard of living.

Developed countries have post-industrial economies, meaning the service sector provides more wealth than the industrial sector. They are contrasted with developing countries, which are in the process of industrialization, or undeveloped countries.

A developing country or underdeveloped country, is a nation with an underdeveloped industrial base, and a low Human Development Index (HDI) relative to developed countries. There is no universal criterion as to what makes a country developing or developed although there are general markers such as a nation's GDP per capita, HDI, demographic state etc. A developing country is well short of the modern and Western standards of democratic governments, economic development, social security and civil rights guarantees for their citizens.

NIC: Newly industrialized country (NIC) is one which adopted the market model of growth; is showing rapid growth of economy for a considerable period of time; falls between a developed country and a developing country characterized by rapid export-driven economic growth and migration of workers from rural to urban areas.For example, India, Brazil, South Africa etc.NICs are attractive investment destinations given their strong economic growth rates and future potential.

World Bank classification of countries (2017)

Category	**Per Capita (current US$)**
Low-income	< 1,005
Lower-middle income	1,006 - 3,955
Upper-middle income	3,956 - 12,235
High-income	> 12,235

A high-income economy is defined by the World Bank as a country with a per capita income of US$12,235 or more in 2017. The term "first world" commonly refers to those prosperous market economies like the west, Japan etc.

According to the United Nations, for example, some high income countries may also be developing countries. The GCC (Persian Gulf States) countries, for example, are classified as developing high income countries. Thus, a high income country may be classified as either developed or developing. GCC countries for example are rich but not developed. They have pockets of export economy based on oil and gas and the rest of the economy is under developed.

The term developed country, or advanced country, is used to categorize countries that have achieved a high level of industrialization in which the tertiary and quaternary sectors of industry dominate; a high income per capita and a high Human Development Index (HDI).

First, Second, Third and Fourth World countries

First world was the western deeloped world. Second world was the communist countries with command economies but they do not exist today. Third world was made up of the developing countries.

Least Developed Countries (LDCs/ Fourth World countries)

They are countries which according to the United Nations exhibit the lowest indicators of socioeconomic development, with the lowest Human Development Index ratings of all countries in the world. The concept of LDCs originated in the late 1960s. A country is classified as a Least Developed Country if it meets three criteria:

- Poverty. As of 2015 a country must have per capita less than US $1,035 to be included on the list, and over $1,242 to graduate from it.
- Human resource weakness (based on indicators of nutrition, health, education and adult literacy) and
- Economic vulnerability (based on instability of agricultural production, instability of exports of goods and services, economic importance of non-traditional activities, merchandise export concentration, handicap of economic smallness, and the percentage of population displaced by natural disasters)

Least developed countries (LDCs) are low-income countries confronting severe structural impediments to sustainable development. They are highly vulnerable to economic and environmental shocks and have low levels of human assets.LDC criteria are reviewed every three years by the Committee for Development Policy (CDP) of the UN Economic and Social Council (ECOSOC). Countries may "graduate" out of the LDC classification when indicators exceed these criteria. There are currently 47 countries on the list of LDCs.

SRIRAM'sIAS

ECONOMIC DEVELOPMENT AND NITI AAYOG

Independent India's economic development was driven by socio-economic planning by government. India opted to be a planned economy. Planned economy is one in which the state owns, partly or wholly the economy and directs it. State sets the priorities for growth. Private sector has only a residuary role. High level of government regulation characterizes planned economies. It is refered to as command economy or centrally planned economy. State control of economy extends to

- all major sectors of the economy
- distribution of income
- decisions on what should be produced and how much and sold at what price

In a market economy, it is the opposite- state has a minimal role in the management of the economy- production, consumption and distribution decisions are predominantly left to the market. State plays certain role in redistribution. State is called the laissez faire state here. It is a French phrase literally meaning "Let do."

Indicative plan operates where there is a mixed economy with State and market playing significant roles to achieve targets for growth that they together set. It is operated under a planned economy but not command economy.

Indian planned growth is not a classical command economy as it operated in a democratic system. Command economies were classically set up in China and USSR, mainly for rapid economic growth and social and economic justice but have been dismantled in the last two decades as they do not create wealth sustainably and are not conducive for innovation and efficiency. Cuba and North Korea are still command economies.

History of Economic Planning in India

Bombay Plan

India being devastated economically after more than two centuries of colonial exploitation resulting in chronic poverty, eradication of poverty was the driving force for the formulation of various models of growth before Independence.

In 1944 leading businessmen and industrialists (including Sir Purshotamdas Thakurdas, JRD Tata, GD Birla and others) put forward "A Plan of Economic Development for India" -popularly known as the 'Bombay Plan'. It saw India's future progress based on further expansion of the textile and consumer industries already flourishing in cities like Bombay and Ahmedabad. It saw an important role the State in post-Independent India: to provide infrastructure, invest in basic industries like steel, and protect Indian industry from foreign competition. Its objectives were a doubling of the output of the agricultural sector and a five-fold growth in the industrial sectorover 15 years.Bombay Plan was premised on the view that that the economy could not grow without government intervention and regulation.

Sir Mokshagundam Visvesvarayya

M. Visvesvaraya (1860-1962) was an engineer by: He designed the Krishnasagar Dam and sponsored the Bhadravati Iron Works. He was an admirer of Japan's industrial progress and also studied the Soviet Five Year Plans and the initiatives of the American President Roosevelt. In 1934 he published his own suggestions for a ten-year plan for India. This was the first attempt at economic planning in India. It is proposed under the Plan to double the income of the country within ten years. He believed that left to private enterprise, industries will not make satisfactory progress. Government should take the lead; bold policies should be laid down and adhered to; an official organization should be brought into existence, and correct comprehensive reports of progress supported by adequate statistics should be published yearly. In his book titled "Planned Economy for India" (1934), he set the goal of poverty eradication through growth.

National Planning Committee (1938)

The Indian National Congress established a National Planning Committee under the chairmanship of Jawaharlal Nehru. It (1938) stated the objective of planning for development "was to ensure an adequate standard of living for the masses, in other words, to get rid of the appalling poverty of the people". It advocated heavy industries that were essential both to build other industries, and for Indian self-defence; heavy industries had to be in public ownership, for both redistributive and security purposes; redistribution of land away from the big landlords would eliminate rural poverty.

MN Roy

During the 1940's, the Indian Federation of Labour published its People's Plan by MN Roy that stressed on employment and wage goods.

SN Agarwala

He was a follower of Mahatma Gandhi and published Gandhian Plan that emphasized on decentralization; agricultural development; employment; cottage industries etc.

Mixed Economy

India is a mixed economy combining features of both capitalist market economies and socialist command economies. Thus, there is a regulated private sector (the regulations have decreased since liberalization from the late 1980's) and a public sector. The public sector generally covers areas which are deemed too important; or not profitable enough for the private sector. Thus such services as railways and postal system are carried out by the government.

Since Independence, for the first three-four decades the public sector dominated and in fact sectors like banking saw nationalization. From the time of economic reforms since 1991 greater role for the private sector defined the economy- be it by deregulation, divestment or privaisation. Thus, the state-market mix changed towards the market since 1991 but the economy is predominantly mixed.

Planning Goals

India launched five year plans for rapid growth from 1951. The long term goals that were common to all the five year plans:

- Growth
- Modernization

- self-reliance and
- social justice

Economic growth is the increase in value of the goods and services produced by an economy. Growth measures quantitative increase in goods and services. Growth is expected to spread to all sections and regions; raise resources for the Government to spend on socio-economic priorities etc. It takes a long time for growth to trickle down to all people and regions. Therefore, State plans for an expeditious process of inclusive.growth.

Growth is the precondition for all other objectives like poverty eradication, employment generation; inequality reduction; human capital building etc. However, the objectives mentioned above need not necessarily emerge from groath.

Economic development is different from growth and refers to growth that includes redistributive aspects and social justice. GDP may be only growth and not welfare and human development like education, access to basic amenities, environmental quality, freedom, or social justice. Economic growth is necessary for development but not sufficient.

Modernization is improvement in technology. It is driven by innovation and investment in R and D. Education is the foundation of modernization. The more modernized the economy, the greater the value created by it.

Self-reliance means relying on the resources of the country and not depending on other countries and the MNCs for investment and growth. India embarked on the goal partly due to the colonial experience and partly due to the need to develop its economy independently. Since India had no foregn exchange to import, it was important that we produce the goods ourselves. Invitation to MNCs re-generated the fears of colonialism returning as neo-colonialism. Nehru-Mahalanobis model of growth that closed Indian economy and relied on basic industries is the main plank for self-reliance. However, opting for the Liberalization,Privatization and Globalization model (LPG) since 1991 and later becoming a founding member of World Trade Organization (WTO) in 1995 made us depart from self-relaince as LPG offered scope for faster growthand also by then India was in a position to globalize and benefit unlike immediately after Independence.

The term self-reliance should not be confused with self-sufficiency – the former means depending on resources of the country and avoid dependence on external inflows; the latter means that the country has all the resources it needs. No country can be self-sufficient.

Social justice means inclusive and equitable growth where inequalities are not steep and benefits of growth reach all- rural-urban, man-woman; caste divide and inter-regional divides are reduced. While the above four are the long term goals of the planning process, each five year plan has specific objectives and priorities.

Financial Resources For The Five Year Plans

The resources for the Plan come from

- Central budget
- State budgets
- PSEs
- Domestic private sector and
- FDI

Gross Budgetary Support

GBS is the amount from the central Budget that goes to fund the plan investments during the plan period of three units: Centre's, assistance to states' budgets to the extent the centre can afford and also the public sector units.

History of Planning

First Plan (1951- 56) The First Plan stressed on agriculture, in view of large scale import of foodgrains and inflationary pressures on the economy. Other areas of emphasis were power and transport. The annual average growth rate during the First Plan was 3.61% as against a target of 2.1%. Renowned economist KN Raj, who died in 2010 was one of the main architects of India's first five-year plan.

Second Plan (1956-61) With agricultural targets of previous plan achieved, major stress was on the establishment of heavy industries. Rate of investment was targeted to increase from 7% to 11%. The Plan achieved a more than targeted growth rate of 4.32%. This Plan envisaged to give a big push to the economy so that it enters the take off stage. It was based on Nehru-Mahalanobis model- self-reliance and basic-industry driven growth.

Nehru-Mahalanobis Model of Economic Growth

Indian economy at the time of Independence was characterized by dependence on exports of primary commodities; negligible industrial base; underproductive agriculture etc. 1st FYP focused on agriculture for food security. But industrialization was urgently needed to modernize the economy and improve its technology.

The model adopted for the 2nd FYP plan is known as the Nehru-Mahalanobis strategy of development as it was articulated by Jawahar Lal Nehru's vision and P.C.Mahalanobis was its chief architect. The central idea underlying this strategy is well conveyed by the following statement from the plan document. 'If industrialization is to be rapid enough, the country must aim at developing basic industries and industries which make machines to make the machines needed for further development.'

The Mahalanobis model of growth is based on the predominance of the basic goods (capital goods or investment goods which are goods that are used to make further goods like machines, tools, factories, etc). It is based on the premise that it would attract all round investment, ancillarisation, build townships and result in a higher rate of growth of output- trickle down effect. That will boost employment generation, poverty alleviation, exports etc. The emphasis was on expanding the productive ability of the system, through forging strong industrial linkages, as rapidly as possible.

Other Elements of The Model Are

- Import substitution. Protective barriers against foreign competition to enable Indian companies to develop domestically produced alternatives for imported goods and to reduce India's reliance on foreign capital.
- A sizeable public sector active in vital areas of the economy including atomic energy and rail transport.
- A vibrant small-scale sector driving consumer goods production for dispersed and equitable growth and producing entrepreneurs.

In terms of the core objective of stepping up the rate of growth of industrial production, the strategy paid off. Rate of growth of overall industrial production picked up. The strategy laid the foundation for a well-diversified industrial structure within a reasonably short period and this was a major achievement. It gave the base for self-reliance.

However, the strategy is criticized for the imbalances between the growth of the heavy industry sector and other spheres like agriculture and consumer goods etc that resulted. It is further criticized as it relied on 'trickle down effect'- benefits of growth will flow to all sections in course of time. This approach to eradication of poverty is slow and incremental. It is believed that frontal attack on poverty is required. The debates about growth and redistribution-Sen-Bhagawati- debates that raged in 2013 centre around the trickle down effect largely. It should be noted trickle down effect does produce results but given our size, growth has to be in double digits for a long period sustainably for the trickle down effect to work.

Third Plan (1961-66) It tried to balance industry and agriculture. The aim of Third Plan was to establish a self sustaining economy. For the first time, India resorted to borrowing from IMF. Rupee was also devalued for the first time in 1966. India's conflict with Pakistan and repeated droughts also contributed in the failure of this Plan.

Annual Plans As the Third Plan experienced difficulties on the external front (war with China in 1962 and Pakistan in 1965); and the economic troubles mounted on the domestic front- inflation, floods, forex crisis- and there was political instability with the death of Nehru and Lal Bahadur Shastri, the Fourth Plan could not be started from 1966. There were three annual plans till 1969. This period is called plan holiday- that is when five year plans are not implemented. The Annual Plans were: 1966-67, 1967-68 and 1968-69.

Fourth Plan (1969-74) The main objective of this Plan was growth with stability. The Plan laid special emphasis on improving the condition of the under privileged and weaker sections through provision of education and employment. Reducing the fluctuations in agricultural production was also a point of emphasis of this Plan. The Plan aimed at a target growth of 5.7% and the achievement against this was 3.21%.

Fifth Plan (1974-79) The main objective of the Plan was Growth for Social Justice. The targeted growth rate was 4.4% and we achieved 4.8%. It was cut short by the Janata Party that came to power in 1977.

Janata 6th FYP was launched in 1977 but was removed from official records by the government that came to power in 1980 and the official 6th FYP was launched. The year 1979-80 was thus a gap year when there was no FYP and is called plan holiday.

Rolling Plan

It was adopted in India in 1962, in the aftermath of Chinese attack on India, in the Defence Ministry in India. Professor Gunnar Myrdal (author of 'Asian Drama') recommended it for developing countries in his book - Indian Economic Planning in Its Broader Setting. Rolling plan becomes necessary in circumstances that are fluid. It was contemplated by the Janata government in 1977. In the rolling plan model, even as annual and multi year goals are set, they are not rigidly followed as ground level conditions may not be conducive. It is in between a normal FYP and a plan holiday (annual plans)

The main advantage of the rolling plans is that they are flexible and are able to overcome the rigidity of fixed five year plans by mending targets, projections and allocations as per the changing conditions in the country's economy. The main disadvantage of this plan is that if the targets are revised each year, it becomes very difficult to achieve them. Frequent revisions result in instability of the economy.

Sixth Plan (1980-1985) Removal of poverty was the foremost objective of Sixth Plan. Another area of emphasis was infrastructure, which was to be strengthened for development of both industry and agriculture. The achieved growth rate of 5.7% was more than the targeted one.Direct attack on poverty was the main stress of the Plan.

Seventh Plan (1985-90) This Plan stressed on rapid growth in food-grains production and increase in employment opportunities. The growth rate of 5.81% achieved in this Plan was more than the targeted one. The plan saw the beginnings of liberalization of Indian economy. The 8^{th} Plan could not start in 1990 due to economic crisis and political instability. There were two annual plans- plan holiday.

Eighth Plan (1992-1997) This Plan was formulated keeping in view the process of economic reforms and restructuring of the economy. The main emphasis of this Plan were

- to stabilize the adverse balance of payment scenario sustainably
- improvement in trade and current account deficit
- Human development as main focus of planning.

It was indicative plan for the first time. The Plan was formulated in a way so as to manage the transition from a centrally planned economy to market led economy. The targeted annual average rate of growth of the economy during Eighth Plan was 5.6%. Against this, we achieved an average annual growth of 6.5%. The Plan was based on Rao-Manmohan Singh model of liberalization.

Rao-Man Mohan Singh Model of Growth

Economic reforms since 1991 are based on the Rao-Manmohan model - Mr. Narasimha Rao, the PM in 1991 and Finance Minister Dr. Man Mohan Singh. Its essence is contained in the New Industrial Policy 1991 and extends beyond it too. The model has the following contents:

- Reorient the role of State in economic management. State should refocus on social and infrastructural development, primarily
- Dismantle, selectively controls and permits in order to permit private sector to invest liberally
- Open up the economy and create competition for PSEs- for better productivity and profitability
- External sector liberalization in order to integrate Indian economy with the global economy to benefit from the resource inflows and competition.

Its success is seen in the more than 6.5% average annual rate of growth of economy during the 8^{th} Plan (1992-1997). Forex reserves accumulated thus alleviating BOP pressures and the foreign flows- FDI and FII increased.

Indicative Planning

It is characterized by an economy where the private sector is given a substantial role. State would turn its role into a facilitator from that of a controller and regulator. With the launch of the economic reforms in 1991, indicative planning was inevitable. It was adopted since 8th five year plan (1992-97). It was decided that trade and industry would be increasingly freed from government control and that planning in India should become more and more indicative and supportive in nature. In other words, the remodeling of economic growth necessitated recasting the planning model from imperative and directive ('hard') to indicative (soft) planning. Since the Government did not contribute the majority of the financial resources, it had to indicate the policy direction to the corporate sector and encourage them to contribute to plan targets. Government should create the right policy climate- predictable, irreversible and transparent- to help the corporate sector contribute resources for the plan: fiscal, monetary, forex and other dimensions.

Indicative planning is to assist the private sector with information that is essential for its operations regarding priorities and plan targets. Here, the Government and the corporate sector are more or less equal partners and together are responsible for the accomplishment of planning goals. Government, unlike earlier, contributes less than 50% of the financial resources. Government provides the right type of policies and creates the right type of milieu for the private sector-including the foreign sector to contribute to the results. Indicative planning gives the Government an opportunity to give the private sector encouragement to achieve growth in areas where the country has inherent strengths. It is known to have brought Japan results in shifting towards microelectronics. In France, too indicative planning was in vogue.

Planning Commission would work on building a long-term strategic vision of the future. The concentration would be on anticipating future trends and evolving strategies for competitive international standards. Planning will largely be indicative and the public sector would be gradually withdrawn from areas where no public purpose is served by its presence. The new approach to development will be based on a re-examination and re-orientation of the role of the government". This point is particularly stressed in the development strategy of the Tenth Five Year Plan (2002-2007). Indicative planning was not contemplated at the beginning of fifties as there was hardly any corporate sector in India and Government shouldered almost the entire responsibility of socio-economic planning.

Ninth Five Year Plan (1997-2002) The salient features of the Ninth Five Year Plan are a target annual average growth rate of 6.5 per cent for the economy as a whole, and a growth rate of 3.9 per cent for agriculture sector, among others. The key strategies envisaged to realise this target rest on attaining a high investment rate of 28.2 per cent of GDP at market prices. The domestic saving rate, which determines the sustainable level of investment, is targeted at 26.1 per cent of the GDP. Care has been taken to ensure achievement of a sustainable growth path in terms of external indebtedness as well as fiscal stability. Rate of growth achieved was 5.4%. The plan oeriod saw many crises- political instability; south east Asian economic crisis; Kargil war; 2011 September terrorism in USA etc. However, the first India company was listed on the Nasdaq (Infy) followed by many others.

Tenth Five Year Plan (2002-2007) The main objectives of the tenth Five Year Plan of India were:

- Attain 8% GDP growth per year.
- Reduction of poverty rate by 5 percentage points by 2007.
- Providing gainful and high-quality employment at least to the addition to the labor force.
- Reduction in gender gaps in literacy and wage rates by at least 50% by 2007.

Eleventh Five Year Plan 'Towards Faster and More Inclusive Growth' is the central theme of the plan that sought to lower poverty by 10%, generate 70 million new jobs, and reduce unemployment to less than 5% Eleventh Five-Year Plan promised to accelerate economic growth and make it more inclusive. The chief thrust of the plan, that will run from 2007-08 to 2011-12, will be agriculture, education and infrastructure -- all areas that remain a concern in a rapidly growing economy. As many as 27 detailed national targets were set in the plan, ranging from enhancing incomes and reducing poverty, to education, literacy, health, infant mortality, maternal mortality and child development.

Twelth Five Year Plan (2012-17) aimed to achieve annual average economic growth rate of 8 per cent. During the 11th Plan (2007-12), India recorded an average economic growth rate of 7.9 per cent. This, however, is lower than the 9 per cent targeted in 11th Plan.12th Plan aimed to achieve 4 per cent agriculture sector growth during 2012-17. The growth target for manufacturing sector was pegged at 10 per cent. It aimed to bring down the poverty ratio by 10 per cent.

Growth Performance in the Five Year Plans (per cent per annum)

	Target	Actual
1. First Plan (1951-56)	2.1	3.61
2. Second Plan (1956-61)	4.5	4.32
3. Third Plan (1961-66)	5.6	2.38
4. Fourth Plan (1969-74)	5.7	3.21
5. Fifth Plan (1974-79)	4.4	4.80
6. Sixth Plan (1980-85)	5.2	5.69
7. Seventh Plan (1985-90)	5.0	5.81
8. Eighth Plan (1992-97)	5.6	6.7
9. Ninth Plan (1997-2002)	6.5	5.35
10. Tenth Plan(2002-2007)	8%	7.8%
11. Eleventh Plan(2007-12)	9%	7.9%
12. Twelfth FYP	8%	5.1% in 2012-13; 6.9% in 2013-14; 7.2% in 2014-15: 7.6% in 2015-16; 7.1% in 2016-17

Achievements of Planning

In the last about 65 years since planning began, the National Income has increased many times. Today, India is the third largest economy in Asia with about $2.25 trillion GDP after China and Japan. By 2017, For the first time in 150 years, India surpassed its erstwhile colonial master in terms of GDP and is now the fifth largest in the world after the U.S., China, Japan and Germany. By PPP measurement, India is 3rd largest in the world. India overtook Japan to become the world's third-largest economy in purchasing power terms. India's GDP PPP Per Capita is forecast to be billion 7,773.16 $ in Mar 2018 as reported by International Monetary Fund - World Economic Outlook. It records an increase from the last reported number of 7,153.25 billion $ in Mar 2017.

The PPP system allows GDP comparisons to be made by asking how much money would be needed to purchase the same goods and services in two countries and using that to calculate an implicit foreign exchange rate.

The Economist magazine's proprietary Big Mac Index, which takes the price of a McDonald burger across 120 countries to calculate the 'real' price of their currencies, is another crude way to measure PPP. India was included in the index recently. It showed that the Indian rupee was undervalued by more than 60% against the US dollar in 2016.

Social indicators improved though there is a long way to go- IMR, MMR, literacy, disease eradication etc. (Given elsewhere in the Notes) The industrial infrastructure is relatively strong – cement, steel, fertilizers, chemicals, etc Agricultural growth is also gaining momentum with food grains production at 274 mt in 2016-17.

Forex reserves are $400 b (October 2016) which is a dramatic turnaround from 1991 when we had one billion dollars.

The Government of India has set a target of 175 GW renewable power installed capacity by the end of 2022. This includes 60 GW from wind power, 100 GW from solar power, 10 GW from biomass power and 5 GW from small hydro power.India has emerged as a back office of the world and its prowess in software is growing.India occupies the sixth position among the world's 10 largest manufacturing countries,according to United Nations Industrial Development Organization (UNIDO) report in 2017.India's services sector, which stands at about $1.48 trillion is acknowledged globally.There has been considerable expansion of higher education. At the time of Independence there were 20 universities and 591 colleges, while today (2016) there are more than 700 universities and about 40,000 colleges.

India's literacy rate has increased six times since Independence — from 12 per cent to 74 per cent in 2011.

The failures of planning are equally clear

- As per the ***Rangarajan*** panel estimates, poverty stood at 38.2 per cent in 2009-10 and became worse at 29.5 per cent in 2011-12- (2014)
- Unemployment is high
- Regional imbalances are intensifying
- Malnutrition haunts about half the children in India.

Financial Planning

Here, physical targets are set in line with the available financial resources. Mobilization and setting expenditure pattern of financial resources is the focus in this type of planning.

Physical Planning

Here, the output targets are prioritized with inter-sect oral balance. Having set output targets, the finances are raised.

Economic Reforms

Since July 1991, India has been taking up economic reforms to achieve higher rates of economic growth so that socio-economic problems like unemployment, poverty, shortage of essential goods and services, regional economic imbalances and so on can be successfully solved. The force behind the reforms is

- Indian economy reached a level of growth and strength to benefit from an open market economy.
- Private sector in India had come of age and was willing and capable of playing a major role
- Indian economy needed to integrate with the world with all the advantages like capital flows; technology; higher level of exports; state of art stock markets; Indian corporates can raise finances abroad and so on.

The country under the leadership of Dr. Manmohan Singh, Union Finance minister (1991-1996 and Prime Minister 2004-14) converted the economic crisis – caused by , domestic cumulative problems of economy, political instability and gulf crisis-into an opportunity to initiate and institutionalise economic reforms to open up the economy. The deep crisis in 1991 could not be solved by superficial solutions. Therefore, structural reforms were taken up.

It was realized that by closing economy to global influences, the country was missing on technology developments and also gains from global trade and investments. India needed exports, FDI and FII for stability on the balance of payments front and higher growth rates for social development. Worldwide, countries were embracing market model of growth, for example China, with proven results. So, India could make the historic shift from centralized planning to market-based model of growth.

Initially reforms were feared and resisted as there was scepticism and fear as the experience in Latin American countries in the 1980s was not a success in economic and social terms. The fears related to

- Inflation as there will be little left for domestic consumption as exports would be the focus to earn foreign exchange
- Large scale unemployment due to capital intensity of growth process to be competitive
- Worsening of poverty as fiscal concerns will reduce social sector expenditure
- Flood of imports as customs duties will come down.
- food security will suffer as social sector expenditure will be reduced
- Pressures on labour sector due to domestic industry's compulsions to cut costs

Some fears have indeed come true- jobless growth and uncertainty in farming. But by and large, reforms have done well.

Reforms mainly targeted the following areas:

- Dismantling the licence raj so that private sector and government were on a level playing field
- Drive public sector towards sustainable profitability and global play by dereservation; disinvestment; professionalization of management etc
- Fiscal reforms for stabile economic growth.
- Banking sector is deregulated and made to conform to stringent reforms for higher competitive strength and performance globally

- move towards free float of rupee and relaxation of controls on convertibility; aggressive export promotion; FDI and FII inflows etc.

Reforms were prioritized and sequenced in such a way as to make them sustainable and render further reforms feasible. For example, first generation reforms involved essentially non-legislative government initiatives- reduce SLR and CRR for the banking sector. Disinvestment of the PSEs. Deregulation of the rupee gradually and later make exchange rate of the rupee market-driven and so on. The second generation reforms involve legislative reforms and touch a wider section of the society- labour reforms; GST, FDI expansion etc. The former prepares the economy for the latter.

Above all, reforms with human face was the goal, unlike elsewhere in the world like in South America in the 1980's. It yielded results- the social effect of the reforms in India is seen in the flagship schemes making an impact on health, education, social protection etc. The reforms gained consensus and showed positive results as can be seen below.

- Rates of growth went up
- BOP crisis has been solved in the first few years and today the country has about $ 400 b forex reserves (2017 October)
- Services sector (tertiary sector) has grown in importance and today contributes almost 60% of GDP (2017) emerging as a global player-India being the global back office.
- Resilience of the economy in the face of Great Recession
- Consumer choice has increased
- Tax-GDP ratio may have shrunk but the tax collections and base increased
- Nature of external debt has changed and the short term component is less
- Indian companies are listed on Nasdaq and New York Stock Exchange and raised billions of dollars for investment
- FIIs and FDI picked up.
- Indian corporates have acquired global majors like Jaguar and Anglo-Dutch steel maker Corus; Bharati bought Zain's African telecom operations.

While the above facts paint a positive picture of reforms, there are deficiencies as well

- poverty is a challenge and reforms with a human face is the need of the hour
- jobless growth is worrying the policy makers
- regional economic imbalances are intensifying
- While foodgrains production is at 274mt(2017), there is still pressure on food security
- farmers are feeling directionless under the WTO regime
- Globalization threatens to destabilize agriculture with cheaper imports and questionable provisions related to intellectual property rights impacting negatively on availability of medicines etc.
- Infrastructure so far received inadequate attention except telecom ,roads and ports
- PSU reforms have not made progress and disinvestment and privatization are still to see substantial movement

Second Generation Reforms

Having begun with the reforms in all the above sectors and seen the economy benefit from them, the second generation reforms were initiated by the end of 1990's. The reason for calling the latter set of reforms SGR is that they followed the initial reforms which laid the foundation for the reform process to deepen. It is a matter of sequencing in line with prioritization; economic preparation; consensus-building and so on. In fact, unless the success in material and human terms of the initial reforms was demonstrated, the next round of 'difficult' reforms would not be possible.

Second generation reforms - labour law flexibility, pension reforms based on employee contribution and the pension funds being deployed in the stock market; GST; liberalized FDI including FDI in retail etc - touch on the lives of ordinary people and need successes in other sectors- first generation reforms- to make a convincing case. Otherwise, they may not be allowed by public opinion as we have seen in the case of FDI-Multibrand retail(Walmart etc) debate.

Second generation reforms are difficult as they are directly involved with the daily lives of people like

- User charges need to be rationalized to make these utilities viable but there are bound to be protests
- Man power rationalization in banks and PSUs through VRS faced resistance.
- Labour law flexibility will make TUs agitate.
- Interst rate cut, for example, for small savings will mean less returns for the middle class etc
- Agro reforms may mean small and marginal farmers' resistance

However, unless the SGRs are carried out, investment and growth will suffer with long term adverse consequences for poverty alleviation and employment generation. As the long term benefits of the reforms are bound to show in terms of higher growth rates and more social welfare, consensus needs to be built for successful legislation and implementation of SGRs. Labour laws being reformed in 2014 under the Modi government are an example of 2nd generation reforms. Deregulation of petrol and diesel prices and introduction of dynamic pricing (2014-17); LPG subsidy reforms in 2016 etc.

12 FYP-Related

India@75

It is a path breaking initiative. It envisions how India should be in her 75th year of independence and seeks to bring together all stakeholders including the industry, government, institutions, community groups and individuals to translate the vision into a reality.Prof (Late) C.K.Prahalad has been the inspiration behind India@75. While commemorating the 60th year of India's independence, in 2007 he articulated the idea of holistic three dimensional development of India to acquire enough economic strength, technological vitality and moral leadership by 75 years of independence. CII adopted his vision in 2008.The concept was adopted by CII to bring together all stakeholders, including the industry, government, institutions, community groups and individuals to translate the vision into reality.

IBIN

- Planning Commission jointly with India@75 foundation launched in 2013, its unique initiative-India Backbone Implementation Network (IBIN) to remove bottlenecks for improving implementation of policies. "The IBIN, structurally an organisation, is essentially a process that will promote widespread capabilities in the country to systematically convert confusion to coordination, contention to collaboration, and intentions to implementation," an official statement says. IBIN aims to seed new techniques into the service delivery system; build a network of partners to create capability to manage effective stakeholder dialogues, resolve dispute and conduct policy impact analysis.

It will also build a knowledge base of tools, techniques and examples to systematically analyse situations or challenges and proactively create solutions.

IBIN is the model of a process for rapidly improving a nation's capabilities to get things done systematically and democratically s in the Total Quality Movement (TQM) in Japan. In less than two decades, Japan, that had a reputation for poor quality and low-cost products, became the international benchmark of quality in many industries and several of its public services too. The essence of the TQM movement was the deployment, at several levels in many organisations: especially the 'shopfloor' levels, but higher levels also, even to top management, of simple techniques for systems thinking, cooperative action and continuous improvement. These techniques were developed by experts in companies and universities and disseminated in the country through industry and other institutional networks, and through radio, pamphlets, competitions and other means of connecting with the public.

The 'movement' grew as a network: it was not a centrally-managed government programme. There was a principal node in the network: a non-governmental body, the Japanese Union of Scientists and Engineers (Juse), in which many persons from industry and academia, and also government participated to provide a facilitative leadership to the movement.The architecture of IBIN is along similar lines as the TQM movement of Japan. Experience of other countries, such as South Korea and, more recently, Malaysia, which have systematically improved capabilities of coordination and implementation, has also been considered while developing IBIN to fit India's conditions.

NITI Aayog

In 2015, Government of India set up the NITI Aayog or National Institution for Transforming India Aayog with modified functions in comparison to its predecessor Planning Commission. The reasons were that the nature of economy changed towards a market-dominated system and that the rights of states were to be given greater consideration for which a new structure and dynamic was required. Planning Commission is largely portrayed as overriding the sensitivities and priorities of states and thus was not respectful of federalism. Niti Aayog is a policy think-tank of Union Government of India that aims to involve the states in economic and development policy making in India. It provides strategic and technical advice to the government. Prime Minister of India heads the Aayog as its chairperson.

In Hindi, NITI means Policy, and Ayog means Commission."India is a diversified country and its states are in various phases of economic development along with their own strengths and weaknesses. In this context, a 'one size fits all' approach to economic planning is obsolete. It cannot make India competitive in today's global economy"

The NITI Aayog comprises the following:

1. Prime Minister of India as the Chairperson
2. Governing Council comprising the Chief Ministers of all the States /UTs and Lieutenant Governors of Union Territories
3. Regional Councils may be formed to address specific issues and contingencies impacting more than one state or a region. These are formed for a specified tenure. The Regional Councils will be convened by the Prime Minister and will comprise of the Chief Ministers of States and Lt. Governors of Union Territories in the region. These will be chaired by the Chairperson of the NITI Aayog or his nominee
4. Experts, specialists and practitioners with relevant domain knowledge as special invitees nominated by the Prime Minister
5. Full-time organizational framework comprises of
   - Vice-Chairperson
   - Members: four Full-time
   - Part-time members: Maximum of two from leading universities research organizations and other relevant institutions in an ex-officio capacity. Part-time members will be on a rotational basis
   - Ex Officio members: Maximum of four members of the Union Council of Ministers to be nominated by the Prime Minister
   - Chief Executive Officer: To be appointed by the Prime Minister for a fixed tenure
   - Secretariat as deemed necessary

Aim's and Objectives of NITI Ayog

NITI Aayog provides a critical directional and strategic input into the development process. It is a "think-tank" that will provide Governments at the central and state levels with relevant strategic and technical advice across the spectrum of key elements of policy such as Make in India, Digital India and Swachh Bharat.

It will foster better Inter-Ministry coordination and better Centre-State coordination. It will help evolve a shared vision of national development priorities, and foster cooperative federalism, recognizing that strong states make a strong nation.

The NITI Aayog will develop mechanisms to formulate credible plans at the village level and aggregate these progressively at higher levels of government- bottom up approach to development. It will ensure inclusive economic growth.

The NITI Aayog will create a knowledge, innovation and entrepreneurial support system through a collaborative community of national and international experts, practitioners and partners.

NITI Aayog will monitor and evaluate the implementation of programmes and focus on technology upgradation and capacity building.

Through the above, the NITI Aayog will aim to accomplish the following objectives and opportunities:

- An administration paradigm in which the Government is an "enabler" rather than a "provider of first and last resort."

- Progress from "food security" to focus on a mix of agricultural production, as well as actual returns that farmers get from their produce..
- Ensure that the economically vibrant middle-class remains engaged, and its potential is fully realized.
- Leverage India's pool of entrepreneurial, scientific and intellectual human capital.
- Incorporate the significant geo-economic and geo-political strength of the Non-Resident Indian Community.
- Use urbanization as an opportunity to create a wholesome and secure habitat through the use of modern technology.
- Use technology to reduce opacity and potential for misadventures in governance.
- Leveraging of India's demographic dividend, and realization of the potential of youth, men and women, through education, skill development, elimination of gender bias, and employment
- Elimination of poverty, and the chance for every Indian to live a life of dignity and self-respect
- Reddressal of inequalities based on gender bias, caste and economic disparities
- Integrate villages institutionally into the development process
- Policy support to more than 50 million small businesses, which are a major source of employment creation
- Safeguarding of our environmental and ecological assets

NITI Aayog vs Planning Commission

1. Planning Commission had allocative functions – recommending plan financial transfers; centrally sponsored schemes etc. Niti Aayog does not have such function
2. Planning Commission had many more members and all were full time members.
3. Planning Commission was directed by the National Development Council to flesh out the FYPs. Niti Aayog on the other hand has both the political wing composed Union Ministers and Chief Ministers as well as the think tank wing in a single body.
4. Niti Aayog has provision of regional councils that Planning Commission did not have.
5. In the NITI Aayog, State governments play a more significant role through Governing Council than they did in the Planning Commission.Planning Commission - States' role was limited to the National Development Council and annual interaction during Plan meetings

Critical Appraisal

The government's move to replace the Planning Commission with a new institution called 'NITI Aayog' is open to criticism that it is only a nomenclatural change. However, the new body also does contribute to cooperative federalism. Former Planning Commission member Arun Maira." The idea to create an institution where states' leaders will be part and parcel of the collective thinking with the Centre and other stakeholders in formulating a vision for the development of the country is right on as compared with the previous structure, where a handful of people formulated the vision and then presented it to the National Development Council (NDC). This was not entirely absorbed and adopted by the latter."

One important change introduced is to resize and restructure. From 1,250 positions, a downsizing was done to about 500 employees in the institution. There has also been a restructuring within the institution dividing the staff into two hubs—one is the Knowledge and Innovation hub, and the other is called the Team India hub. Team India hub largely interfaces with states because cooperative competitive federalism is one of our important mandates. Knowledge and Innovation hub is going has about 12-14 verticals which will deal with different sectors. It also adopted a different approach in its relationship with states. The relationship under the previous institution (Planning Commission) wasunequal, because the institution gave plan assistance to states and became the 'giver' and states became the 'recipients' of the money. This made the relationship unequal. Now, Niti tried to have a more equal relationship.

There is a very good example of the equality in the relationship (between NITI Aayog and states). In 2015, three sub- groups of chief ministers were set up for making recommendations in three important areas (centrally-sponsored schemes, skill development and Swachh Bharat). The sub-group on centrally-sponsored schemes was asked to study 66 centrally-sponsored schemes and recommend which ones to continue, which to transfer to states, and which to cut down.

NITI Aayog will monitor, coordinate and ensure implementation of the globally accepted Sustainable Development Goals. It is nominated as the nodal body that will bring the 17 development goals into action across India. The SDGs are aimed at eradicating all forms of poverty.

NITI's Achievements By 2017

Vision Document, Strategy & Action Agenda beyond 12th Five Year Plan: Replacing the Five Year Plans beyond 31st March, 2017, NITI Aayog prepared the 15-year vision document keeping in view the social goals set and/ or proposed for a period of 15 years; A 7-year strategy document spanning 2017-18 to 2023-24 to convert the longer-term vision into implementable policy and action as a part of a "National Development Agenda". The 3-year Action Agenda for 2017-18 to 2019-20 is aligned to the predictability of financial resources during the 14th Finance Commission Award period.

I. Reforms in Agriculture:

- **Model Land Leasing Law**
  Taking note of suboptimal use of land with lesser number of cultivators, NITI Aayog has formulated a Model Agricultural Land Leasing Act, 2016 to both recognize the rights of the tenant and safeguard interest of landowners. A dedicated cell for land reforms was also set up in NITI. Based on the model law, Madhya Pradesh has enacted separate land leasing law and Uttar Pradesh and Uttarakhand have modified their land leasing laws. Some States, including Odisha, Andhra Pradesh and Telangana, are already at an advance stage of formulating legislations to enact their land leasing laws for agriculture.

- **Reforms of the Agricultural Produce Marketing Committee (APMC) Act**
  NITI Aayog consulted States on critical reforms –

  i) Agricultural marketing reforms
  ii) Agricultural land leasing

  Subsequently, Model APMC Act version 2 prepared. States are being consulted to adopt APMC Act version 2.

- **Agricultural Marketing and Farmer Friendly Reforms Index**
  NITI Aayog has developed the first ever 'Agriculture Marketing and Farmer Friendly Reforms Index' to sensitise states about the need to undertake reforms in the three key areas of Agriculture Market Reforms, Land Lease Reforms and Forestry on Private Land (Felling and Transit of Trees). The index carries a score with a minimum value "0" implying no reforms and maximum value "100" implying complete reforms in the selected areas.

  As per NITI Aayog's index, Maharashtra ranks highest in implementation of various agricultural reforms. The State has implemented most of the marketing reforms and offers the best environment for undertaking agri-business among all the States and UTs. Gujarat ranks second with a score of 71.50 out of 100, closely followed by Rajasthan and Madhya Pradesh. Almost two third States have not been able to reach even the halfway mark of reforms score, in the year 2016-17. The index aims to induce a healthy competition between States and percolate best practices in implementing farmer-friendly reforms.

II. Reforming Medical Education

A committee chaired by Vice Chairman, NITI Aayog recommended scrapping of the Medical Council of Indi and suggested a new body for regulating medical education. The draft legislation for the proposed National Medical Commission has been submitted to the Government for further necessary action.

III. Digital Payments Movement

- An action plan on advocacy, awareness and co-ordination of handholding efforts among general public, micro enterprises and other stakeholders was prepared. Appropriate literature in print and multimedia was prepared on the subject for widespread dissemination. Presentations/ interactions were organized by NITI Aayog for training and capacity building of various Ministries/Departments of Government of India, representatives of State/UTs, Trade and Industry Bodies as well as all other stakeholders.

- NITI Aayog also constituted a Committee of Chief Ministers on Digital Payments in November 2016 with the Chief Minister of Andhra Pradesh, Chandrababu Naidu, as the Convener to promote transparency, financial inclusion and a healthy financial ecosystem nationwide. The Committee submitted its interim report to Prime Minister in 2017.

- Niti Aayog also launched two incentive schemes to promote digital payments across all sections of society - the Lucky Grahak Yojana and the Digi Dhan Vyapar Yojana.

- Digi Dhan Melas were also held for 100 days in 100 cities.

IV. Atal Innovation Mission

The Government has set up Atal Innovation Mission (AIM) in NITI Aayog with a view to strengthen the country's innovation and entrepreneurship ecosystem by creating institutions and programs that spur innovation in schools, colleges, and entrepreneurs in general. In 2016-17, the following major schemes were rolled out:

- Atal Tinkering Labs (ATLs): To foster creativity and scientific temper in students, AIM is helping to establish 500 ATLs in schools across India, where students can design and make small prototypes to solve challenges they see around them, using rapid prototyping technologies that have emerged in recent years.

- Atal Incubation Centres (AICs): AIM will provide financial support of Rs.10 crore and capacity buidling for setting AICs across India, which will help startups expand quicker and enable innovation-entrepreneurship, in core sectors such as manufacturing, transport, energy, education, agriculture, water and sanitation, etc.

V. Indices Measuring States' Performance in Health, Education and Water Management

As part of the Prime Minister's Focus on outcomes, NITI has come out with indices to measure incremental annual outcomes in critical social sectors like health, education and water with a view to nudge the states into competing with each other for better outcomes, while at the same time sharing best practices & innovations to help each other - an example of competitive and cooperative federalism.

VI. Sub-Group of Chief Ministers on Rationalization of Centrally Sponsored Schemes

Based on the recommendations of this Sub-Group, a Cabinet note was prepared by NITI Aayog which was approved by the Cabinet on 3rd August, 2016. Among several key decision, the sub-group led to the rationalization of the existing CSSs into 28 umbrella schemes.

VII. Sub-Group of Chief Ministers on Swachh Bharat Abhiyan

Constituted by NITI Aayog on 9th March, 2015 the Sub-Group has submitted its report to the Hon'ble Prime Minister in October, 2015 and most of its recommendations have been accepted.

VIII. Sub-Group of Chief Ministers on Skill Development

Constituted on 9th March, 2015, the report of the Sub-Group of Chief Ministers on Skill Development was presented before the Hon'ble Prime Minister on 31/12/2015. The recommendation and actionable points emerging from the Report were approved by the Hon'ble Prime Minister and are in implementation by the Ministry of Skill Development.

IX. Task Force on Elimination of Poverty in India

Constituted in 2015 under the Chairmanship of Dr. Arvind Panagariya, Vice Chairman, NITI Aayog, the report of the Task Force was finalized and submitted to the Prime Minister on 11th July, 2016.The report of the Task Force primarily focusses on issues of measurement of poverty and strategies to combat poverty. It is recommended that an expert committee be set up to arrive at an informed decision on the level at which the poverty line should be set." With respect to strategies to combat poverty, the Task Force has made recommendations on faster poverty reduction through employment intensive sustained rapid growth and effective implementation of anti-poverty programs.

X. Task Force on Agriculture Development

The Task Force on Agricultural development was constituted in 2015 under the Chairmanship of Dr. Arvind Panagariya, Vice Chairman, NITI Aayog. The Task Force based on its works prepared an occasional paper entitled "Raising Agricultural Productivity and Making Farming Remunerative for Farmers" focusing on 5 critical areas of Indian Agriculture. These are (i) Raising Productivity, (ii) Remunerative Prices to Farmers, (iii) Land Leasing, Land Records & Land Titles; (iv) Second Green Revolution-Focus on Eastern States; and (v) Responding to Farmers' Distress. After taking inputs of all the

States on occasional paper and through their reports, the Task Force submitted the final report to Prime Minister in 2016. It has suggested important policy measures to bring in reforms in agriculture for the welfare of the farmers as well as enhancing their income.

National Development Agenda

NITI Aayog's third Governing Council meet held earlier in 2017 saw the Prime Minister presenting National Development Agenda.

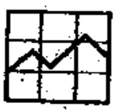
The National Development Agenda includes:

- Vision: A 15-year-long vision between 2017-18 to 2031-32 that combines national goals with international sustainable goals.
- Strategy: A 5-year long plan between 2017-18 to 2023-24 to convert broader vision into implementable policy.
- Action Plan: A three year short-term action plan between 2017-18 to 2019-2020 to translate policies into action by 2019.

The National Development Agenda aims at good governance and best practices in sustainable and equitable development.It offers a resolution method for inter-sector and inter-departmental issues in order to accelerate the implementation of the development agenda.

5 YEAR PLAN →
NATIONAL DEVELOPMENT AGENDA

VISION	STRATEGY	ACTION PLAN
2017-18 to 2031-32	2017-18 to 2023-24	2017-18 to 2019-20
▪ 15-year long-term Vision ▪ Combines national social goals and international Sustainable Development Goals ▪ Expands beyond the traditional Plan mandate to include internal security, defence, etc.	▪ 7-year mid-term Strategy ▪ Converts a broader vision into implementable policy	▪ 3-year short-term Action Plan ▪ Translates policy into action by 2019 ▪ Aligned to the predictability of financial resources during the 14th Finance Commission Award Period



Beginning 2017-2018

There are over 300 specific action points that had been identified, covering the whole gamut of sectors. The period of action agenda coincides with the period of the 14th Finance Commission's award.

India And The Manufacturing Sector

India's development experience with planning in the 1950's had a foundational approach to manufacturing. The Nehru-Mahalanobis model (2^{nd} FYP) is premised on capital goods industry and self-reliance. India had the manpower. Technical institutes were set up and higher education received its due. R&D was focused upon to feed into manufacturing through better technology. Howeve, the momentum could not be sustained as we did not have the land resources necessary; R&R policy could not be implemented satisfactorily and thus land acquisition was difficult in a democracy; domestic private sector investment was scarce; we did not open upto FDI and thus competition suffered as did productivity. Lack of an outward looking policy dented on our competitiveness. By the nineties, China already was becoming an global industrial powerhouse. Since then, the following factors acted as deterrents to India's manufacturing drive.

1. Infrastructure bottlenecks – power, roads, telecom etc.
2. from the last decade, Chinese imports did not allow local manufacturing and in fact led to de-industrialisation in India whether solar cells, tyres, steel, electronic items etc.
3. reservation for the MSMEs and favourable terms to them led to the moral hazard- they developed a vested interest in not scaling up
4. labour laws were made to protect labour that was already working. They could not be retrenched and thus companies preferred capital intensity as there was no liberal "exit policy"
5. India did not spend on R&D for product development.
6. Lack of ease of doing business also hampered investment and industrial growth.
7. In the last two decades, services sector emerged as a globally strong force and it seemed that we could skip the secondary sector and focus on becoming a global back office.

Services sector –led growth in India: Certain dimensions

The services sector is the dominant sector in India's GDP. There is more FDI into services sector than manufacturing. Service exports are making up for merchandise trade deficit. However, India's economic growth path has been markedly different.

In today's developed economies, manufacturing led the growth process in early stages of development. After agriculture matured, services took over the lead role only after a fairly high level of industrial development had been reached. The same pattern was also observed in the East Asian "tiger" economies and in China.

Like many other developing countries, India's economic growth has not conformed to this classical historical pattern of agriculture to industry to services. We opted to promote services sector in preference to manufacturing as we saw global opportunity in it as also because our land resources did not allows us to go for large scale manufacturing- witness the friction in setting up the special economic zones. India differs from China in this regard as well as the fact that China is authoritarian and the government held all the land. Suiting India, the world offered historic opportunities by way of digitization and globalization.

In the 1990's certain government policies favoured services and disadvantaged manufacturing. Compared to manufacturing, services have been lightly taxed and taxing began only in 1994. Rise in per capita income also had a significant effect on the demand for better services in the country- education, health, transport, finance, advertising, telecom, insurance etc.

Inadequate attention to development of physical infrastructure constrained manufacturing more than services. And since the reforms of the early 1990s, trade and foreign investment for services have been more liberal than those for manufacturing. The digital push to economic growth made globalization inevitable and irreversible and raised prospects for service sector growth in India.

Services contribute more than manufacturing to India's "output growth, productivity growth and job growth."

Earlier there were fears that services sector could not sustain an economy but in three critical areas there is parity or even superiority established by the services sector- trade-ability, transport-ability and scal-ability. Thanks to digital technologies connecting the world seamlessly.

About the sustainability of service sector led growth in India, Ejaz Ghani, World Bank economist and a service sector evangelist for India's rapid economic growth, says: "The digital revolution, by lowering transaction costs in services and overcoming problems of asymmetric information, has made services more dynamic than in the past. The emergence of e-commerce platforms is an example of how digital revolution can lower transaction costs, increase productivity as well as make it more inclusive. For many internet-based businesses or services, fixed up-front costs can be high initially, but once the physical infrastructure is in place, each additional customer, user, or transaction incurs very little extra cost.There is mounting empirical evidence that developing countries are relying more on services and less on manufacturing as drivers of growth and job creation .Globalization of services is the tip of the iceberg. Services, which account for more than 70% of global output are still in their infancy. The long-held view that services are non-transportable, non-tradable, and non-scalable no longer holds for a host of services that can be digitized.The globalization of services provides new opportunities for India to find niches beyond manufacturing, where it can specialize, scale up, and achieve high growth. As the services produced and traded across the world expand with globalization, the possibilities to develop based on services will continue to expand. This pace of change will be rapid in line with the digital revolution. Global internet usage has grown. But this growth is much faster in developing countries. India alone adds one million new users every month to a booming mobile phone market.

Ghani's Prescriptions: Investments in both physical and human infrastructure matter greatly for attracting new enterprises in both manufacturing and service industries. But unlike in the manufacturing sector, investments in human infrastructure, education and skills, matter much more. Given its stage of development, India needs accelerated investments in both physical and human infrastructure to support new drivers of growth and job creation.

Some policy experts have rightly argued that India is on the "brink" of a techno-institutional revolution. Take the example of mobile technology and examine its role in banking. Banking is currently concentrated in the urban areas, but cities are saturated with bank branches. On the other hand, 300 million rural people across 300 districts in India have no access to banking. Expansion of digital technology can play a big role in improving rural access to banking. Financial inclusion can be achieved through last-mile connectivity. Payments Banks since 2016 have been helping in the process. India Post Payments Bank is likely to revolutionalise financial inclusion even more. That in turn could help medium-size cities, small towns and villages to become new drivers of growth. Digital India, Jan Dhan, Skill India, Payments Banks are some examples.

Services Sector Growth And Jobs In India

Three basic groups of services can be defined: traditional services which include "wholesale and retail trade, "hotels and restaurants" and "transport and storage"; modern services which include "communication" (a category that includes telecom services), "financial services" and "real estate-renting-business services" (a category that includes software services); and social services which include "public administration and defence" and "community, social and personal services". The traditional and the social services are non-tradable while the modern services are internationally tradable. The traditional and the modern services are mostly in the private sector while the social services are mostly in the public sector.

Services stand out in many important ways. Some generalities need to be noted to begin with. Services are of three types: traditional, modern and social services. "Modern services"—banking and insurance, education, computer related services, research and development, health, communication, legal services and accounting—together account for about 16% of GDP. Modern and social services are produced in the organised sector and mainly by formal employees. Traditional services are essentially produced in the unorganised sector and mainly by self-employed workers and employ generally low-skilled workers while modern and social services employ high-skilled workers. Labour productivity in traditional services is much lower than that in modern services. In 2010, modern services accounted for less than 11 per cent of total services employment and 38 per cent of services output, while traditional services accounted for 58 per cent of services employment and 40 per cent of services output. Thus, modern services productivity is higher.

Overall, services provide better-quality employment and more high skilled workers in comparison to manufacturing. It helps in formalisation of employment with all the benefits to employees.

As can be inferred from above, there is a wide gap between what the services sector contributes to the economy and its employment.For India, the share of the services sector in GDP is 53.2%, while its share of total employment is much less, at 28.6%.

Construction sector is in the secondary sector in the classification of components of economy by the CSO in the national income calculations.

A common misperception has to be corrected. India's services-led growth has not been "jobless". It has created not only large number of jobs but also high quality, formal, highly skilled jobs. Real wages of both regular-formal and casual employees have also increased though the former have gained much more than the latter.

Manufacturing is far less job-intensive and creates low-skilled jobs unlike the services-led growth. Experts on the basis of the above evidence say that manufacturing-led growth could be used to shift labour out of agriculture and thus reduce underemployment and povertyand the rise in income inequality.

1990s, saw a combination of factors driving services sector growth domestically and globally raising hopes that it can more than substitute for the manufacturing led growth. Digital technology grew at exponential speed and services sector was the biggest beneficiary particularly for India with its higher education advantages. It automatically led to growth in financial services, telecom, retail and spread to transportation, travel, tourism, media, health services and so on as government policies favoured and the percapita incomes rose. Technology facilitated new ways of doing business via increasing computing power, data storage capacity and data transmission capacity. Telecom connectivity has grown at a rapid pace Farmers who were earlier dependent on middlemen, now have better information on pricing. The organised retail sector has brought in efficiency in the supply chain. We are now seeing the rapid growth of e-commerce and online retail stores.The automobile industry is a key contributor as the rise in sales of personal vehicles has created a multiplier effect on support services required after sales.

Transportation and logistics services grew rapidly as demand for goods grew across the country. Service sector not only creates direct output and direct employment, but also the ancillary services and employment generation. For every job created in the IT and IT enabled services sector, four jobs are created elsewhere.

India's current per capita income is about $1,800 (India in 2017) and has enormous implications for savings growth, consumption demand and the ability to be a sustainable driver for the demand in services. Travel sector is seeing growth as air and road travel grow, in turn leading to a growth in demand for tourism and hotels. It is aided by initiatives like "Paryatan Parv organized by Ministry of Tourism in collaboration with other Central Ministries and State Governments across the country in October 2017.

Similarly other sectors like media, entertainment, health care and education all benefited with increased aspirations of the retail consumer.

Technology continues to drive innovation and creation of new smart business models which are based on leveraging digitisation, mobility and social media. Given these factors, coupled with our demographic dividend and the expected jump to a higher trajectory for both growth and per capita GDP, we have the right conditions for a virtuous cycle to sustain for many years that will have a GOI wants services sector boosted and so has many incentives in wide variety of sectors such as health care, tourism, education, engineering, communications, transportation, information technology, banking, finance, management, among others.

India signed Comprehensive Economic Partnership Agreement (CECA) with Malaysia and Singapore and Comprehensive Economic Cooperation Agreement (CEPA) with Japan and South Korea. Both have a service component.

After the trade facilitation agreement (TFA) in goods under the World Trade Organization (WTO) came into force in 2017, India submitted the draft legal text at the multilateral body for a similar agreement in services which is expected to help in the smooth movement of professionals.The implementation of the Goods and Services Tax (GST) would create a common national market and reduce the overall tax burden on goods. It is expected to reduce costs in the long run on account of availability of GST input credit, which will result in the reduction in prices of services.

India-ASEAN free trade *agreement* (FTA) in *services* and investments *came into force* from 2015 in countries which have ratified it.

FISCAL SYSTEM

Fiscal Policy Definitions

- That part of government policy which is concerned with raising revenue through taxation and with deciding on the amounts and purposes of government spending.
- The government's policy in regard to taxation and spending programs. The balance between these two areas determines the amount of money the government will withdraw from or feed into the economy, which can counter economic peaks and slumps.
- Government spending policies that influence macroeconomic conditions. These policies affect tax rates and government spending, in an effort to control the economy.
- Government policy for dealing with the budget-especially with taxation and borrowing
- The policy of a government in controlling its own expenditures and taxation, which together make up the budget
- Fiscal policy is the means by which a government adjusts its levels of revenue and spending in order to monitor and influence a nation's economy

Fiscal policy involves use of taxation and government spending to influence economy. In other words, fiscal policy relates to raising and spending money in quantitative and qualitative terms.

As far as fiscal receipts are concerned, taxes, user charges (power, water, transport charges etc.); disinvestment proceeds; borrowings from internal and external sources are the main channels. All receipts are not earned and some are borrowed. Receipts and expenditure are divided into revenue and capital accounts. Expenditure is also shown as Plan and Non-plan items.

Fiscal policy deals not only with the quantity but the quality of public finance as well. In other words, not merely how much is raised and spent but how has it been raised- is it raised by way of taxes or borrowings; are they excessive or irrational etc. Also, the way the finances so raised are used- wastefully or productively. How much is spent on plan heads and how much populistically targeted etc also is studied.

Fiscal policy can achieve important public policy goals like growth; equity; promotion of small scale industries; encouragement to agriculture; location of industries in rural areas; labour - intensive growth; export promotion; development of sound social and physical infrastructure etc.

Art.112 of the Constitution mandates that expenditure be shown in revenue and other categories.

Non-Plan expenditure is not a Constitutional term but is in use to emphasize on the point that government spends financial resources for consumption (maintenance) as well as asset creation. It includes expenditure on interest payments; defense; subsidies; and public administration.

A break up of the finances into revenue and capital streams, in general, is as follows:

- Revenue receipts are recurrent receipts. Revenue account includes the following receipts: taxes and non-tax sources. Taxes are income tax , corporation tax, excise duty, customs duty etc; non tax resources include user charges ;interest receipts; dividends; profits etc

- Revenue account expenditure is essentially the non-plan expenditure that does not create assets, that is, - interest payments, defence; subsidies and public administration. It is synonymous with maintenance and consumption expenditure as also welfare expenditure.
- Capital account receipts are recoveries of loans and advances made by the Union Government to States, UTS and PSUs; fresh borrowings from inside the country and from abroad; disinvestment proceeds etc. As is clear from above, some of them are debt and some are non-debt.
- Capital account expenditure is loans made to States, UTs and PSUs; expenditure for asset creation in infrastructure and social areas; loans repaid etc.

Definitions of Deficits

Revenue deficit is the difference between the revenue receipts on tax and non-tax sides and the revenue expenditure. Revenue expenditure is conventionally considered synonymous with consumption and non-development, in general. But in the case of India, the social sector expenditure like on education, labour welfare, health, contributions to agriculture, social security etc on government - flag ship schemes are in the revenue expenditure. When revenue deficit is zero, we can fund for consumption from government's own resources and not borrowing.

ERD

An additional fiscal indicator, namely effective revenue deficit, was introduced in the FRBM Act by the Finance Act, 2012. Effective revenue deficit has been defined as the difference between "the revenue deficit and the grants for creation of capital assets".

Grants for creation of capital assets are defined as "the grants-in-aid given by the Central Government to the State Governments, constitutional authorities or bodies, autonomous bodies and other scheme implementing agencies for creation of capital assets". The amendment seeks to eliminate effective revenue deficit by 2015 which was later postponed to 2018 March.

The government is committed to reduce the effective revenue deficit to 0.7 per cent in 2017-18 and take it to 0.2 per cent by 2019-20

The 14th Finance Commission suggested the government scrap this concept because the Constitution has provisions only for revenue and capital expenditures."Under the Constitution, there are only two categories of expenditure — the one on the revenue account and that broadly expressed as capital expenditure. Artificially carving out revenue account deficit into effective revenue deficit... leads to an accounting problem and raises the moral hazard issue of creative budgeting," the Commission had said.

Fiscal deficit is the difference between what the government earns and its total expenditure. That is, the difference between what is received by the government on revenue account and all the non-debt creating capital receipts like recovered loans and disinvestment proceeds ; and the total expenditure. It amounts to all borrowings of the government in a given period. It is targeted at 3.2% of GDP in 2017-18 compared with 3.5% in the previous year.

FD = Total expenditure of the Government in a budget minus (Revenue receipts + non-debt creating capital receipts).

Difference between Gross FD and Net FD. The Central government makes capital disbursements as loans to the different segments of the economy. In the developing countries, a large part goes as loans to other sectors-States and local Governments, public sector enterprises and the like. Net fiscal deficit can be arrived at by deducting net domestic lending from gross fiscal deficit.

Budget deficit considers only the difference between the total budgeted receipts and the expenditure, the amount that was printed by RBI and supplied to the GOI as credit It was abolished in 1997.

Fiscal Deficit mirrors the health of government finances most accurately unlike the budget deficit concept. BD does not cover all borrowings but only that portion of the borrowings for which government relies on printing money by the RBI

Monetised deficit is the borrowings made from the RBI through printing fresh currency. It is resorted to when the government can not borrow from the market (banks and financial institutions like LIC etc.) any longer due to pressure on interest rates or for reasons like fresh money injection into the economy is necessary to push growth up. It means infusion of fresh currency into the market. It corresponds to the budget deficit that is discarded as a concept since 1997. It is discontinued from 2006 as a part of the FRBM 2003.

Primary deficit is the difference between the fiscal deficit and the interest payments. The concept helps in assessing the progress of the government in its fiscal control efforts.

Deficit Financing

Deficit Financing is the phrase used to describe the financing of gap between Government receipts and expenditure. Such gap is called budgetary deficit. It is financed by printing fresh money by the RBI. The gap can be genuine as the Government wants to spend on welfare and infrastructure for which it has no money and so borrows from the RBI; or due to bad finances of the government; or mainly for consumption and populism.

When the Government has to spend more than what it can raise through tax, non-tax and other sources, it borrows from the market. It can not borrow above a certain amount from the market as it may be inflationary; push up interest rates and thus make it even more costly for the government to service the loan which also tilts the balance away from capital expenditure; and crowd out private investment. Then Reserve Bank of India prints money and supplies credit though at a cost and not free. In other words, when the resources from taxes, user charges, public sector enterprises, public borrowings, small scale borrowings and others are not enough, RBI prints and gives to the Government. It is called deficit financing.

The money printed by the RBI is called high powered money or reserve money or monetary base.

The concept of budget deficit was dropped from 1997 budget and as a result deficit financing also was stopped in that limited sense. That is, as a concept both were discontinued as the two were two sides of the same coin- budget deficit is monetized through deficit financing. In fact, FRBM disallows RBI printing money to finance government deficit in normal conditions.

The beneficial contribution of deficit financing to India's economic planning and development is manifold. First, in the early 1950s, our domestic savings ratio was less than 9 per cent of GDP, and that constrained the investment and welfare activity of the government.

Second, the capacity to raise non-inflationary sources of financing (taxes, small savings, genuine public borrowings, etc.) was highly limited.

Third, external aid could supplement domestic funding only to a limited extent. It is better to source debt from inside than outside.

Fourthly, foreign direct investment was discouraged as a source of investment and thus scarcity of investment resulted. Therefore, government borrowing became necessary through monetization.

There are two views on the matter. There are some people who regard deficit financing as essential for the purposes of development and welfare; as a healthy means of stimulating economy. There are those who regard any deficit financing as inflationary and a serious threat to the stability of the economy.

On balance it may be said that, if deficit financing is done prudently and the borrowed money is used well, it is healthy. However, if the borrowed money is wasted for maintenance, is it against good economics as it can negatively affect money supply and inflation; and also dampen growth.

The viability and desirability of deficit financing, in short, depends on

- Extent of borrowing
- End use of the money borrowed.

How Much of Fiscal Deficit Is Right?

Fiscal deficit is bridged by market borrowings and central bank printing fresh currency (monetization), if necessary. To a limited extent, FD is important as the Government's ability to help growth and welfare increases. Government can always return the loans when its revenues improve due to tax buoyancy. However, FD becomes problematic and even destabilizing when it overshoots a rational threshold. Sovereign debt crisis in Greece and the fiscal woes of USA are the result of unsustainably high debt and borrowing.

Therefore, moderation of fiscal deficit is important. Large and persistent fiscal deficits are a cause of concern, as they pose several risks. Fiscal deficits may cause macroeconomic instability by inflating the economy as money supply rises.

Corporate sector is crowded out – they are left with inadequate funds in the markets as the government borrowing requirements increase. Added to that, interest rates will be high as there is pressure on the available money in the market. If the funding route is through RBI monetization, it means inflation and instability. Inflation may mean less savings, less investment and eventually it hurts the sustainability of high growth.

Large deficits, even if they do not spill over into macroeconomic instability in the short run, will require higher taxes in the long term to cover the heavy burden of internal debt. It means, as the FRBM Act says, inter-generational parity is hurt if debt mounts as future generations will have to pay higher taxes to help the government repay the debt.

Government liabilities- interest payments- increase and there is far less for development.

BOP pressures may mount if inflows drop due to the country being downgraded by rating agencies like Standard and Poor, Moody etc. Therefore, FDs must be moderated- they are desirable within limits but hurtful beyond the limits.

The above analysis applies to FD in normal times. But in abnormal times like since 2008-09 when the world slipped into recession impacting Indian economy negatively, FD must be allowed to be increased for the fiscal stimuli which are necessary to arrest downturn in the economy and revive growth. FRBM allows such counter-cyclical expenditure. Even then, deficit should be incurred not for populist expenditure but to stimulate the economy.

The sovereign debt crisis (SDC) of Greece is due to excessive FD. However, an SDC is by definition inability of the government to service the loans taken from offshore credit market in foreign currency. It has no relation with internal debt. Though the two are intimately related as explained here: Greece borrowed from overseas market and spent excessively. Taxes were not collected efficiently and there was large scale evasion. Government revenues fell drastically due to recession and tax leakages. The need for massive borrowing and spending increased. The stimulus package aimed at keeping up social services did not yield any returns in monetary terms which meant that the Government could not return the loans it took and so could not raise further loans that were affordable: government was not able to raise the money at normal rates of interest. It had to pay high rates of interest. That means it was debt-trapped- borrow to pay the existing debt at higher and higher rates. The banks and other financial institutions that invested in Greek government bonds panicked. Their share prices fell. Financial system was in danger of instability. Similar crisis was seen in Ireland later and Spain and Portugal too. These countries are acronymally called PIGS. The lesson from Greek crisis is that FD may be incurred only for productive reasons and ensure good returns and external loans for budgetary purposes are to be at a minimal level. Tax collections should be efficient. Accounts of government should be properly maintained and not dressed up.

Reducing FD

FD has to be reduced and the FRBM targets are to be conformed to, under normal conditions. But upto3% of GDP for FD as laid down by FRBM Act is necessary and desirable as the Government can borrow and spend for welfare and growth.

The extent of reduction and the manner of reduction matter. More resources should be raised from taxes, user charges, disinvestment etc. Expenditure control should not involve cuts on social sector expenditure as it hurts poor and demographic dividend can not be reaped.

The level of FD should be determined keeping in consideration the following

- whether the debt can be put to productive deployment
- The rate of return on the borrowed funds' use is adequate
- the impact on private sector investment by way of crowding out effect etc.

Even more important is not to cut social spending in a move to reduce deficit. In other words, while FD reduction is needed for macroeconomic stability and inter-generational parity. Introduction of GST, the DTC amendments, selective disinvestment, broadening of tax base, tax buoyancy etc. will yield enough to moderate borrowings.

Global Crisis And The FD In India

Global recession impacted India and our growth rate slipped. Tax revenues were hit. There was a massive fall in demand. Corporate sectors postponed investment. Threat to employment was real. Therefore, Government took it upon itself to spend more by borrowing. The result is that fiscal deficit reached an abnormally high level- 6.8% in the year 2009-10. The fiscal measures taken by the government to counter the negative fall -out of the global slow down on the Indian economy paid off.

Firstly, the Government responded by providing three focused fiscal stimulus packages in the form of tax relief to boost demand and increased expenditure on public projects to create employment and public assets.

Secondly, the RBI took a number of monetary easing and liquidity enhancing measures to facilitate flow of funds from the financial system to meet the needs of productive sectors.

This fiscal accommodation led to an increase in fiscal deficit from 2.7 per cent in 2007-0.8 to 6.2 percent of GDP in 2008-09.These measures were effective in arresting the fall in growth rate of GDP in 2008-09 and stemmed the fall and achieved a growth of 6.7 per cent. The growth rate further improved to 8.4 % for the next two fiscal years of 2009-10 and 2010-11.

The deficit was financed by raising Internal Debt and from Public Account surplus cash.
The unsustainably high fiscal deficit could not be continued for long and had to be phased back to normal levels by a calibrated rollback since 2010-11.

FRBM Act 2003

Fiscal Responsibility and Budget Management (FRBM) Act 2003 was notified in 2004 with the following salient features

- annual targets of reduction in deficits, government borrowing and debt
- Government to annually reduce the revenue deficit by 0.5 per cent and the fiscal deficit by 0.3 per cent beginning fiscal 2004-05.
- elimination of revenue deficit and reduction of fiscal deficit to 3% of GDP by March 31, 2009
- a cap on the level of guarantees and total liabilities of the Government.
- Prohibits Government to borrow from the RBI (primary borrowing) after April 1, 2006. RBI can not print money to lend to the government.
- On a quarterly basis, that Government shall place before both the Houses of Parliament an assessment of trends in receipts and expenditure.
- Annually present the macro-economic framework statement, medium term fiscal policy statement and fiscal policy strategy statement. The three statements would provide the macro-economic background and assessment relating to the achievement of FRBM goals.
- Under exceptional circumstances, Government may be compelled to breach targets. In case of deviations, the Government would not only be required to take corrective measures, but the Finance Minister shall also make a statement in both the Houses of Parliament.

Borrowing from the RBI is permitted in exceptional situations like natural calamities. FRBM was brought in for fiscal discipline; increase plan expenditure; reduce the amount of borrowings; meet consumption from government's own fiscal resources; leave the RBI with autonomy as far as money creation goes etc. Fiscal consolidation is necessary particularly in the era of globalization when the penalty for irresponsibility is high.

New Zealand was the first country to enact a Fiscal Responsibility Act in 1994, thereby setting legal standards for transparency of fiscal policy and reporting; and holding the Government formally responsible to the public for its fiscal performance. A similar legislation, the Charter of Budget Honesty, has been enacted in Australia. The UK, too, has enacted a Code for Fiscal Stability. The global recession from 2008 onwards has made the government breach the FRBM targets vastly. But fiscal consolidation since then has been on track and the target for FD in 2017-18 as mentioned above is 3.2% of GDP and to be made 3% by 2018-19.

FRBM 2.0

The 13th Finance Commission reviewed the Act in 2009 and suggested that there should be greater flexibility regarding the fiscal targets as there is uncertainty in general and also about the global economy.These include agro-climatic events of a national dimension, global recessions impacting the country's exports and shocks caused by domestic or external events like asset price bubbles or systemic crises in important sectors like the financial markets.

Following these recommendations, the Act was amended by the Finance Act 2012. One of the amendments was that, along with the Medium-Term Fiscal Policy Statement, Fiscal Policy Strategy Statement and the Macroeconomic Framework Statement, the Central Government would also have to lay a Fourth Statement viz., the Medium Term Expenditure Framework (MTEF) Statement in both the Houses of Parliament, immediately following the Session of the Parliament in which the Budget has been presented. MTEF statement set forth a three-year rolling target for expenditure indicators.

Another significant change made in the amendment to the FRBM Act in 2012 was that, instead of targeting the revenue deficit, the FRBM Act would target a new concept, the 'effective revenue deficit'—the difference between revenue deficit and grants for creation of capital assets. In essence, this placed capital expenditure out of the purview of the revenue deficit.

Finally, the dates by which the effective revenue deficit and fiscal deficit targets were to be met were extended. The effective revenue deficit was to be eliminated and the fiscal deficit was to be below three per cent by March 2015. These targets were once again revised in the Finance Act 2015, postponing the dates of achievement to March 2018.

Fiscal Consolidation

Fiscal consolidation means strengthening government finances. Fiscal consolidation is critical as it provides macro-economic stability; cuts wasteful expenditure; can enable government to spend more on infrastructure and social sectors. Tax reforms, disinvestment, better targeting of subsidies and so on are the hallmarks of fiscal consolidation.

Enactment of FRBM Act provides an institutional framework and binds the government to adopt prudent fiscal policies. There is a need to involve states to effect overall fiscal consolidation and strengthen the growth momentum.

GST and revised DTC are an important federal effort toward fiscal reforms and consolidation. Also, without fiscal consolidation- conversion of subsidies into capital expenditure that forms assets- it is not possible to step up public investment, especially in areas such as agriculture, where gross capital formation has dropped from 1.9 per cent to 1.3 per cent of GDP since 1990-91.

Fiscal consolidation in India includes the following reforms:

- Revenue reforms include tax reforms on both direct and indirect tax front; rationalization of tax exemptions, improving efficiency of tax collection, and tax stability.
- On the expenditure side, reform areas include cutting out non-essential and unproductive activities, schemes and projects, allocation of resources to priority areas, reducing cost of services, rationalizing subsidies; reduction of time and cost overruns on projects, getting proper 'outcome' from output

The reduction in fiscal deficit should not be achieved by a reduction in plan expenditure. It should be done by way of realisation of higher revenues and rationalizing revenue non-plan expenditure.

Kelkar Committee 2012

A roadmap for fiscal consolidation was worked out by a committee headed by former Chairman of the 13th Finance Commission Vijay Kelkar to retrieve fiscal prudence after the stimulus. Kelkar committee said that the reduction in deficit could be achieved through a combination of share sale of state-owned companies, pruning petro-product subsidies through raising prices of diesel and LPG or cooking gas and implementation of the Goods and Services Tax or GST.Administrative reforms including beefing up of IT infrastructure have also been suggested.

Bimal Jalan Committee on Expenditure Management

NDA Government in 2014 set up Expenditure Management Commission, headed by formerRBI Governor Bimal Jalan, to suggest ways to reduce food, fertiliser and oil subsidies and narrow the fiscal deficit.

The panel has been set up as there is a need to review the allocative and operational efficiencies of the government expenditure to achieve maximum output. Government proposes to overhaul the subsidy regime, including food and petroleum subsidies, and make it more targeted while providing full protection to the poor. The subsidy bill on food, petroleum and fertilisers is estimated at Rs2.4 lakh crore for 2017-18 fiscal.

Austerity

When the fiscal position weaken much, the austerity measures taken can be: ban on five-star venues for government meetings; foreign locations for conferences, exhibitions and seminars; and executive class airline tickets for officials; keep the size of delegations going abroad at an "absolute minimum; banned recruitment for central government posts for one year and the purchase of new vehicles.

N.K. Singh panel to review India's Fiscal Responsibility and Budget Management (FRBM)

The N.K. Singh panel to review *India's Fiscal Responsibility and Budget Management (FRBM) Act* suggested the creation of a new Fiscal Council and a focus on public debt to GDP ratio- target of 60% debt to GDP by 2023 from the present level of about 68%.

The FRBM Committee, set up in May 2016 to review the Centre's fiscal roadmap, had submitted its four-volume report in January 2017.

The committee favours a debt-to-GDP ratio of 60% for the general government by 2022-23, 40% (38.74%) for the central government and 20% for state governments. Within the framework, the committee has recommended adopting fiscal deficit as the key operational target consistent with achieving the medium-term debt ceiling, at 3% of GDP for three years, between 2017-18 and 2019-20. Revenue deficit-to-GDP ratio has been envisaged to decline steadily by 0.25 percentage points each year from 2.3% in 2016-17 to 0.8% in 2022-23.

The committee has prescribed a so-called glide path to these targets—steady progress towards them—and also suggested that there be some flexibility in the deficit targets on both sides, downwards when growth is good and upwards when it isn't.

The panel has recommended enacting a new Debt and Fiscal Responsibility Act after repealing the existing Fiscal Responsibility and Budget Management (FRBM) Act, and creating a fiscal council.

The proposed three-member fiscal council will prepare multi-year fiscal forecasts for the central and state governments (together called the general government) and provide an independent assessment of the central government's fiscal performance and compliance with targets set under the new law.

However, to deal with unforeseen events such as war, calamities of national proportion, collapse of agricultural activity, far-reaching structural reforms, and sharp decline in real output growth of at least 3 percentage points, the committee has specified deviation in fiscal deficit target of not more than 0.5 percentage points.

The committee said that if there is a sharp increase in real output growth of at least 3 percentage points above the average for the previous four quarters, fiscal deficit must fall by at least 0.5 percentage points below the target.

For any deviations, the Centre would be expected to hold formal consultations with the three-member Fiscal Council that would also make multi-year fiscal forecasts for Central and General governments.

The committee has also called for institutional reforms in general government's fiscal management, including the Centre giving consent to State borrowings under Article 293 of the Constitution.

Major Budget Reforms 2017

- Budget presentation preponed – Union budget was traditionally presented in the last week of February and passed by mid-May. However, in 2017, budget was presented on February 1.
- There was no vote on account(Art.116) thus
- Railway Budget merged – The Railway Budget was presented separately since 1924 on the recommendation of committee led by Sir William Acworth. This was done because Railway revenue was high. But railway revenue has shrunk to 11.5 percent of general revenue. From 2017 onwards, railways will be part of the general budget. By merging the two budgets, the government can take a wholistic view.
- Plan and non-plan expenditure removed
- Shankaracharya committee on calendar for budget

Plan And Non Plan Expenditure Classification And Its Unsustainability

In the Budget, expenditure is shown both as revenue and capital and also as plan and non-plan within both. In conventional understanding, 'Plan' expenditures, as the name implies, encompass annual plan projects contributing to five-year plan; these include projects like dams, roads, power plants etc. Non-Plan expenditure relates to maintenance, consumption and welfare. Non-plan expenditure does not create assets. When a project is being built, it is a plan item of expenditure. When completed and being maintained, it is a non-plan item of expenditure.

However, in India there is plan and non-plan in both revenue and capital expensiture and revenue plan expenditure is composed of flagship programmes as seen below. At present, non-Plan expenditure constitutes approximately 70-75 percent of the budgetary expenditure at central and state levels.

'Non-plan' expenditure may be on the revenue or capital accounts and has the following items

- Interest payments
- Subsidies
- Defence
- Public Admn.
- Loans and grants to States, PSEs and UTs
- acquisition of ships, vessels andaircrafts for Coast Guard Organisation , construction of road works by Border Roads Development Board, purchase of ready-built accommodation for CBDT, construction of office buildings by CPWD, acquisition/construction of residential and non-residential buildings for Indian Missions abroad and investment in International Financial Institutions, Capital Outlay on Police
- grants to foreign governments : for Bhutan, Nepal, African Countries, Bangladesh , Sri Lanka, Myanmar, Afghanistan, Maldives, and other developing countries

Rangarajan Committee 2012

The high-level expert committee was set up in 2010 under the Chairmanship of Dr. C. Rangarajan to suggest measures for efficient management of public expenditure and was mandated to see whether the classification of expenditure into Plan and Non-Plan is rational and can be continued. The report of the Committee was presented in 2012 and the following are the salient points:

- The government should do away with the distinction between Plan and Non-Plan expenditure and redefine roles of the Planning Commission and the Finance Ministry. Plan and Non-Plan distinction in the budget is not able to provide a satisfactory classification of developmental and non-developmental dimensions of government expenditure. It has therefore become dysfunctional. The committee recommended that Plan and Non-Plan distinction in the budget should be removed.
- The report suggested a basic shift to outputs and outcomes.
- The report also called for strengthening the Central Plan Monitoring System (CPMS) and empowering the citizens to seek information on flow of resources and utilisation with a view to promoting transparency and accountability.

The distinction between plan and non-plan expenditure items has become simplistic and is artificial and untenable. The building of a new school or a primary health centre is considered a Plan investment but its running and maintenance is considered non-Plan spending. Thus, very often it had led to Government allocation being reduced for maintenance as it is classified as non-plan item and will be criticized.

In the Sarva Siksha Abhiyan, expenditure on teachers' salary constituted Plan Revenue Expenditure, and that on construction of school buildings was Plan Capital Expenditure. The government made allocations to the Rural Development Ministry for building roads under the Pradhan Mantri Gram Sadak Yojana as Plan Expenditure, but their maintenance belonged to Non-Plan budget. Similarly, funds for teachers (Kendriya Vidyalayas, Navodaya Vidyalas, other government schools) and for doctors (Health centres and Medical colleges of the government) came from Non-Plan Budget while school buildings and hospital buildings were plan expenditure. Thus there are buildings without employees.

Expensive equipments in hospitals were bought under plan spending but maintenance suffered as employees were not hired. Thus, assets are neglected. New projects are allotted money while the completed projects are neglected.

It is important to take a consolidated view of finances keeping in perspective the interdependence of Plan and non-Plan expenditures.This classification had given rise to a misleading notion that Plan expenditure was developmental and Non Plan was non-developmental. Resource allocation would be easier now by putting plan and non-plan expenditure together; this approach of looking at expenditure as a whole will also help link outlays to outcomes better.

The reasons for scrapping the distinction from 2017-18 are

- 5 Year Plans are discontinued
- Planning Commission is no longer there
- Undesirability of keeping the distinction for the reasons detailed above.

Public Debt

Public debt includes government's internal debt comprising borrowings inside the country like market loans; borrowing from the RBI through printing; and external debt comprising loans from foreign countries, international financial institutions, NRI deposits, commercial institutions etc. In the expression `public debt and "other liabilities". "Other liabilities" include outstanding against the various small saving schemes, provident funds etc. External debt means what the nation owes to foreign lenders- includes private sector borrowings too. However, public debt includes what the government owes to lenders inside and outside the country. *(More in the classroom)*

Public debt is justified as the government does not have adequate resources and taxation can not be done beyond a point. It should be for productive reasons and also welfare reasons. The spiral of deficit and debt run the risk of undermining the country's creditworthiness, devaluing the currency and destabilising the entire economy with grave social consequences. Therefore, it should be incurred judiciously.

India's debt to GDP ratio, when the total outstanding liability –internal and external, is included as of March 31, 2017, is Rs 68.5%.

Generally, Government debt as a percent of GDP is used by investors to measure a country's ability to make future payments on its debt, thus affecting the country's borrowing costs and government bond yields.

External Debt

Annual Publication 'India's External Debt: A Status Report 2016-17' prepared by the Department of Economic Affairs, Ministry of Finance, Government of India gives a detailed analysis of India's External Debt position at end-March 2017.

The salient features of the Report are:

- India's external debt stock stood at US$ 471.9 billion, decreasing from 2016.The decline in external debt was due to the decrease in long-term debt particularly NRI deposits and commercial borrowings.
- long-term external debt was US$ 383.9 billion and accounted for 81.4 per cent of total external debt
- Short-term external debt increased by 5.5 per cent to US$ 88.0 billion. This is mainly due to the increase in trade related credits, a major component of short-term debt with a share of 98.3 per cent.
- Government (sovereign) external debt was US$ 95.8 billion and constituted 20.3 per cent of the total external debt.
- India's external debt has remained within manageable limits and the external debt situation has improved as indicated by the increase in foreign exchange reserves cover to debt to 78.4 per cent and fall in the external debt-GDP ratio to20.2 per cent. External debt of the country continues to be dominated by the long-term borrowings.

A cross country comparison based on 'International Debt Statistics 2017' of the World Bank, which presents the debt data for 2015, shows that India continues to be among the less vulnerable countries with its external debt indicators comparing well with other indebted developing countries. External debt comprises of commercial borrowings, NRI deposits, short-term debt as well as multilateral and bilateral debt.

Commercial borrowings continued to be the highest with a share of 37.4 per cent of total external debt, followed by NRI deposits (24.1 per cent) and short-term debt (18.4 per cent). Multilateral debt is at 12% and bilateral debt is at about 5%. The share of US dollar denominated debt continued to be the highest in external debt, followed by the Indian rupee, SDR, Japanese yen and euro.The ratio of concessional debt to total external debt was 8.7 per cent.

The valuation effect arises because external debt is denominated in different currencies, and the US dollar value which is the international unit for debt, fluctuates over time vis-à-vis other currencies. If US dollar appreciated against Indian rupee and most other major currencies or otherwise, there is a change in the total debt stock.

External Debt Management

The prudent external debt management policy of the Government of India continues to focus on monitoring long and short-term debt, raising sovereign loans on concessional terms with longer maturities, regulating external commercial borrowings through end-use, encouraging rupee denominated bonds like Masala bonds, and rationalizing interest rates on Non-Resident Indian deposits.

Rupee Debt

Rupee denominated debt refers to that part of India's total external debt that is denominated in India's domestic currency, the Rupee.

Unlike foreign currency denominated external debt like ECBs, FCCBs etc, in case of rupee denominated debt the *currency risk* (the risk arising from appreciation or depreciation of the nominal exchange rate) is borne by the creditor and not by the borrower. Borrower returns as much as he borrowed (as many rupees) with interest as fixed irrespective of the exchange rate . Thus, if the domestic currency appreciates vis-à-vis the foreign currency, the creditor stands to gain vis-à-vis the borrower since he receives more rupees than the current rate suggests.

In India rupee denominated debt comprises the following categories;

- *Rupee Debt;* Includes the outstanding defense and civilian state credits extended to India by the erstwhile Union of Soviet Socialist Republics (USSR). The repayment is primarily through exports of goods to Russia.

- *Rupee denominated* Non-Resident Indian (NRI) Deposits.

- Foreign Institutional Investors (FII) investment in Government Treasury-Bills and dated securities and

- FII investment in corporate debt securities (with such investments ceiling set by GOI annually).

In short, external debt consists of

- long-term external debt which is the bulk part
- NRI deposits
- multilateral loans
- commercial borrowings
- bilateral loans and
- Trade credit

Internal Debt

Internal debt includes loans raised by the government in the open market through treasury bills and government securities, special securities issued to the RBI and most importantly, various bonds like the oil bonds, fertilizer bonds etc.The money sterilized from the market in by the Market Stabilisation Scheme (MSS) is also shown in the government's statement of liabilities. Introduced in 2004, MSS envisages the issue of treasury bills and/or dated securities to absorb excess liquidity arising out of the excessive foreign currency inflows. (Read ahead)

The internal debt of the government also includes others like the outstanding against small-savings schemes, provident funds, deposits under special deposit schemes etc. These debts are shown under a separate head titled 'other liabilities'.

Debt should be moderated for the reasons cited in the discussion on FD above.

Masala Bonds

Masala bond is a term used to refer to a financial instrument through which Indian entities can raise money from overseas markets in rupee, not foreign currency. By issuing bonds in rupees, an Indian entity is shielded against the risk of currency fluctuation, typically associated with borrowing in foreign currency. Besides helping diversify funding sources, the cost of borrowing is lower than domestic markets. As masala bonds are denominated in rupees, foreign investors will be taking the currency risk.

Masala is an Indian word for spices. The term was used by International Finance Corporation (IFC) to evoke the culture and cuisine of India. Dim sum bonds are bonds issued outside of China but denominated in Chinese renminbi, and not the local currency. They are named after dim sum, a popular style of cuisine in Hong Kong. Similarly, Samurai bonds for Japan.

Unlike dollar bonds, where the borrower takes the currency risk, masala bond makes the investors bear the risk. The first Masala bond was issued by International Finance Corporation in 2014 when it raised money to fund infrastructure projects in India. Later in International Financial Corporation for the first time issued green masala bonds to be used for private sector investments that address climate change in India.

In 2016 HDFC issued Masala bonds and thereby became the first Indian company to issue masala bonds and later NTPC issued first corporate green masala bonds. NHAI, Shriram Transport Finance and Indiabulls Housing Finance are the others (2017).

An investor who buys a bond issued by an Indian entity at a rate that is, say, 200 basis points above the globally accepted pricing benchmark — the London Interbank Offered Rate or Libor is optimistic about India, and hoping that currency and inflation would be stable enough to ensure good returns after factoring in exchange rate risks. With India's GDP or national income rising, and projected to grow at a reasonably fast rate over the next few years, many overseas investors like to buy such bonds to earn higher returns compared to the US and Europe where interest rates are still low.

The key for the success of these bonds will be a stable exchange rate. If the masala bonds take off it could lower India's cost of capital over a period of time. Inflows from these financial instruments could also support the rupee. It is seen as a small incremental step towards internationalisation of rupee and full rupee convertibility. Masala bonds are a step to help internationalise the Indian rupee and also deepen the Indian financial system. IFC's 5-year green Masala bond is listed on the London Stock Exchange. Similar offerings from other countries have also been after the food or culture of that country like "dim sum" label for Chinese offshore issues or "Samurai" bonds for Japanese offshore issues.

Before masala bonds, corporates have had to rely on avenues such as external commercial borrowings or ECBs. The challenge with the likes of ECBs is the entity raising money is faced with a currency risk - they have to be raised and repaid in dollar terms.

The Reserve Bank of India has issued guidelines allowing Indian companies, non-banking finance companies (HDFC, India Bulls Housing Finance are examples of such companies) and infrastructure investment trusts and real investment trusts (investment vehicles that pool money from various investors and invest in infrastructure and real estate sectors) to issue rupee-denominated bond overseas.

Zero Base Budgeting

Tenth Plan Approach Paper says that ZBB will be followed for rationalization of expenditure. The ZBB methodology was taken up first in 1987 in the Union Budget and was recommended for the Government departments and PSUs. Many state governments also applied it, for example, Government of Rajasthan and Maharashtra .The Maharashtra Government renamed it ` Development –based budget'

Under the ZBB, a close and critical examination is made of the existing government programmes, projects and other activities to ensure that funds are made available to high priority items by eliminating outdated programmes and reducing funds to the low priority items. Governmental programmes and projects are appraised every year as if they are new and funding for the existing items is not continued merely because a part of the project cost has already been incurred. Programmes are discarded if the cost-benefit ratio is below the prescribed norms.

The objective of the ZBB is to overhaul the functioning of the government departments and PSUs so that productivity can be increased and wastage can be minimised. Scarce government resources can be deployed efficiently. ZBB as a resource planning and control technique and process yielded substantial benefits in the advanced countries like New Zealand, UK, Australia and Sweden in terms of efficiency gains, better resource use, lower costs and finally surplus budgets, particularly in New Zealand. However, the use of ZBB to human development programmes and poverty alleviation and employment generation programmes is limited and the results are cumulative and can not be assessed annually.

The Economic Survey 2014 says that the expenditure on social schemes needs to be rationalised. 'What is needed is a 'zero budgeting' approach with a revamp, reorganization, and convergence of schemes.' Zero-based budgeting runs contrary to traditional budgeting where the previous year's budget is taken as a base. It re-evaluates the entire budget

WMAs

Prior to 1997, the RBI lent to central government against ad hoc Treasury bills, (since mid-50's) This provision for extending short-term financing was created to bridge temporary mismatches in receipts and payments. However, the central government slipped into the practice of rolling over this facility, resulting in automatic monetisation of the government's deficit. Automaticity refers to RBI having to print money if the Government's cash balances with the RBI went below a threshold fixed. It had no choice but to create currency and lend to the Government of India. The process of creating 91-day bills and subsequently funding them into non-marketable special securities at a very low interest rate (4.6%) emerged as a principal source of borrowing. It was thought to be irrational for the reasons that the interest rate is not market driven and was very concessional. Nor did the RBI have any voice in deterring the same. Nor was there a limit to how much could be printed in this way.

In the case of state governments, the RBI provides two types of WMAs. Normal WMAs are clean or unsecured advances extended at the bank rate(marginal standing facility), while special WMAs are extended against the government securities. The latter is exhausted first and then the former may be sought to a limited extent. If the state government borrows over and above the WMA allowed for it by the RBI, it is called overdraft and there is a limit to that too set by the RBI.

Adhoc Treasury Bills and WMA

Union Government replaced adhoc treasury bills with WMAs in 1997. WMAs given by RBI to GOI do not require any collateral. Its amount is limited and arrived at the beginning of the fiscal year through consultation between Government and the RBI. There are penal interest rates if the pre-agreed amount is violated. Ways and Means Advances are made at the Repo Rate. Overdraft is charged penally at two percent above the repo rate

Replacement of the adhoc bills with WMA represents an advance in fiscal discipline and harmonization of the fiscal and monetary policies as the RBI is consulted in Governmental short term borrowing and the `automaticity' is dropped in the creation of currency by the RBI to fund governmental expenditure.

Some Words

Fiscal Drag

A situation where inflation pushes income into higher tax brackets- bracket creep. The result is increase in income taxes but no increase in real purchasing power. This is a problem during periods of high inflation. Government gains due to higher tax collections and the economy suffers as growth is dragged down due to less demand. In high-growth and high inflation economies ('overheated'), fiscal drag acts as an automatic stabiliser, as it acts naturally to keep demand stable. *More in the Classroom*

Fiscal Neutrality

When the net effect of taxation and public spending is neutral: neither stimulating nor dampening demand.

Crowding Out

Excessive government borrowing can lead to shrinkage of the liquidity in the market; forces the interest rates to go up; private investment is crowed out for two reasons: liquidity availability is less and the rates are high. Investment suffers and growth decelerates. The Government also may not spend the borrowed resources well to generate returns. It may spend on populist schemes. However, if the government deploys the funds well, it may have a 'crowding in' effect: the infrastructure built can have a multiplier effect on investment, jobs, tax collections and growth. For example, Bharatmala that was announced in October 2017.

Pump-Priming

Deficit financing and spending by a government on public works in an attempt to revive economy during recession – countercyclical measures. It can raise the purchasing power of the people and thus stimulate and revive economic activity to the point that deficit spending will no longer be considered necessary to maintain the desired economic activity.

Small Savings

Small savings instruments are Post Office Monthly Income Schemes and Time Deposits; National Savings Scheme; Indira Vikas Patra; Kisan Vikas Patra; Public Provident Fund and so on. They are aimed at promoting safe and long-term savings by individuals. They are called small savings because the amount saved is relatively small. They are initiated by the central Government but mobilized by the State Governments; and are deposited with and managed by the central government. As a reward State Governments receive all such savings as loan.

Small savings are a sizeable portion of the financial savings of the country. They contribute to the finances of the Government- federal and State- that is, they are an important source of borrowing for the government. These schemes have a built in tax concession that enhances their attraction for the small savers. They also earn a rate of interest that is higher in comparison to what the banks offer. They are meant to be savings by low income and other groups but are open to all.

Small savings instruments in India are retailed through 1.53 lakh post offices of which about 1.29 lakh are in rural areas.

The National Small Savings Fund (NSSF), in the Public Account of India has all the small savings. Money in the Fund is invested in Central and State Government Securities. The investment pattern is as per norms decided from time to time by the Government of India.

The Fund is administered by the Government of India, Ministry of Finance (Department of Economic Affairs) under National Small Savings Fund (Custody and Investment) Rules, 2001, framed by the President under Article 283(1) of the Constitution.

2017

The government in 2017 exempted all but four States from mandatory investment norms for the National Small Savings Fund (NSSF). It means that all other states except the four are not on-lent the savings mobilized. They have other ways of raising loans, presumably at cheaper rates. But the centre needs to keep up with these schemes to promote savings and offer attractive rates to senior citizens and such other needy.

It will help the Centre lower its dependence on market borrowings through the RBI, it will also help keep the fiscal deficit in check though only in statistical terms. Public Account of India where the NSSF is placed is outside the budgetary approvals from Parliament. However, repayment of the principal and interest will be from the Union Budget. Economists said the Centre could provide other public sector units a dispensation similar to the one given to the FCI.

Public Goods, Merit Goods And Demerit Goods

Public goods are those goods whose consumption by some does not diminish them for others. That is, they are non-rivalrous. Common examples include law and order, parks, street-lighting, defence etc. They are goods meant for the entire public. Merit goods are goods like education, health care etc. that are important for the society as a whole- that is, they have positive externalities. Market may not supply them in adequate quantities. Government supplements the market. Demerit goods are those whose consumption should be discouraged. They have negative externalities. Examples include: tobacco, alcohol etc. Thirteenth Finance Commission calls them sin goods and wants them to be harshly taxed.

Giffen Goods

They include goods whose demand goes up when the price increases. They are the status markers and exclusivist in nature.

Twin Deficits

Budget deficit (fiscal deficit) and current account deficit-the former fuelling the latter as the borrowings increase are known as twin deficits. USA is a prime example. So is India!!!!
(Recent developments in the classroom)

'Fiscal Cliff'

A combination of expiring tax cuts and across-the-board government spending cuts that were scheduled to become effective Dec. 31, 2012. The idea behind the fiscal cliff was that if the federal government allowed these two events to proceed as planned, they would have a detrimental effect on an already weak economy, perhaps sending it back into an official recession as it cut government spending and investment, collected more taxes which cut down both consumption and investment, increased unemployment rates and undermined consumer and investor confidence.

SRIRAM'S IAS

MONETARY AND CREDIT POLICY

Definitions:

- The strategy of influencing movements of the money supply and interest rates to affect output and inflation
- The actions of a central bank that determine the size and rate of growth of the money supply, which in turn affects interest rates.
- A macroeconomic policy tool used to influence interest rates, inflation, and credit availability through changes in the supply of money available in the economy
- An attempt to achieve broad economic goals by the regulation of the supply of money
- The regulation of the money supply and interest rates by a central bank in order to control inflation and stabilise currency
- Monetary policy is the process of managing a nation's money supply to achieve specific goals—such as constraining inflation, achieving full employment etc.
- Monetary policy is made by the central bank to manage money supply to achieve specific goals—such as constraining inflation, maintaining an appropriate exchange rate, generating jobs and economic growth. Monetary policy involves changing interest rates, either directly or indirectly through open market operations, setting reserve requirements, or trading in foreign exchange markets.

Monetary Policy

The use by the Central Bank of interest rate and other instruments to influence money supply to achieve certain macro economic goals is known as monetary policy. Credit policy is a part of monetary policy as it deals with how much and at what rate credit is advanced by the banks. Objectives of monetary policy are:

- accelerating growth of economy
- price stability
- exchange rate stabilization
- balancing savings and investment
- Generating employment and

Monetary policy can be expansionary or contractionary: expansionary policy increases the total supply of money in the economy, for example, in 2008-09 all over the world including India, to beat recession/slowdown; and a contractionary policy decreases the total money supply by tightening credit conditions. Expansionary policy is traditionally used to combat unemployment in a recession by lowering interest rates, while contractionary policy has the goal of raising interest rates to control inflation.

Historically, Monetary Policy was announced twice a year - a slack season policy (April-September) and a busy season policy (October-March) in accordance with agricultural cycles. However, since monetary Policy has become dynamic in nature, RBI reserved its right to alter it from time to time, depending on the state of the economy. Reserve Bank of India decided to announce Bi-monthly Monetary Policy Statements- once every two months- from April 1, 2014. This statement is in keeping with the recommendation of the Urjit Patel Committee.

The tools available for the central bank to achieve the monetary policy ends are the following

- Bank rate
- Reserve ratios
- Open market operations
- Intervention in the forex market and
- Moral suasion

Bank Rate

Bank Rate is the rate at which RBI lends long term to commercial banks. Bank Rate is a tool which RBI uses for managing money supply. Any revision in Bank Rate by RBI is a signal to banks to revise deposit rates as well as prime lending rate (PLR is the rate at which banks lend to the best customers. It is not in use any more.)

Since beginning of the last decade, bank rate is in a limbo. It has no effective use. It is a penal rate. In 2011, the bank rate was aligned with the newly introduced marginal standing facility. Today it stands at 6.5% (2017).Bank Rate is aligned with Marginal Standing Facility (MSF) rate, which, in turn, is linked to the policy repo rate. Alignment was because the MSF is also a penal rate. (Read ahead).

Earlier, bank rate was the policy rate. Bank rate has been replaced with repo rate as the policy rate for many years now. The Bank Rate today acts as the penal rate charged on banks for shortfalls in meeting their reserve requirements (cash reserve ratio and statutory liquidity ratio). Read ahead.

Ready Forward Contracts (Repos)

It is a transaction in which two parties agree to sell and repurchase the same security. Under such an agreement the seller sells specified securities with an agreement to repurchase the same at a mutually decided future date and a price. Similarly, the buyer purchases the securities with an agreement to resell the same to the seller on an agreed date in future at a predetermined price.

In India, RBI lends on a short term basis to banks on the security of the government bonds (repo). Banks undertake to repurchase the security at a later date- over night or few days. RBI charges a repo rate for the money it lends. It is 6.25 % presently (2017)

Reverse repo is when RBI borrows from the market (absorbs excess liquidity) on the basis of securities and repurchases them the next day or after a few days. The rate at which it borrows is called reverse repo rate as it is the reverse of the repo operation. Reverse repo rate 25 basis points (0.25%) below the repo rate- 6% (2017)

The Repo/Reverse Repo transaction can only be done in securities as approved by RBI (Treasury Bills, Central/State Govt. securities). RBI uses Repo and Reverse repo as instruments for liquidity adjustment in the system.

Repo rate is known as policy rate and is used as signal to the financial system to adjust their lending and borrowing operations.

MSF

In 2011, RBI introduced the Marginal Standing Facility as a window through which the commercial banks can borrow from the RBI at a rate that is more than the repo rate. It is meant to ease liquidity in the market. Banks can use the repo route for the securities that they hold over and above the mandatory SLR level- 19.5% of bank deposits. If the banks do not have securities over and above the SLR requirement for any reason, MSF is open to them. They can use securities below the stipulated SLR. MSF is open to the banks that want to borrow from the RBI even if the credit is costlier. However, there are limits to how much can be borrowed from the MSF window. The aim is to ease liquidity.

MSF is the penal rate- because the SLR limit is breached. Bank rate is also a penal rate- for breaching the SLR and CRR limits. Therefore, there is a need to bring the bank rate on par with the MSF as was done by the RBI in 2011-12. Both stand at 6.25% today (2017).

MSF window also has become necessary because the repo operations are limited to a specific period during the day. Banks have securities in excess of the SLR requirement as is a safe investment and also repo window opens. Only Scheduled Commercial banks use this route. They use the *collateral of* government securities *including* SLR. (Read above)

LAF

Liquidity Adjustment Facility (LAF) was introduced by RBI in 2000. Funds under LAF are used by the banks for their day-to-day mismatches in liquidity. LAF covers credit at repo and reverse repo rates. *Under LAF, Minimum credit limits are* Rs. 5 crore. It has uses for Banks, NBFCs, DBs (Development banks) and government. That is, all the clients of RBI. Money is lent by the RBI at Repo rate. *Collateral used includes* all the government securities.

Reserve Requirements

In economics, fractional-reserve banking is the near-universal practice of banks in which banks keep a fraction of the total deposits managed by a bank as reserves that are not to be lent. The reserve ratios are periodically changed by the RBI. The reserve requirement is a bank regulation, that sets the minimum reserves each bank must hold as a part of the deposits. These reserves are designed to satisfy various needs like providing loans to the Government), safety of banking operations, regulation of liquidity, management of interest rates, checking speculation and inflation management(CRR).They are in the form of RBI approved securities (SLR) kept with themselves or cash that is kept with the RBI (CRR).

Statutory Liquidity Ratio (SLR)

It is the portion of time (fixed deposits) and demand liabilities(savings bank and current accounts) of banks that they should keep in the form of designated liquid assets like government securities and other RBI-approved securities like public sector bonds ; current account balances with other banks and gold .SLR aims at ensuring that the need for government funds is partly but surely met by the banks. SLR was progressively brought down from 38.5% in 1991 to 19.5% (2017).

The main objectives for maintaining the SLR ratio are the following:

- to control the expansion of bank credit. By changing the level of SLR, the Reserve Bank of India can increase or decrease bank credit expansion.
- to ensure the solvency of commercial banks.
- to make the commercial banks to invest in government securities like government bonds so that government has adequate financial resources for its commitments

SLR is a blunt instrument and was unchanged for more than a decade and half till the Lehman-induced global financial and economic crisis of 2008.

Banking Regulation Act, 1949 fixed the floor and cap on SLR at 25% and 40% respectively. But the amendment made in the statute in 2007 removed the lower limit but retained the cap at 40%. RBI has, as a result, the freedom to reduce the SLR to any rate depending on the macro economic conditions. The amendment was an enabling one. SLR is governed by the provisions of Section 24 of the Banking Regulation Act.

CRR

CRR is liquidity management and a monetary tool to regulate money supply. It is the portion of the bank deposits that a bank should keep with the RBI in cash form. CRR deposits earn no interest. The Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949 fixed the floor and cap on CRR at 3% and 20% respectively. But the amendment made in these statutes in 2007 removed the limits-lower and upper. RBI has, as a result, greater operational flexibility to make its monetary adjustments. CRR is adjusted to manage liquidity and inflation. The more the CRR, the less the money available for lending by the banks to players in the economy. CRR was 15% in 1991 and today it is 4% (2017). If inflation is high, money supply needs to be taken out and so CRR is generally increased. But in a regime of moderate inflation, low CRR is in place. CRR is governed by the provisions of Section 42 of the Reserve Bank of India Act, 1934.

RBI uses CRR either to drain excess liquidity or to release funds needed for the growth of the economy from time to time. Increase in CRR means that banks have less funds available and money is sucked out of circulation. Thus it serves two purposes is a portion of bank deposits is kept with RBI and is totally risk-free enables RBI to control liquidity in the system, and thereby, inflation. RBI increases CRR to tighten credit and lowers CRR to expand credit. During the downturn after the global Great Recession 2008 October onwards, CRR was reduced but as growth and inflation returned since 2009, CRR was gradually increased.

CRR as a tool of monetary policy is used when there is a relatively serious need to manage credit and inflation. Otherwise, normally, RBI relies on signaling its intent through the policy rates of repo and reverse repo. Based on these rates, RBI conducts open market operations for liquidity management.

Incremental CRR

In a circular to banks, the RBI said that on the increase in deposits between September 16 and November 11, scheduled banks will have to maintain incremental CRR of 100%. This measure is intended to absorb a part of the surplus liquidity arising from the return of the demonetised ₹500 and ₹1,000 bank notes. RBI observed that with the demonetisation decision, there was a surge in deposits relative to the expansion in bank credit, leading to large excess liquidity in the system.

It assessed that the magnitude of surplus liquidity available with the banking system was expected to increase further in the weeks to come. In view of this, RBI decided to absorb this surplus liquidity by applying an incremental CRR as a purely temporary measure. The process of putting in place other liquidity absorption measures like issuance of Market Stabilization Scheme (MSS) bonds was taking time and in the meantime the incremental CRR hike was an interim measure. It also aimed at signaling RBI's apprehension that interest rates could fall sharply with such unprecedented excess of liquidity.

Banks raise deposits to lend and make profitBut in the case of remonetisation deposits, they will be allowed to be withdrawn after some time- months or weeks and if the bajkks don't have the money having lent all, there will be a crisis. The deposits that came into the banking system as a result of the demonetization were not voluntary but forced. They were not savings but only to get remonetized. Thus, their nature is different. They were not to be lent and therefore had to taken out of the system. That explains the 100% CRR on these deposits within a certain period. That is why it is called incremental CRR and not CRR. CRR continued to be 4%.

SLR vs CRR

Both Cash Reserve Ratio (CRR) and SLR are instruments in the hands of RBI to regulate money supply in the markets. Both manage liquidity. But they are used for different purposes. CRR has a short and medium term relevance while SLR is a long term tool. SLR enables banks to earn money while CRR part does not earn any interest.CRR is maintained in cash form with central bank, whereas SLR is money held as govt. securities and kept with the banks themselves.

Open Market Operations of RBI

OMOs of the RBI can be described as outright purchase and sale of government securities in the open market (open market essentially means banks and financial institutions) by the RBI in order to influence the volume of money and credit in the economy. Purchase of government securities injects money into the market and thus expands credit; sales have the opposite effect- absorb excess liquidity and shrink credit. Open market operations are RBI's most important and flexible monetary policy tool. Open market operations do not change the total stock of government securities but change the proportion held by the RBI, commercial and cooperative banks.

There are two methods that the RBI uses to control the money supply in the economy-

- Qualitative Method
- Quantitative Method- through reserve requirements and ratios

Qualitative Method

By *Quality* we mean the uses to which bank credit is directed.

For example- the Bank may feel that speculators or the big industrialists are getting a disproportionately large share in the total credit, causing various disturbances and inequality in the economy, while the small-scale industries, consumer goods industries and agriculture are starved of credit. Correcting this type of discrepancy is a matter of Qualitative Credit Control.

Because it does not reduce the total quantum of credit available to the market but changes the quantum of what is available to a particular sector.

Qualitative Method controls the manner of channelizing of cash and credit in the economy. It is a 'selective method' of control as it restricts credit for certain section and may expand for the others known as the 'priority sector' depending on the situation.

Tools used under this method are-

Margin Requirement
Lending to a select sector may be accompanied by having to set aside a certain percentage of money for safety. When banks have to keep aside some money (margin) whenever they lend to the specified sectors, it hurts them with blocked funds. Thus, the credit flow to such sectors comes down as intended. In case the flow of credit has to be increased, the margin requirement will be lowered.

Rationing of Credit
Under this method there is a maximum limit to loans and advances that can be made, to a particular sector which the commercial banks cannot exceed. RBI fixes ceiling for specific categories. Such rationing is used for situations when credit flow is to be checked, particularly for speculative activities.

Both these tools make up selective credit controls(SCCs) that can be imposed for meeting various goals like discouraging hoarding and black-marketing of certain essential commodities by traders etc by giving them less credit. In SCCs, the total quantum of credit does not change, but the amount lent and the cost of credit may be changed for specific sector or sectors.

Controlling credit in the Economy is amongst the most important functions of the Reserve Bank of India. The basic and important needs of Credit Control in the economy are-

- To encourage the overall growth of the *"priority sector"* like agriculture etc
- To keep a check over the channelization of credit so that credit is not delivered for undesirable purposes.
- To achieve the objective of controlling "Inflation" as well as "Deflation".
- To boost the economy by facilitating the flow of adequate volume of bank credit to different sectors to develop the economy.

Moral Suasion

A persuasion measure used by Central bank to influence and pressure, but not force, banks into adhering to policy. Measures used are closed-door meetings with bank directors, increased severity of inspections, discussions, appeals to community spirit etc.

Recently the RBI Governor appealed to banks not to raise rates even though the central bank was following a tight money policy.

MCLR And Base Rate

Passing on the rate changes made by the MPC is crucial for growth, equity, inflation management etc. It is called monetary policy transmission. The experience with the Marginal Cost of Funds Based Lending Rate (MCLR) system introduced in 2016 for improving the monetary transmission has not been entirely satisfactory, even though it has been an advance over the Base Rate system that was introduced in 2011. An internal Study Group has been constituted by the Reserve Bank of India (RBI) to study the various aspects of the MCLR system from the perspective of improving the monetary transmission and exploring linking of the bank lending rates directly to market determined benchmarks. The Group will submit the report by September end 2017.

MCLR is based on current cost of funds rather than overall cost of funds which was used to calculate based rate. This will ensure quicker transmission of RBI rate cuts to borrowers.

Market Stabilization Bonds

For normal liquidity management, there are open market operations of the RBI when the RBI sells and buys G-secs as the market conditions demand. But when the need to absorb huge amounts of cash arises for example post-demonetisation in 2016, normal OMOs do not work. Similar has been the condition since 2004 when India started attracting foreign currency inflows of unprecedented magniture. In 2004, RBI floated Government securities, as a part of the Market Stabilization Scheme, to absorb excess liquidity from the market. When RBI started buying US dollars with freshly minted rupee it led to over-supply of the domestic currency raising inflationary fears. MSS was introduced to mop up this excess liquidity. The excess liquidity is the result of RBI buying dollars from the market. MSS is a sterilization effort of the central bank. The normally available government securities are not enough for the RBI to suck out the huge rupee supply (printed money) that was caused for buying dollar. Therefore, the MSS was started.

There are limits to MSS. The limits were raised to absorb the post-demonetisation deposits. The raising took time and in the meantime the incremental CRR was brought in at 100% of incremental deposits as detailed above.

Interest Rates And Their Significance

Interest rates are the rates offered to money that is deposited in the banks; rates offered for investment in bonds; rates at which money is borrowed from banks and financial institutions etc.

Savers want higher interest rate while investors want the cost of credit to be low. There has to be a balance. The determinants of interest rates are:

- Inflation- the higher the inflation, the higher the interest rates because the same money invested in commodities and other assets should not fetch more, because of the inflation. Savers need to be ttracted which is possible only when their money neutralizes inflation.
- Need for growth :lower interest rates reduce cost of credit and facilitate investment for growth
- Promotion of savings
- Government's need to borrow: the magnitude of government's borrowing programme also determines interest rates. The more the borrowing, the higher the interest rates.

- Need to generate demand :as interest rates come down, consumer demand for credit goes up and there will be a stimulus for growth
- Global trends as we need to retain foreign funds. For example, interest rates on NRI deposits are kept high to attract their dollar deposits under the FCNR (B).

Deregulation of Interest Rates

As a part of banking sector reforms, interest rates have been deregulated. The rationale is that banks can adjust rates quickly according to market conditions; financial innovations should be facilitated; competitive rates can be good for savers and investors; global alignment is possible more dynamically; etc. RBI however, uses repo rates and CRR adjustments to influence interest rates.

Floating and Flexible Rates of Interest

There are two types of interest rate- fixed and floating. If they are offered together (when they co-exist), it is called flexible interest rate regime. Floating interest rates are linked to an underlying benchmark rate. In other words, the interest rate offered 'floats' in relation to the interest rate of a government security instrument of similar maturity (5 years or 10 years maturity etc) as determined by the market. That is, floating rates of interest are basically market driven rather than 'fixed'. The effective rate is adjusted on a quarterly or semi-annually or annually.

Inflation Targeting

Under this policy approach the target is to keep inflation in a particular range or at a particular level. Government and the RBI agree on convergence between the fiscal and the monetary policies to achieve the common goal. RBI is given autonomy to manage inflation while the government agrees to have a fiscal policy that will contribute to price stability- for example, not borrow excessively etc. India does not follow it.

This monetary policy approach was pioneered in New Zealand. It is currently used in the Eurozone, Australia, Canada, New Zealand, Sweden, South Africa, Norway and the United Kingdom. (See Chapter on I

Urjit Patel Committee 2014

An expert committee appointed to examine the current monetary policy framework of the Reserve Bank of India (RBI) in early 2014 suggested that the apex bank should adopt the new CPI (consumer price index) as the measure of the nominal anchor for policy communication. That is, the policy should centre around the new CPI and not any other index like WPI etc.

The expert committee was headed by Urjit R. Patel, Deputy Governor of the Reserve Bank of India. Recommendations are:

- The target for inflation should be set at 4 per cent with a band of +/- 2 per cent around it.
- The nominal anchor should be defined in terms of headline CPI inflation, which closely reflects the cost of living and influences inflation expectations relative to other available metrics. This target should be set in the frame of a two-year horizon.

- The committee asked the Central Government to ensure that the fiscal deficit as a ratio to GDP (gross domestic product) is brought down to 3.0 per cent by 2016-17. "Administered setting of prices, wages and interest rates are significant impediments to monetary policy transmission and achievement of the price stability objective and so these required a commitment from the government towards their elimination.
- The Patel panel felt that the monetary policy decision-making should be vested with a monetary policy committee (MPC). It went on to recommend that the Governor of the RBI should be the Chairman of the MPC.

While Urjit Patel committee said that RBI should fix inflation target, Central government believes that it should specify 'inflation targets' for the Reserve Bank of India (RBI) to achieve. The reason is that t is best that inflation targets are set by the governments elected by the people.

Indian Financial Code (IFC), MPC and Inflation Targeting

The Financial Sector Legislative Reforms Commission was constituted in 2011. The commission was set up since it was felt there was a need to review the legal and institutional structures of the financial sector in India and recast these in tune with contemporary requirements. The commission gave its first report in 2013 containing an analysis of the current regulatory architecture and a draft Indian Financial Code to replace the bulk of the existing financial laws. IFC proposes changes in the way monetary policy is made and public debt is managed etc. Indian Financial Code (IFC) suggested an MPC to take rate decisions by a majority vote.

Under the pre-MPC set-up, the government appointed RBI Governor, who controlled the monetary policy and had veto power over the existing advisory committee of RBI members and outside appointees that sets rates. The final policy is usually a consensus arrived at by the governor, the Deputy Governor in-charge of monetary policy and the Executive Director In-charge of monetary policy. But ultimately the responsibility is the governor's.

There are three advantages of taking the decision of monetary policy formulation away from the Governor and giving it to a committee. First, a committee can represent different viewpoints and studies show that its decisions are typically better than an individual's. Second, spreading the responsibility for the decision can reduce the internal and external pressure that falls on an individual. Third, a committee will ensure broad monetary policy continuity when any single member including the governor changes.

It leads to institutionalising the process of monetary policy formulation which is vital given that the government has given the RBI a clear inflation objective.

Reserve Bank of India

The central bank of the country is the Reserve Bank of India (RBI). The Reserve Bank of India Act, 1934 came into effect in 1935. The Act provides the Statutory basis of the functioning of the bank.It was established with a share capital of Rs. 5 crores on the basis of the recommendations of the Hilton Young Commission. The share capital was entirely owned by private shareholders in the beginning. The Government held shares of nominal value of Rs.2,20,000.

Reserve Bank of India was nationalised in the year 1949. The general superintendence and direction of the Bank is entrusted to Central Board of Directors of 20 members, the Governor and four Deputy Governors, one Government official from the Ministry of Finance, ten nominated Directors by the Government to give representation to important elements in the economic life of the country, and four nominated Directors by the Central Government to represent the four local Boards with the headquarters at Mumbai, Kolkata, Chennai and New Delhi.

RBI

Functions

The Reserve Bank of India Act of 1934 entrusts all the important functions of a central bank to the reserve bank of India.

Bank of Issue

Under Section 22 of the Reserve Bank of India Act, the Bank has the sole right to issue bank notes of all denominations. The distribution of one rupee notes and coins and small coins all over the country is undertaken by the Reserve Bank as agent of the Government. The Reserve Bank has a separate Issue Department which is entrusted with the issue of currency notes.

RBI should maintain gold & foreign exchange reserves of Rs. 200 cr, of which Rs. 115 cr. should be in gold. This is a technical criterion. In reality, in a growing globalized economy like ours, as foreign currency inflows take place, the RBI will acquire them by printing more rupee thus adding to the rupee stock and the money supply keeping the demand for money satisfied in the economy for the given macroeconomic goals. The only restriction on RBI is the systemic one; it should not create instability with too much or too less of money supply. Money supply should have a correspondence to the goods in the economy and the rates of growth.

Banker to Government

The second important function of the Reserve Bank of India is to act as Government banker, agent and adviser. The Reserve Bank is agent of Central Government and of all State Governments in India. The Reserve Bank has the obligation to transact Government business, to receive and to make payments on behalf of the Government and to carry out their other banking operations. The Reserve Bank of India helps the Government - both the Union and the States to raise loans. The Bank makes ways and means advances to the Governments. It acts as adviser to the Government on all monetary and banking matters.

Banker's Bank And Lender of The Last Resort.

The Reserve Bank of India Acts As The Bankers' Bank

The scheduled banks can borrow from the Reserve Bank of India on the basis of eligible securities by rediscounting bills of exchange. CRR deposits of banks are kept with the RBI. Since commercial banks can always expect the Reserve Bank of India to come to their help in times of banking crises, the Reserve Bank is the lender of the last resort.

Controller of Credit

The Reserve Bank of India is the controller of credit i.e. it has the power to influence the volume of credit created by banks in India. It can do so through the variety of instruments available to it like reserve requirements etc (see above). According to the Banking Regulation Act of 1949, the Reserve Bank of India can ask any particular bank or the whole banking system not to lend to particular groups or persons. All its monetary policies are aimed at this function directly or indirectly.

Agent and Adviser of The Government

The RBI acts, as the financial agent and adviser to the Government. It renders the following functions:

a) As an agent to the Government, it accepts loans and manages public debts on behalf of the Government.

b) It issues Government bonds, treasury bills, etc.

c) Acts as the financial adviser to the Government in all important economic and financial matters.

Debt Management Office (DMO)

Public Debt Management Agency (PDMA) is a specialized independent agency that manages the internal and external liabilities of the Central Government and renders advice. PDMA manages the issue and trading of Government securities and undertakes cash management for the government.

PDMA is considered to be set up with the objective of "minimising the cost of raising and servicing public debt over the long-term within an acceptable level of risk at all times, under the general superintendence of the central government". This will include managing the public debt and related activities.

As of now, RBI manages the market borrowing programmes of Central and State Governments. External debt is managed by the GOI DEA (Department of Economic Affairs), Ministry of Finance, Government of India along with Reserve Bank of India, monitors and regulates ECB guidelines and policies. Establishing a debt management office would consolidate all debt management functions in a single agency and bring in holistic management of the internal and external liabilities.

It is considered as an internationally accepted best practice that debt management should be disaggregated from monetary policy, and taken out of the realm of the central bank. Most advanced economies have dedicated debt management offices. Several emerging economies, including Brazil, Argentina, Colombia, and South Africa, have restructured debt management in recent years and created an independent agency for the same.

There is a conflict of interest between setting the short term interest rate (i.e. the task of monetary policy) and selling bonds for the government. RBI has to manage inflation for which the rates have to be kept high when the prices are high. But being a debt manager, it has to borrow at lower rates of interest for the GOI.

Where the Central Bank also regulates banks, as in India, there is a further conflict of interest. If the Central Bank tries to do a good job of discharging its responsibility of selling bonds, it has an incentive to mandate that banks hold a large amount of government paper. This bias leads to flawed banking regulation and supervision, so as to induce banks to buy government bonds, particularly long-dated government bonds. Having a pool of captive buyers undermines the growth of a deep, liquid market in government securities, with vibrant trading and speculative price discovery. This, in turn, hampers the development of the corporate bond market - the absence of a benchmark sovereign yield curve makes it difficult to price corporate bonds.

Ministry of Finance formed an Internal Working Group, Chaired by Shri. Jahangir Aziz, to analyse how best to move forward on establishing a DMO. Report of the Internal Working Group on Debt

Management (2008), suggested creating a "National Treasury Management Agency (NTMA)" as an independent public debt management office.

Dr Raghuram Rajan chaired Committee on Financial Sector Reforms (2009) constituted by the Planning Commission pointed out that internationally, there has been a strong movement towards establishing independent debt management offices (DMOs) which is now considered as the best practice, and favoured it.

Justice B. N. Srikrishna chaired FSLRC or Financial Sector Legislative Reforms Commission report (2013) also recommended setting up the independent "Public Debt Management Agency (PDMA) at the earliest.

The Constitution of India gives the executive branch of the Government t powers to borrow upon the security of the Consolidated Fund of India. Reserve Bank as an agent of the Government (both Union and the States) implements the borrowing program. The Reserve Bank draws the necessary statutory powers for debt management from the Reserve Bank of India Act, 1934. While the management of Union/Central Government's public debt is an obligation for the Reserve Bank, the Reserve Bank undertakes the management of the public debts of the various State Governments by agreement. The debt management functions comprise of formulation of a calendar for primary issuance, deciding the desired maturity profile of the debt, size and timing of issuance, designing the instruments and methods of raising resources, etc. taking into account government's needs, market conditions, and preferences of various segments while ensuring that the entire strategy is consistent with the overall macro-economic policy objectives.

The Indian central bank has countered this by saying that in countries such as India, given the large size of the government borrowing programme, the sovereign debt management is much more than merely an exercise in resource-raising, as it could impact interest rates which, in turn, could have wider public policy implications.Other arguments which have been put forward by those backing the RBI are that the size and dynamics of government borrowing programmes have a much wider influence on interest rate movements, systemic liquidity and even loan growth through the crowding out of private sector loan demand.Management of public debt, therefore, has necessarily to be seen as part of broader macroeconomic management framework involving various trade-offs. According to them, once this is recognised, the centrality of central banks in this regard becomes quite evident and that only central banks have the requisite market pulse and instruments which an independent debt agency, driven by narrow objectives, will not be able to do.

The concern which has been flagged off is that if debt management is moved away from the RBI to DMO, which could function as an extended arm of the ministry of finance, the possibility of conflict of interest is greater as the government is the owner of the majority of banks in India.This conflict of interest is more potent in the backdrop of banking sector continuing to be the dominant player for government market borrowing, with banks holding over 50% of outstanding government securities. As an interim arrangement for a full-fledged agency for managing public debt to be called as Public Debt Management Agency (PDMA), the government in 2016 set up Public Debt Management Cell (PDMC) at RBIs Delhi office.

RBI as National Clearing House

In India RBI acts as the clearing house for settlement of banking transactions. This function of clearing house enables the other banks to settle their interbank claims easily. Further it facilitates the settlement economically. It essentially means the inter-bank cheque clearing settlement.

RBI as Lender of Last resort

The RBI acts as a lender of last resort or emergency fund provider to member banks. If the commercial banks are not able to get financial assistance from any other sources, then as a last resort, they can approach the RBI for the necessary financial assistance. In such situations, the RBI provides credit facilities to the commercial banks on eligible securities including genuine trade bills which are usually made available at repo Rate/MSF. This facility comes into operation when the bank is struggling to survive and there are no sources of credit available because of its weakness.

Custodian of Foreign Reserves

The Reserve Bank of India has the responsibility to act as the custodian of India's reserve of international currencies. It takes up operations in the forex market to stabilize the exchange rate of rupee and ensure that there is no speculation and there is order. To be able to do so effectively, it holds forex reserves which it acquires from the market (purchases). It has about $400 b of forex reserves (2017 November) which includes foreign currency assets, gold and IMF's SDRs. SDRs are increasing in importance since 2008 when dollar stability came under question. Diversification and hedging of risk is being done by all central banks. Even though rupee exchange rate is market driven, RBI watches the movement to ensure order and normalcy and there is no volatility. Thus, it maintains exchange rate oversight. It has many levers which we will discuss in the chapter ahead on BOP.

Supervisory Functions

The Reserve Bank Act, 1934, and the Banking Regulation Act, 1949 have given the RBI wide powers of supervision and control over commercial and co-operative banks, relating to licensing and establishments, branch expansion, setting reserve ratios etc. They are:

- Granting license to banks.
- Inspect and make enquiry or determine position in respect of matters under various sections of RBI and Banking Regulation Act.
- Implementation of Deposit Insurance Scheme.
- Periodical review of the work of commercial banks.
- Giving directives to commercial banks.
- Control the non- banking finance corporations.
- Ensuring the health of financial system through on-site and off-site verifications
- Banking Regulation (Amendment) Act 2017 enables the GOI to authorise the RBI to issue directions to banks to initiate insolvency resolution process to recover bad loans.

Promotional Functions

Since Independence, the range of the Reserve Bank's functions has steadily widened. The Bank now performs a variety of developmental and promotional functions. The Reserve Bank promotes banking habit, extend banking facilities to rural and semi-urban areas, and establish and promote new specialised financing agencies. Accordingly, the Reserve Bank helped in the setting up of the IFCI and the SFC; the Industrial Development Bank of India in 1964, the Agricultural Refinance

Corporation of India in 1963 and the Industrial Reconstruction Corporation of India in 1972. These institutions were set up directly or indirectly by the Reserve Bank to promote savings, and to provide industrial finance as well as agricultural finance. NABARD was set up in 1982. It has an important role in facilitating microfinance for financial inclusion. Further, its innovations include banking correspondent model for rural banking.

Functions of Central Bank, In Sum

- monopoly on the issue of banknotes
- the Government's banker
- bankers' bank
- Lender of Last Resort
- manages the country's foreign exchange and gold reserves
- regulation and supervision of the banking industry;
- setting the official interest rate - used to manage both inflation and the country's exchange rate.

The central bank's main responsibility is making of monetary policy to ensure a stable economy, including a stable currency. It aims to manage inflation (rising average prices) as well as deflation (falling prices). It is the lender of last resort, and assists banks in cases of financial distress (see Note on bank runs).

Furthermore, it holds foreign exchange reserves and official gold reserves, and has influence over exchange rates. Some exchange rates are managed, some are market based (free float) and many are somewhere in between ("managed float" or "dirty float"). India falls in the market-determined category largely. Typically a central bank controls certain types of short-term interest rates (repo and reverse repo rates). These influence the stock- and bond markets as well as mortgage and other interest rates.

RBI Act Amended 2006

Government made amendments to RBI Act 1934 and Banking Regulation Act for allowing the apex bank to have more flexibility to fix the Cash Reserve Ratio (CRR). It removed the floor and cap on CRR to provide flexibility to RBI to manage liquidity. This would result in better liquidity management in the system.

RBI And Bitcoin

Bitcoin is a worldwide private cryptocurrency and digital payment system. It is the first decentralized digital currency, as it works without a central repository or single administrator. It was developed under the name Satoshi Nakamoto and released as open-source software in 2009. The system is peer-to-peer, and transactions take place between users directly, without an intermediary.These transactions are verified by network nodes and recorded in a public distributed ledger called a *blockchain*.

Bitcoins are created as a reward for a process known as *mining*. They can be exchanged for other currencies, products, and services. Because of bitcoin's decentralized nature, restrictions or bans on it are impossible to enforce, although its use can be criminalized.The legal status of bitcoin varies substantially from country to country and is still undefined or changing in many of them. While some countries have explicitly allowed its use and trade, others have banned or restricted it.

The Reserve Bank of India is in control of fiat but not bitcoins which is private. A fiat currency is the legal status given to a currency issued by the central bank. Non-fiat cyptocurrencies like bitcoins are not approved or disapproved by the RBI nor does RBI find them to be viable and desirable.

Reserve Bank had talked of possible "black money" risks from virtual currencies like bitcoins and that they are "susceptible to misuse" by terrorists and fraudsters for laundering money. Some have expressed concerns that bitcoin could be a Ponzi scheme. Bitcoins can be inflationary and thus RBI should have a role in regulating it.

The Reserve Bank of India has not given any licence and authorisation to any entity or company to operate such schemes or deal with bitcoins or any virtual currency (VCs). An inter-disciplinary committee, which includes an RBI representative, has been constituted by the Finance Ministry to examine the regulatory framework with regard to virtual currencies in 2017.

Autonomy for RBI

RBI being the architect of the monetary policy requires autonomy to be effective. Advocates of central bank independence argue that a central bank should be autonomous to manage money, credit and exchange rate dynamics in the globalizing economy. It helps check populist pressures and schemes that the political leadership may be tempted to indulge in. For example, the RBI may come under pressure to reduce rates to allow banks to lend easy to corporates and consumers to stimulate growth even as the inflation is high. It can resist the pressure if . it has autonomy.

Others believe that the elected governments should have the final say within which RBI should be autonomous both while tendering advice and also with enough discretionary powers. For example, demonetization of 2016 November when the government suggested to the RBI and RBI agreed.

The recent measures to make RBI independent are

- replacement of adhoc treasury bills with WMA from 1997
- FRBM Act empowers RBI with autonomy- no primary borrowing from 1-4-2006.
- RBI Act amended in 2006 to give it more power for reserve requirement management

The arguments in favour of autonomy are:

- monetary stability which is essential for the efficient functioning of the modern economic system can be best achieved if professional Central bankers with the long term perspective are given charge. Otherwise, political leadership may be tempted to populism
- without such autonomy, government tends to be profligate with its policies of automatic monetization

The arguments against are:

- democratic systems are run with Parliament and Cabinet making all important policies
- monetary policy is an integral policy of the overall economic policy and so RBI has to subordinate itself to the larger objective.

The best course is to have a middle path like in the MPC where the RBI and others together take decisions.

RBI Dividend

The RBI functions according to the Reserve Bank of India Act of 1934. Chapter 4, section 47 of the Act, titled "Allocation of Surplus funds" lays down that profits("surplus) made by the RBI from its operations should be transferred to the GOI.The original provision states :"After making provision for bad and doubtful debts, depreciation in assets, contributions to staff and superannuation funds .. the balance of the profits shall be paid to the Central Government."

The RBI earns its profits through its open market operation; forex market interventions etc. When what it costs the RBI is deducted from the gross profit, net is arrived at and that is called surplus and goes to the GOI.

Specified Bank Notes (Cessation of Liabilities) Act 2017enabled the Central Bank to write off the unreturned amount from its balance sheet after the demonetisation.The written-off amount, under the law, can be transferred to the government as a special dividend.

The Centre had budgeted Rs 58,000 crore as dividend from the RBI in 2017. The Reserve Bank of India (RBI) paid a dividend of Rs 30,659 which was less than half of the Rs 65,876 crore that was transferred in FY 2015-16. The fall in the amount may be due to the additional costs incurred because of printing of new currency notes and in managing the excess liquidity due to the unexpected and huge inflow of deposits into the banking system post remonetisation.

The lower dividend may make it necessary to borrow more from market thus widening the fiscal deficit, unless tax collections or some other budgetary source shows better than expected performance.

Money Supply

This refers to the total volume of money circulating in the economy. Money supply can be estimated as narrow or broad money.

M1 equals the sum of currency with the public and demand deposits with the banks. It is the narrow money.

M3 or the broad money, as it is also known, includes time deposits (fixed deposits), savings deposits with post office saving banks and all the components of M1.

These notions are important for the RBI to understand the demand in the economy so that it can gauge inflation, demand and so on for it to adjust the same. But with the coming of credit cards, bitcoins etc, the utility of these concepts is relatively diminished.

Liquidity Trap

A **liquidity trap** is a situation when rates and reserve requirements are lowered to stimulate demand but it does not impact on reviving demand and growth. There are no takers for bank credit. It happens in times of recession that is getting worse. There are deflationary expectations and the economy can be faced with the problem of short-term interest rates reaching or nearing zero. This makes the monetary policy ineffective. To come out of liquidity trap, QE is attempted. Otherwise, recession can turn into depression.

Quantitative Easing

The term quantitative easing describes an unconventional form of monetary easing used to stimulate an economy. It involves the central bank to buy financial instruments which in ordinary times are not accepted for OMOs- for example, the housing market securities that were discredited in the USA since 2008. It is a step that is taken after the interest rate reduction to very low levels and similar downward adjustment of reserve ratios like CRR fail to induce any positive change. It involves printing fresh currency and de-risking lending as rates and supply of money ease to unprecedented levels. Central bank uses unconventional means, other than the usual monetary policy tools, to flood the financial system with new money through quantitative easing.

Federal Reserve of the US (its central bank like the RBI) used quantitative easing to overcome the liquidity crisis since the fall of Lehman Brothers in 2008 September when many banks went bankrupt and credit froze. It worked as US came out of recession. In 2017, GDP of USA increased at about 3% leading to announcement of its ending in October 2017.

EU, Japan and Britain also used the technique of QE to shore up growth.

Taper Tantrums

The unconventional monetary policy called quantitative easing means printing money by the central bank and supplying it to the market to stimulate demand and revive growth. US Central Bank Federal Reserve Started it in 2009 and since it is not meant to be a long term solution to recession and deflation, it is being phased out with the return of growth and inflation. Also, continuation of QE unduly leads to asset bubbles. Closing it in phases is called -tapering. When QEs is being tapered, markets react adversely as rates become dearer and consumers will not like it. Bonds sell off and stocks may fall as money supply decreases. On the other hand, when rates go up as taper takes effect, global money goes to USA as it earns them more in US banks. Other currencies may fall as Indian Rupee did in 2013 when QE taper started. These aftershocks of QE taper are called —taper tantrum. The US Federal Reserve in 2017 September announced the unwinding of the biggest experiment in the history of central banking starting from October. It will start the process of normalizing its balance sheet from October.There is such talk again and the question is how India will be affected. India is said to be more comfortable in late 2017 for the following reasons:

1. Real GDP growth is good though the potential is far higher than the actual. Therefore, foreign flows will continue thus checking any fall in rupee.
2. The country's foreign exchange reserves are at a record high of $404 billion in November 2017 mainly due to a rise in foreign currency assets (FCAs) and will arrest the possible fall in rupee.
3. Because India's interest rate is relatively high, existing foreign money will stay and more will come to take advantage of it.

Experts suggested that because of the volatility created in domestic and global markets due to the QE taper, there should an international mechanism to regulate it as US dollar is a global reserve currency and US GDP is worth about $19 trillion.

FSDC

Financial Stability and Development Council is apex-level body constituted by government of India. The idea to create such a super regulatory body was first mooted by Raghuram Rajan Committee in 2008.The recent global economic meltdown has put pressure on governments and institutions across globe to regulate the financial sector towards greater stability.

The new body envisages to strengthen and institutionalise the mechanism of maintaining financial stability, financial sector development, inter-regulatory coordination along with monitoring macro-prudential regulation of economy.

Its Chairperson is the Union Finance Minister of India.

Members are:

- Governor Reserve Bank of India (RBI),
- Finance Secretary and/ or Secretary, Department of Economic Affairs (DEA),
- Secretary, Department of Financial Services (DFS),
- Chief Economic Advisor, Ministry of Finance,
- Chairman, Securities and Exchange Board of India (SEBI),
- Chairman, Insurance Regulatory and Development Authority (IRDA),
- Chairman Pension Fund Regulatory and Development Authority (PFRDA),
- Joint Secretary (Capital Markets), DEA, will be the Secretary of the Council,
- The Chairperson may invite any person whose presence is deemed necessary for any of its meeting(s).

Responsibilities

- Financial Stability
- Financial Sector Development
- Inter-Regulatory Coordination
- Financial Literacy
- Financial Inclusion
- Macro prudential supervision of the economy including the functioning of large financial conglomerates
- Coordinating India's international interface with financial sector bodies like the Financial Action Task Force (FATF), Financial Stability Board (FSB) and any such body as may be decided by the Finance Minister from time to time.

17th Meeting of FSDC

The seventeenth Meeting of the Financial Stability and Development Council (FSDC) was held in mid-2017.

The Council noted that India has macro-economic stability today on the back of improvements in its macro-economic fundamentals, structural reforms with the launch of the Goods and Services Tax (GST), action being taken to address the Twin Balance Sheet (TBS) challenge, financial market confidence, reflected in high and rising bond and especially stock valuations and long-term positive consequences of demonetization. The Council also discussed the issues and challenges facing the Indian economy.

The Council also took note of the progress of Financial Sector Assessment Program for India, jointly conducted by the International Monetary Fund and the World Bank. Council directed that the assessment report should be finalized by the end of this calendar year. FSDC took note of the developments and progress made in setting up of Computer Emergency Response Team in the Financial Sector (CERT-Fin) and Financial Data Management Centre and discussed measures for time bound implementation of the institution building initiative. A brief report on the activities undertaken by the FSDC Sub-Committee Chaired by Governor, RBI was placed before the FSDC. The Council discussed the Central KYC Registry (CKYCR) system. The Council also deliberated on strengthening the regulation of the Credit Rating Agencies (CRAs).

CKYCR: Central KYC Registry or CKYCR replaces the multiple KYC submission process while opening savings bank accounts, buying life insurance or investing in mutual fund products into one time centralized process. The Government of India authorized the Central Registry of Securitization and Asset Reconstruction and Security interest of India (CERSAI) to manage Central KYC Registry process. From 1st August, 2016 this new process was made applicable to all individuals.

India and Financial Stability Board (FSB)

FSB was established in 2009 under the aegis of G20 by bringing together the national authorities, standard setting bodies and international financial institutions for addressing vulnerabilities and developing and implementing strong regulatory, supervisory and other policies in the interest of financial stability. India is an active Member of the FSB having three seats in its Plenary represented by Secretary (EA), Deputy Governor-RBI and Chairman-SEBI. The FSDC Secretariat in the Department of Economic Affairs coordinates with the various financial sector regulators and other relevant agencies to represent India's views with the FSB.

Macro Prudential Analysis

Macro prudential analysis is a method of economic analysis that evaluates the health, soundness and vulnerabilities of a financial system. Macro prudential analysis looks at the health of the financial institutions in the system and performs stress tests(simulate financial crises and check impact on the banks and other financial institutions) and scenario analysis to help determine the system's sensitivity to economic shocks.

Monetary Policy Committee (MPC)

Monetary policy decisions by central banks are crucial for individuals for their consumer loans, corporates for their investment and government for its fiscal operations like borrowing. They are also crucial for savings, economic growth, price stability and financial stability. Therefore, the decisions need to be taken by a committee as many governments do. Committee system has many voices; not subject to vagaries of individual judgement; has multiple stakeholders and institutional continuity

In 2016, the Government amended the RBI Act to create Monetary Policy Committee (MPC). MPC was set up consequent to the agreement reached between Government and RBI to task RBI with the responsibility for price stability through inflation targeting. The Reserve Bank of India and Government of India signed the Monetary Policy Framework Agreement in February 2015.

Subsequently, in the Finance Act 2016 the government amended the Reserve Bank of India (RBI) Act, 1934 for giving a statutory backing to the MPC Agreement and for setting up a Monetary Policy Committee (MPC). By this amendment, it was written into the preamble of the RBI Act that the primary objective of the monetary policy is to maintain price stability, while keeping in mind the objective of growth and to meet the challenge of an increasingly complex economy. A new Chapter was introduced in the RBI Act detailing the operation of MPC. The new MPC is to be a six-member panel headed by the RBI Governor that is expected to bring value and transparency to interest rate-setting decisions. It is entrusted with the task of fixing the benchmark policy interest rate (repo rate) to contain inflation within the specified target level. The MPC replaces the system where the RBI governor, with the aid and advice of his internal team and a technical advisory committee, had complete control over monetary policy decisions.

It has three members from the RBI- Governor, the RBI Deputy Governor in charge of monetary policy, one official nominated by the RBI Board; and three independent members to be selected by the Government. The three central government nominees of the MPC appointed by the search cum selection committee will hold office for a period of four years and will not be eligible for re-appointment. RBI Act prohibits appointing any Member of Parliament or Legislature or public servant. A search committee will recommend three external members, experts in the field of economics, banking or finance, for the Government appointees. The MPC will meet atleast four times a year to decide on monetary policy by a majority vote. And if there is a tie, the RBI governor has the deciding vote.

Functions of the MPC: Under the Monetary Policy Framework Agreement, the RBI will be responsible for containing inflation targets at 4% (give or take 2%) in the medium term. Central Government determines the inflation target in terms of the headline (unadjusted) Consumer Price Index, once in every five years in consultation with the RBI. RBI would have to give an explanation in the form of a report to the Central Government, if it failed to reach the specified inflation targets for three consecutive quarters. It shall, in the report, give reasons for failure, remedial actions as well as estimated time within which the inflation target shall be achieved. Further, RBI has to publish a Monetary Policy Report every six months, explaining the sources of inflation and the forecasts of inflation for the coming period of six to eighteen months.

MPC decides the changes to be made to the policy rate (repo rate) so as to contain the inflation within the target level specified to it by the Central Government. Minutes of the MPC meeting are published by RBI after 14 days. In addition, subsequent to the MPC meeting, RBI has to publish a document explaining the steps to be taken by it to implement the decisions of the Monetary Policy Committee.

The MPC takes decisions based on majority vote (by those who are present and voting). In case of a tie, the RBI governor will have the second or "casting" vote. It is a casting vote in the sense that it breaks a tie. The decision of the Committee would be binding on the RBI. The government may, if it considers necessary, convey its views, in writing, to the MPC from time to time. RBI is mandated to furnish necessary information to the MPC to facilitate their decision making and if any Member of the MPC, at any time, requests the RBI for additional information, including any data, models or analysis, the same have to be provided, not just to that member but to all members.

In 2002 Y. V. Reddy Committee recommended for a MPC to decide policy actions. Subsequently, suggestions were made to set up a MPC in 2006 by the Tarapore Committee, in 2007 by the Percy Mistry Committee, in 2009 by the Raghuram Rajan Committee and then in 2013, both in the report of the Financial Sector Legislative Reforms Commission (FSLRC) and the Dr. Urjit R. Patel

Committee.As can be seen from above, India's shift to an MPC is driven by a clear inflation-targeting framework.

Negative Interest Rates

The Bank of Japan, the European Central Bank and several smaller European countries started negative interest rates regime lately. It is an attempt to spur demand and revive economy. Negative interest on excess reserves of banks parked with the central bank is an instrument of unconventional monetary policy applied by monetary authorities in order to encourage lending by making it costly for commercial banks to hold their excess reserves at central banks. Commercial banks have accounts with the central bank as the central bank is a bankers' bank. When they deposit their excess of money in their central bank accounts, generally they get paid for it. But in the NI regime, it is the reverse. Thus, NI is a rate when lender pays the borrower.Such policy can be associated with very slow economic growth, deflation, and attempts to prevent currency appreciation. The European Central Bank and central banks of other European countries, such as Sweden, Switzerland, and Denmark, have paid negative interest on excess reserves—in effect taxing banks for exceeding their reserve requirements - as an expansionary monetary policy measure. It makes lending by banks cheaper as banks will not keep their excess reserves in a central bank deposit account due to negative returns. They have to lend it. Further, there is competition among banks to lend their excess reserves and that also will push rates down. Low rates should make euro investors try to move to places where interest rates are higher, such as the U.S. When they do so, they sell euros and buy dollars which can weaken their currency for keeping exports high and attracting tourists. The Swiss National Bank, for instance, wants to keep the Swiss franc from strengthening against the euro. The criticism: Older people who depend on interest income are hurt and may cut their consumption more deeply than those who benefit – rich owners of equity. Many investors will shift their portfolios toward riskier assets, exposing the economy to greater financial instability.

Demonetisation

On 8 November 2016, the Government of India announced the demonetisation of all ₹500 and ₹1,000 banknotes of the Mahatma Gandhi Series. The government sought to curtail the shadow economy and crack down on the use of illicit and counterfeit cash to fund illegal activity and terrorism. Those with these notes had to deposit them in the bank and exchange them for new notes though initially there were some restrictions. By the end of August 2017, 99% of the banned currency was deposited in banks, leaving only around ₹14,000 crore of the total demonetised currency discarded.

The Indian government had demonetised bank notes on two prior occasions—once in 1946 and then in 1978—and in both cases, the goal was to combat tax evasion by "black money" held outside the formal economic system. In 1946, the pre-independence government hoped demonetisation would penalise Indian businesses that were concealing the fortunes amassed supplying the Allies in World War II. In 1978, the Janata Party coalition government demonetised banknotes of 1000, 5000 and 10,000 rupees, again in the hopes of curbing counterfeit money and black money. Demonetisation under the two occasions was done bh an ordinance while the 2016 decision was an executive decision.

Monetary Policy Transmission

(In the classroom)

INFLATION: CONCEPTS, FACTS AND POLICY

Inflation means a persistent rise in the price of goods and services. While inflation may the proof of growth- assuming it is the demand that is riving up prices, inflation when unchecked hurts welfare as it reduces the purchasing power of money. It impoverishes the poor disproportionately more as a greater proportion of their incomes are needed to pay for their consumption. Inflation reduces savings; pushes up interest rates; dampens investment; leads to depreciation of currency thus making imports costlier which feeds into inflation further.

Depending upon the rate of growth of prices, inflation can be of the following types:

Creeping inflation is a rate of general price increase of upto 4% a year. It has the same effect of erodeing the purchasing power of money when continued over many years, but it is "manageable." It is largely welcome inflation as it shows there is growth and is even refered to as price stability. It is a deterrent to deflation. It may even be considered good for the economy as producers an traders make reasonable profits encouraging them to invest.

Trotting inflation is when creeping inflation increases a few more hundreds of basis points. (A basis point is 1/100, 100 basis point is 1%).

If not controlled, trotting inflation may accelerate into a galloping inflation which may be around 8-10% a year.

If it aggravates, galloping inflation can aggravate to "runaway" inflation which may change into a hyperinflation.

Hyperinflation is when prices are "out of control." That is, a monthly inflation rate of 20 or 30% or more- 'an inflationary cycle without any tendency toward equilibrium'. The worst is a monetary collapse, if prices are not reined in, in time, money loses its value and either barter may become popular or a foreign currency will become the dominant medium of exchange

It must be noted that rates of growth of prices that are attached to the above mentioned terms are not of universal application. The tolerance levels differ from country to country. Developed countries have far lower tolerance levels compared to developing countries. In India , from 2008-13, inflation ruled above 10% which is most unlikely to be tolerated in advanced economies.

Other related concepts are:

- deflation when there is a persistent general fall in the level of prices
- disinflation is the reduction of the rate of inflation
- stagflation which is a combination of inflation and rising unemployment due to recession and
- Reflation, which is when inflation returns after a spell of deflation and recession thus showing that growth is back as seen in the US and EU after the great recession (2007-09) when growth was revived.

Measures of Inflation

GDP deflator

It is the most comprehensive measure of inflation as it reports the change in prices of all domestically produced final goods and services in an economy. The GDP deflator is not based on a fixed market basket of goods and services but applies to all goods and services domestically produced as implied above.

Cost of living index

A certain standard of living requiring a specific set of goods and services is defined and the basket is tracked for price rise to check affordability. The cost of living is the cost of maintaining such predefined standard of living. When their cost goes up, the index goes up and is refered to as "dearer.". It has a value of 100 in the base year. An index value of 105 indicates that the cost of living is five percent higher than in the base year.

PPI

The price at which the producer sells to the wholesaler/distributor is the producer price. Tracking it is done by the Producer price index (PPIs). It gauges the change in the prices received by a producer. The difference with the WPI is accounted for by logistics, cost of credit, warehousing costs, transportation costs, margins, risk considerations etc. Producer price inflation measures the increase in prices of inputs like raw materials, wages, rupee exchange rate if imports are involved etc. The Department of Industrial Policy and Promotion, Ministry of Commerce and Industry set up a working group on the PPI in August 2014 under the chairmanship of **B.N. Goldar** to outline the timeline for launch of the PPI series.

WPI

Wholesale price index comprises transactions at first point of bulk sale in the domestic market.

CPI

Consumer price index measures the changes in prices paid by the consumer at the retail level. It can be for the whole economy or group-specific- for example, CPI for industrial workers etc as in India.

Types of Inflation Based On Causes

- **Demand-pull inflation:** inflation caused by increases in demand due to increased private and government spending, etc. It involves inflation rising as real gross domestic product rises and unemployment falls. This is commonly described as "too much money chasing too few goods". For example, food inflation related to protein items have been high-priced for many years in India as demand has shot up due to consumption patterns in India shifting due to income increases. Demand-pull inflation can be caused by money supply increasing. For example, the expansionary monetary policy of the RBI in 2009 saw rates come down and easy and cheap credit pushed up prices as demand grew. Wage inflation, money supply growth etc create this type of inflation. Collapse of demand causes prices to plunge- for example international crude prices crashed since 2014(there are many reasons other than the global slowdown though: US shale gas coming up; renewables emerging in a big way; Iran sanctions were lifted; Iraq was able to produce and export as the country stabilized)
- **Cost-push inflation:** When the cost of production goes up, it leads to cost-push inflation. For example, a higher prices for inputs; higher cost of capital; in India, monsoon failure and

damage to production; international commodity prices go up, for example, crude or food or metals. It is also refered to as "supply shoc," caused by reduced supplies due to increased prices of inputs, for example, crude prices globally had gone up till 2014 causing supply constraints which meant higher costs of production and so higher prices. Just as a shortage of goods tends to push prices up, an oversupply of commodities tends to induce the opposite effect on prices.

- **Structural inflation:** A type of persistent inflation caused by deficiencies in certain conditions in the economy such as a backward agricultural sector that is unable to respond to people's increased demand for food, inefficient distribution and storage facilities leading to artificial shortages of goods, backward technology and the resulting underproductivity is also a structural source of inflation. Food inflation witnessed for a decade in India till mid-2010s was structural in nature as the preference for protein foods is far ahead of its supplies and this is a phenomenon driven by income rise.
- **Speculation** in the commodity exchanges
- **Cartelization** of producers when they come together and manipulate the prices in the market for the goods or services that they produce for their own profits. For example, Competition Commission of India (CCI) had imposed penalties in 2016 upon 10 cement companies and their trade association i.e. Cement Manufacturers Association (CMA) for cartelisation in the cement industry.
- **Hoarding,** that is, accumulation of huge quantities of goods and releasing them into the market in conditions of scarcity at higher prices is also a cause of inflation. In 2017 September, Income Tax department raided major onion traders in Lasalgaon and surrounding areas in Nashik district of Maharashtra, one of the largest onion markets in the country on the basis of information that the onion traders of Lasalgaon and adjoining towns were involved in the hoarding of onions and planning to create an artificial scarcity in the market to inflate the prices. Essential Commodities Act, 1955 aims to check hoarding, among other things. In 2014, GOI included onions and potatoes for one year under the ECA to curb hoarding. The decision taken by the Cabinet Committee on Economic Affairs (CCEA) imposed limits on the quantity of onions and potatoes that individuals and wholesale traders could stockpile. It empowered state governments to take measures to prevent hoarding.
- Imported inflation when a country that depends on imports has its prices rising due to international prices of them rising or due to exchange rate depreciating

High Inflation Hurts

If inflation is high in an economy, the following problems can arise

- low income groups are particularly hurt
- People on a fixed income (e.g. pensioners, students receiving scholarships) will be worse off in real terms due to higher prices and same income as before
- inflation discourages exports as domestic sales are attractive . Inflation may erode the external competitiveness of domestic products if it leads to higher production costs such as wage increases, and higher interest rate.
- inflation can drag down growth as investment climate turns bad due to instability and uncertainty and also as interest rates are raised and cost of credit increases

- Inflation may discourage saving and thus hit investment. The savings pattern also gets skewed in favour of unproductive assets like gold as inflation may be higher than interest rates and yield is negative.
- Inflation tax is a hidden tax. It is the financial loss in the value of money incurred by holders of cash. Another way of seeing it is: when the government wants to tax people, they resist it. But the government needs the money. So it prints and releases the money into market and that inflates the economy which means people pay more for the goods and services they consume. The end result is that the tax that they did not pay is paid by way of price rise.
- strikes can take place for higher wages which can cause a wage spiral. Also if strikes occur in an important industry which has a comparative advantage the nation may see a decrease in productivity, exports and growth.
- Govt. fiscal deficit may go up as the need to subsidise is more to make goods and services affordable

Small Amount of Inflation Can Be Good

Inflation means growth, normally- higher incomes and more demand and so more inflation. It can be argued that a low level of inflation can be good if it is a result of innovation. Thus, there is encouragement for innovation .Also, a small price rise is necessary for wages to go up. It further helps the economy keep off deflation which can otherwise set off a recession. Besides, inflation at a moderate level is an incentive to the producer. Some see mild inflation as "greasing the wheels of commerce."

Losers: Individuals on fixed incomes, retirees, all creditors (who lent at fixed rate of interest.)

Gainers: Individuals whose incomes rise faster than inflation; debtors (who will pay back at fixed rate of interest).

Optimal Inflation

For the consumer, inflation should be negative which means prices should drop in absolute terms as it helps him afford goods and even save. That is possible when supplies outstrip demand on a sustainable basis which is not possible as the producer incurs losses. Negative inflation which is desirable from consumer viewpoint is also possible if government subsidises goods and services adequately. But that is impossible fiscally as deflation hurts fiscal receipts and on top of it, subsidies bill will damage the fiscal position even more. Besides, consumer will not be benefited if prices fall due to recession-driven deflation as it may hurt his own job and business prospects in the medium run.

So we can aim at inflation that is in the positive territory that augurs well for economic well being for all- producers and consumers alike. Too much inflation hurts from all sides. Too little is no incentive for growth. There has to be price stability at a moderate level of inflation. But the question remains how much of inflation will be good for the economy- growth, welfare and stability wise. In India, Reserve Bank of India and Government of India signed a Monetary Policy Framework Agreement in 2015 which says that the objective of monetary policy framework is mainly to maintain price stability, while keeping in mind the objective of growth. The monetary policy framework would be operated by the RBI. RBI would aim to contain consumer price inflation within 4 percent with a band of (+/-) 2 percent. This level of inflation is considered optimal from growth, stability, fiscal consolidation, foreign trade and welfare perspectives.

Concepts

Open Inflation

One of the primary responsibilities of the government is to ensure affordability of goods and services. Governments subsidise goods and services to keep them inexpensive. For example, kerosene, food, transport etc. The inflation that results when the government does not suppress it with subsidies and monetary policy is called open inflation.

Suppressed Inflation

Inflation is too big a risk for the economy for the government to allow it to continue unchecked. Therefore, fiscal and monetary actions are taken to manage it. That is called suppressed inflation. It is named so because, the problem of inflation is only managed and not resolved. It may reemerge if fiscal policies changed- reduce subsidies etc.

Headline Inflation

Headline inflation is a measure of the total inflation. It is an unadjusted number. It is the overall inflation as it is reported. It is best understood when contrasted with core inflation given below. Headline inflation is what consumers experience.

'Core' or' Underlying Inflation'

Core or underlying inflation measures the long-run trend in the general price level. Temporary effects on inflation are factored out to calculate core inflation. For this purpose, certain items are excluded from the computation of core inflation. These items include: changes in the price of fuel and food which are volatile or subject to short-term fluctuations and/or seasonal in nature like food items. In other words, core or underlying inflation is an alternative measure of inflation that eliminates transitory effects .The main argument here is that the central bank should effectively be responding to the demand side- for example, the money available in the market, demand for credit and so on and not the supply shocks like energy and food. Headline inflation on the other hand includes the official rate of increase in prices that excludes no item in the basket. Core inflation excludes the changes in the fuel and food articles and the food processing part of manufacturing.

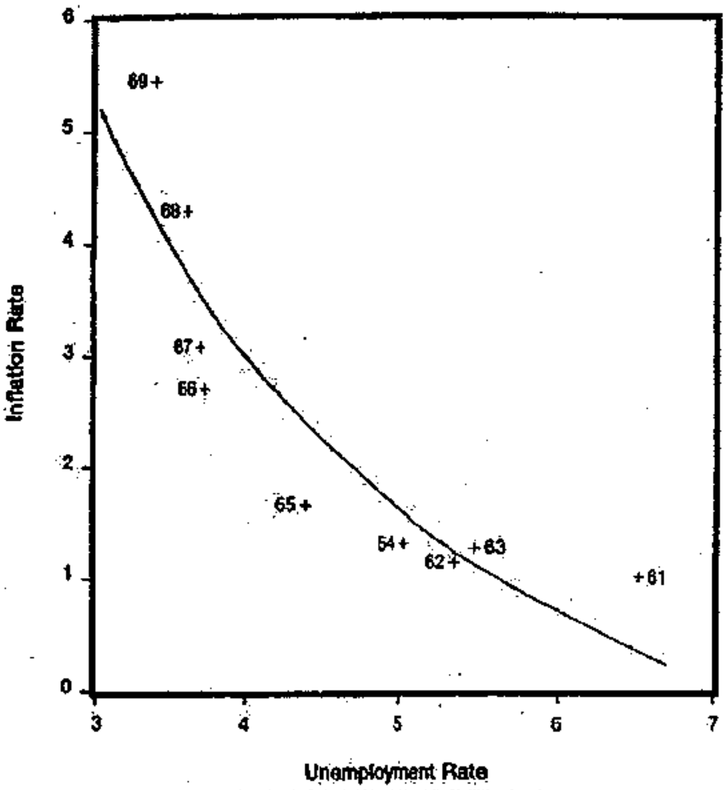
Headline and core inflation are calculated both at the wholesale and consumer levels. CPI (Combined, that is rural and urban) headline inflation is considered when inflation is being targeted in the country by the RBI since 2015.

Philips's Curve

The inverse relationship between rate of inflation and rate of unemployment is shown in the Phillips curve: price stability has a trade-off against employment. Some level of inflation could be considered desirable in order to minimize unemployment.

Potential output (sometimes called the "natural gross domestic product") is an important concept in relation to inflation. It is the level of GDP where the economy is at its optimal level of production, given various constraints- institutional and natural. (Discussed elsewhere in the Notes)

If GDP exceeds its potential, inflation will accelerate and if GDP falls below its potential level, inflation will decelerate as suppliers attempt to use excess capacity by cutting prices.



Deflation

Deflation is a prolonged and widespread decline in prices that causes consumers and businesses to curb spending as they wait for prices to fall further. It is the opposite of inflation, when prices rise, and should not be confused with disinflation, which merely describes a slowdown in the rate of growth of prices. Deflation may occur at the wholesale or retail level. It may result for demand side or supply side reasons.

Deflation is hard to deal with because it is self-reinforcing. Deflation needs to be checked with Keynsian stimulus or it can breed deeper deflation, leading to what is known as a deflationary spiral.

When an economy experiences deflation, demand from businesses and consumers to buy products goes down because they expect to pay less later as prices fall further. With crashing demand, producers can not to sell and go bankrupt, unemployment rises reducing demand further. That causes deflation to become even more aggravated. It makes it more expensive to service existing debts. As debt becomes unserviceable, the risk of default and bankruptcy rises too and banks become reluctant to lend as their own NPAs rise.

Remedy:

- Tax cuts to boost demand from consumers and businesses
- Lowering central bank interest rates to encourage economic activity
- Printing more currency to boost money supply
- Capital injections into the banking system
- Increase government spending on projects that boost the return on private investment

India did not face the threat of deflation at the retail level but till December 2015 for 14 consecutive months, Wholesale Price Index (WPI) inflation was in the negative.

Inflation And Corruption

The link is as follows
- through black money
- hoarding not being checked
- commodity prices being manipulated through speculation as NSEL crisis shows.

Inflation Targeting

Inflation targeting focuses mainly on achieving price stability as the ultimate objective of monetary policy. This approach entails the announcement of an inflation target- either a number or a range, that the central bank promises to achieve over a given time period. The targeted inflation rate will be set jointly by the RBI and the government, the responsibility of achieving the target would rest primarily on the RBI. This would reflect an active government participation in achieving the goal of price stability with fiscal discipline by way of a rational borrowing programme (not borrowing in excess).

Monetary policy and fiscal policy have to converge for achievement of inflation targeting Advantage is that it promotes transparency in the conduct of monetary policy. Further, it increases the accountability of monetary authorities to the inflation objective.

Reserve Bank of India (RBI), entered into an agreement with the Ministry of Finance in 2015 that mandates the RBI to bring inflation below 6% by January 2016, and 4% (plus or minus 2%) in the following years. Target is set by GOI in consultation with RBI but the RBI is responsible for achieving it.

In case of failure to meet targets, RBI has to explain the reason for its failure to meet as well as give a timeframe within which it will achieve it. RBI will publish the operating targets as well as operating procedure for the monetary policy though which the target for the monetary policy will be achieved. The RBI will also be required to bring a document every six months to explain the sources of inflation and forecast for inflation for next 6-18 months.

As recommended by Urjit Patel Committee in 2013, RBI has been using headline CPI (Combined) inflation as the nominal anchor for targeting.

This flexible inflation targeting framework which is a paradigm shift is positive for India because it increases monetary policy transparency, predictability and chances of effectiveness.

Indices of Inflation

Changes in the price levels at the wholesale and retail level are tracked by various price indices in India- WPI and CPI. 3 CPIs exist for different consumer groups each of which is homogenous.

All price indices use a particular year as a "base year". That means that rises or falls in prices are measured with reference to the price in that year. For example, the base year used for the Wholesale Price Index is 2011-12 from the fiscal year 2017-18. Wholesale prices of all products in the basket with their respective weightages in that year add upto "100". If, in the base year, the wholesale price of *gur* was Rs.2 a kg, and rose by 50 paise the following year, it would mean that the wholesale price index for *gur* would rise to 125. But the movement of an index is based on the average of price movement of all the goods in the basket and not just one article.

Ideally the same base year should be used for all indices but different base years are used for different price indices due to convenience, data availability, logistics etc.

WPI

Main uses of WPI

The main uses of WPI are the following: a) Provides estimates of inflation at the wholesale transactions level for the economy as a whole. This helps in timely intervention by the Government to check inflation, in particular inflation in essential commodities, before the price increase spills over to retail prices. WPI is used as deflator for many sectors of the economy for estimating GDP by CSO. It is also used to deflate nominal values of production in high frequency IIP. Global and domestic investors also track WPI as one of the key macro indicators for their investment decisions.

The Indian WPI is updated on a monthly basis. The WPI is published by the Economic Advisor in the Ministry of Commerce and Industry, with a month lag. The various commodities taken into consideration for computing the WPI can be categorized into primary article, fuel and power, and manufactured goods. Primary articles included for the computation of WPI include food articles, non-food articles and minerals. In the fuel, power, light and lubricants, electricity, coal mining and mineral oil are included. The manufactured goods category encompasses food products; beverages, tobacco and tobacco products, wood and wood products, textiles, paper and paper products, basic metals and alloys, rubber and rubber products and many others. The index is a vital guide in economic analysis and policy formulation.

The WPI is not intended to capture the effect of price rise on the consumer though it generally and broadly indicates it. WPI has an All India character. It is due to these attributes that it is widely used in business and industry circles and in Government and is generally taken as an indicator of the rate of inflation in the economy. The inflation rate is calculated on point to point basis i.e. on the basis of the variation between the index of the latest week of the current year and for the corresponding week of the previous year.

There are a number of agricultural commodities, especially, some fruits and vegetables, which are of a seasonal nature. Such seasonal items are handled in the index in a special manner. When a particular seasonal item disappears from the market and its prices are not quoted, the index of such an item ceases to get compiled and its weight is distributed over the remaining items and new seasonal items, if any, in the concerned sub-group.

Limitations on WPI

The accuracy of WPI is unsatisfactory even after the introduction of the revised series in 2017. Services such as rail and road transport, health care, postal, banking and insurance, for example, are not part of the WPI basket. Neither are the products of the unorganised sector that are estimated to constitute about 35 per cent of the total manufactured output of the country. The index thus falls well short of being a broad based indicator of the price level even in its construction.

New All-India Wholesale Price Index (WPI)

The Government periodically reviews and revises the base year of the macroeconomic indicators as a regular exercise to capture structural changes in the economy and improve the quality, coverage and representativeness of the indices. As a part of the ongoing exercise, the base year of All-India WPI has been revised from 2004-05 to 2011-12 by the Office of Economic Advisor (OEA), Department of Industrial Policy and Promotion, Ministry of Commerce and Industry to align it with the base year of other macroeconomic indicators like the Gross Domestic Product (GDP) and CPI. The revision entails shifting the base year to 2011-12 from 2004-05, changing the basket of commodities and assigning new weights to the commodities. For the new series with base 2011-12=100, Working Group was chaired by Late Dr. Saumitra Chaudhuri, Member, erstwhile Planning Commission and comprised most stakeholders. WPI basket does not cover services.

What Is New In The New Series

In the new WPI series significant improvement in concept, coverage and methodology has been made. In the revised WPI basket, the number of items has been increased from 676 to 697. Efforts have been made to enhance the number of quotations from 5482 to 8331. The increase in number of quotations has been done across the major groups to ensure comprehensive coverage and representativeness. New definition of wholesale price index does not include taxes in order to remove impact of fiscal policy. This also brings new WPI series closer to Producer Price Index and is in consonance with the global practices. Further for the first time a Technical Review Committee has been set up to recommend appropriate methodological intervention to continuously improve coverage, quality and timeliness of the WPI.

The new series also present separate 'WPI Food Index' which along with CPI Food Price Index published by CSO would help monitor the food inflation effectively.. The seasonality chart of the Fruits and Vegetables Sub Group under the Food Articles has been updated in the new series. Prices of seasonal fruits and vegetables will be available for longer period. For example, tomato price index will now be available around the year as against eight months in the earlier series of WPI (base 2004-05). Cauliflower was earlier available only for six months but now it will be available for eight months in year.

Why is the indirect tax not been included in the compilation of WPI in the new series?

A significant change in the new series of WPI has been the exclusion of indirect taxes while compiling indices of manufactured products. The Working Group for revision of WPI had recommended that taxes should not figure in this measure so that price signals emerging from production side of the economy are not influenced by the fiscal policy.

Excluding indirect taxes brings the new series of WPI conceptually closer to the concept of output Producer Price Index (PPI). This is also in keeping with the international best practices. The exclusion of indirect taxes would also ensure the continuity and compatibility of new WPI series when Goods and Services Tax (GST) is introduced.

Summary of New WPI

The base year of wholesale price index (WPI) has been revised to 2011-12 from 2004-05 by the Office of the Economic Adviser. Govt. of India, Ministry of Commerce & Industry Department of Industrial Policy & Promotion (DIPP) who is in charge of the WPI. Under the revised series, WPI will continue to consist of three major groups namely, Primary Articles, Fuel & Power and Manufactured Products. Item level prices do not include indirect taxes in order to remove the impact of fiscal policy. There has been an increase in number of source agencies in general across all major groups while dormant sources have been removed. Additionally, a new WPI Food Index has been compiled combining the Food Articles under Primary Articles and Food Products under Manufactured Products.

WPI with 2011-12 base year						
Groups	**Weight**	**Items**	**Quotations**	**Weight**	**Items**	**Quotations**
Base year	**2004-05**	**2004-05**	**2004-05**	**2011-12**	**2011-12**	**2011-12**
Primary Articles	20.12	102	579	22.62	117	983
Fuel & Power	14.91	19	72	13.15	16	442
Manufactured Products	64.97	555	4,831	64.23	564	6,906
WPI	100	676	5,482	100	697	8,331

The overall inflation trajectory of FY17 has shifted downwards due to the change in the base year. The Government of India (Allocation of Business) Rules, 1961, with subsequent amendments, assigns the responsibility for compiling the WPI to the Office of the Economic Adviser in the Department of Industrial Policy and Promotion under the Ministry of Commerce and Industry. The Economic Adviser holds the final authority for all decisions regarding the WPI.

CPI

A **Consumer Price Index (CPI)** measures changes in the prices of a basket of consumer goods and services purchased by households. The CPI measures price changes by comparing, through time, the cost of a fixed basket of commodities. It is based on a point to point comparison like the WPI- that is, prices at two points of time are compared. For example, prices of October 2018 are compared to the prices of October 2017. Sub-indexes are computed for different categories and sub-categories of goods and services, being combined to produce the overall index with weights reflecting their shares in the total of the consumer expenditures covered by the index. CPI can be used to index (i.e., adjust for the effect of inflation) the real value of wages, salaries, pensions, for regulating prices etc.

The dearness allowance of Government employees and wage contracts between labour and employer is based on this index.

Over the years, CPIs have been widely used as a macroeconomic indicator of inflation, and also as a tool by Government and Central Bank for targeting inflation and monitoring price stability (2015 onwards based on Urjit Patel committee report in 2013) . CPI is also used as deflators in the National Accounts. Therefore, CPI is considered as one of the most important economic indicators.

Consumer price index numbers were known as "Cost of Living Index Numbers" prior to 1955. The Sixth International Conference of Labour Statisticians recommended the change in nomenclature from Cost of Living Index to Consumer Price index. The Cost of living index is a more broader term which includes not only changes in prices but several other factors like change in consumption habits and standard of living.

Presently the consumer price indices compiled in India are:

- CPI for Industrial workers CPI (IW)
- CPI for Agricultural Labourers CPI (AL)

- Rural Labourers CPI (RL)
- CPI(Urban)
- CPI(Rural)

Till 2012, in India there were only following three CPIs compiled and released on national level.

- Industrial Workers (IW) (base 2001),
- Agricultural Labourer (AL) (base 1986-87) and
- Rural Labourer (RL) (base 1986-87)

There was another CPI called the Urban Non-Manual Employees (UNME) (base 1984-85) but was discontinued by the CSO from 2010. For Industrial Workers (CPI-IW), a basket of 370 commodities is tracked; for Agricultural Labourers (CPI-AL), 60 commodities. The baskets and the weightages to each item have been determined on the basis of surveys of consumption patterns. All-India figures declared are averages.

Each commodity is given a specific weightage, which differs from one index to another index. For example, the CPI-AL would give a greater weightage to foodgrains than the CPI-UNME (since discarded), since a greater proportion of the agricultural labourer's expenditure would go toward foodgrains, and he would be unlikely to buy the sort of items the office-goer would buy.

In the organised sector, CPI-IW is used as a cost of living index. In accordance with the Government of India (Allocation of Business) Rules, 1961, as amended from time to time, it is the responsibility of the Ministry of Labour to compile and release the data on the CPI for Industrial Workers and the data on the CPI for Rural Labourers.

New CPI Series 2015

The Central Statistics Office (CSO), Ministry of Statistics and Programme Implementation in 2015 revised the Base Year of the Consumer Price Index (CPI) from 2010=100 to 2012=100. In this revised series, many methodological changes have been incorporated, in order to make the indices more robust.Due to change in the consumption pattern from 2004-05 to 2011-12, the weighing diagrams (share of expenditure to total expenditure) have changed. A comparison of weighing diagrams of the old and revised series is given in the table below:

- The number of Groups, which was five in the old series, has now been increased to six. 'Pan, tobacco and intoxicants', which was a Sub-group under the Group 'Food, beverages and Tobacco', has now been made as a separate Group. Accordingly, the Group 'Food, beverages and Tobacco' has been changed to 'Food and beverages'.

- Egg, which was part of the Sub-group 'Egg, fish and meat' in the old series, has now been made as a separate Sub-group. Accordingly, the earlier Sub-group has been modified as 'Meat and fish'.

- Sample size for collection of house rent data for compilation of House Rent Index, which was 6,684 rented dwellings in the old series, has now been doubled to 13,368 rented dwellings in the revised series.

The new CPI index, weight of food and beverages is **45.86%** and weight of fuel and light segmen is 6.84 %.

The basket of items and their weighing diagrams have been prepared to make it consistent with the international practice of shorter reference period for most of the food items and longer reference period for the items of infrequent consumption/purchase.

Price data are collected from selected towns by the NSSO and from selected villages by the Department of Posts.

Consumer Price Indices (Rural, Urban, Combined), compiled by the Ministry of Statistics and Programme Implementation, reflects the realistic picture of the prices of consumer goods and services because of the following reasons:

- prices are collected from 1,181 selected village markets covering all districts of the country for rural areas and from 1,114 urban markets of 310 selected towns of urban areas;
- these markets are, more or less equally, distributed over different weeks of a month to capture price variations during the month;
- only transaction prices, that is prices actually paid by the consumers, are collected for compilation of indices;
- the items having significant share in the overall consumption expenditure of the households, including the Public Distribution System (PDS) items and the items consumed by majority of the households are included in the basket

All cities/towns having population (Census, 2001) more than nine lakh and State/UT capitals not covered therein have been selected. The Consumer Price Index is released every month on 12th day of the following month.

The Reserve Bank of India (RBI) has started using CPI-combined as the sole inflation measure for the purpose of inflation management and monetary policy. As per the agreement on Monetary Policy Framework between the Government and the RBI (February 2015) given in detail elsewhere in the Chapter, the sole objective of RBI is price stability and a target is set for inflation as measured by the Consumer Price Index-Combined- 4% is the anchor with 2% up and down to make the range.

Difference Between Wholesale Prices And Consumer Prices

WPI measures price rise at the wholesale level. Wholesale means sale in large quantities and usually meant for resale. It covers a certain set of goods that are traded at the wholesale level. CPI on the other hand measures price rise at the retail level. There is a difference between the two in terms of prices. The difference is due to a number of factors. A substantial portion of the difference is accounted for by the retailers' margins which are built into what the consumer pays. Besides, the way the two indices are calculated differs both in terms of weightage assigned to products as well as the kind of items included in the basket of products.

While wholesale prices are more or less the same throughout the country, consumer prices or retail prices vary across regions (rural and urban) and also across cities according to the consumer preferences for certain products, supplies and purchasing power. Besides, taxes levied by states comprise an important component of the variation in prices of many products.

Divergence Between WPI and CPI

WPI reflects the change in average prices for bulk sale of commodities at the first stage of transaction while CPI reflects the average change in prices at retail level paid by the consumer. Major difference is in two index baskets. The prices used for compilation of WPI are collected at ex-factory level for manufactured products, at ex-mine level for mineral products and mandi level for agricultural products. In contrast, retail prices applicable to consumers and collected from various markets are used to compile CPI. The reasons for the divergence between the two indices can also be partly attributed to the difference in the weight of food group in the two baskets. CPI Food group has a weight of 39.1 per cent as compared to the combined weight of 24.4 per cent (Food articles and Manufactured Food products) in WPI basket. Similarly weights of the major petroleum products such as petroleum and HSD also vary significantly. The CPI basket consists of services like housing, education, medical care, recreation etc. which are not part of WPI basket.

A significant proportion of WPI item basket represents manufacturing inputs and intermediate goods like minerals, basic metals, machinery etc. whose prices are influenced by global factors but these are not directly consumed by the households and are not part of the CPI item basket. Thus even significant price rise or decline in items included in WPI basket need not necessarily translate into CPI in the short run. The rise or fall in prices at wholesale level spills over to the retail level after a lag. Middlemen and indirect taxes that add on make the CPI higher. The divergence is likely to get greater as the new WPI series excludes indirect taxes.

Which Index Should One Use?

The WPI is useful in certain contexts. For example, for industrialists, the costs of setting up a factory over the course of several years; and further to calculate the costs of production and returns over several years. The basket of items in the CPI does not include machinery, chemicals, and so on; secondly, the price of electricity in the CPI is the consumer tariffs, not the industrial tariffs; and so on.

Services And Price Index

While the WPI now does not include services, consumer price index (CPI) meant for industrial workers includes certain services such as medical care, education, recreation and amusement, transport and communication. On the other hand, some of the other major services such as trade, hotels, financing, insurance, real estate and business services do not find a mention either in the CPI(IW). In India, the services sector accounts for about 57 per cent of the GDP. In 2010, Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce & Industry constituted an Expert Committee to render technical advice for development of Service Price Index (SPI) and its related issues. The Committee is chaired by Prof. C. P. Chandrasekhar.

Producer Price Index

The process of introducing the producer price index (PPI) is underway in India. It means prices of goods as they are sold to the wholesalers by the producers. The difference between WPI and PPI is accounted for by the margins and other transport and distribution costs. The government in late 2014 set up a committee to devise Producer Price Index. The 13-member committee is headed by Professor BN Goldar and has representation from various central ministries and departments.

Food Price Indices

WPI food index

The government in mid-2017 revised the wholesale price index (WPI) by shifting to a new base year of 2011-12 from 2004-05 and added a new WPI food index to capture the rate of inflation in food items. Revision of macroeconomic data is undertaken to reflect changes in the economy.The WPI Food index is compiled by taking the aggregate of WPI for "Food Products" under "Manufactured Products" and "Food Articles" under "Primary Articles" using weighted arithmetic mean.In view of the sensitivity of food to the overall well being of people, it is important to track their prices as they fluctuate. During the 11th FYP period, food prices soared hurting the poor disproportionately. If we track the WPI food prices, the gap with the CPI food component can be better understood and remedies applied.

Consumer Food Price Index (CFPI)

Consumer Food Price Index (CFPI) is a measure of change in retail prices of food products consumed by a defined population group in a given area with reference to a base year. The Central Statistics Office (CSO), Ministry of Statistics and Programme Implementation (MOSPI) started releasing Consumer Food Price Indices (CFPI) for three categories -rural, urban and combined - separately on an all India basis from 2014. Like Consumer Price Index (CPI), the CFPI is also calculated on a monthly basis and methodology remains the same as CPI.

FAO Food Price Index

Globally, food price index is being released by Food and Agriculture Organization of the United Nations. The FAO Food Price Index is a measure of the monthly change in international prices of a basket of food commodities. It consists of the average of five commodity group price indices (Cereal, Vegetable Oil, Dairy, Meat and Sugar) weighted with the average export shares of each of the groups for 2002-2004.

National Housing Bank Residex

RESIDEX, the country's first official housing price index (HPI) was launched in 2007 covering 26 cities and was published till 2015 on a quarterly basis. It was discontinued then and has been revived in 2017. The revamped RESIDEX has been expanded to 50 cities spread over 18 States and UTs. These include 38 smart cities, of which 18 are state capitals. NHB RESIDEX enables the policy makers, banks, housing finance companies, builders, developers, investors, individuals, etc., to track the movement of housing prices across different cities in India on quarterly basis.NHB RESIDEX helps buyers and sellers to check and compare prices before entering a transaction. They can also analyse the price trends across different citiesIt not only has expanded city coverage (rising from 26 to 50, to be eventually raised to 100), a new base year (2012-13) and new data sources (with data from banks and home finance companies and market surveys).The NHB Residex currently offers two sets of quarterly Housing Price Indices (HPIs) across the cities it tracks. List prices of under-construction property, collated through a survey of developers, are captured in the'Market HPI'. Data reported by banks and finance companies that extend home loans, is collated into the'Assessment HPI'.

House Price Index (HPI) of Reserve Bank of India (RBI)

The Reserve Bank compiles quarterly house price index (HPI) (base: 2010-11=100) for ten major cities, viz., Mumbai, Delhi, Chennai, Kolkata, Bengaluru, Lucknow, Ahmedabad, Jaipur, Kanpur and Kochi. Based on these city indices, an average house price index representing all- India house price-movement is also compiled. These indices are based on the official data of property price transactions collected from registration authorities of respective state governments.

Beginning with Mumbai city, the Reserve Bank initiated the work of compiling a house price index (HPI) in 2007 .Over the quarters, the coverage has been extended by incorporating 9 more major cities, viz., Delhi, Chennai, Kolkata, Bengaluru, Lucknow, Ahmedabad, Jaipur Kanpur and Kochi and the base is shifted to 2010-11=100.1 Besides separate HPI for individual cities, an average HPI representing all-India house price movement is also compiled.

Collection of Statistics Act, 2008

Collection of Statistics Act, 2008 was made to bring in new rules aimed at improving data collection. Government will levy higher penalty for not sharing data and tougher punishment will be imposed in cases where manipulation of data is involved, they say.

Under the new Act, people or companies not divulging data would have to pay a fine of Rs 1,000 and they would be given a 14-day notice period to comply. If the information is not provided even after two weeks, the penalty will rise to Rs 5,000 per day.

Under the old Act, which was passed in 1953, the penalty was only Rs 500 for the first default and Rs 200 per day thereafter.

The new penalty scheme will ensure that data collection is done on time. It will increase the accuracy of the data. The Act also makes wilful manipulation or omission of data a criminal offence, punishable by a prison term that may extend up to 6 months. This penalty will also apply if a company prevents or obstructs any employee from collecting data. The Collection of Statistics Act, 2008, gives powers to the government to classify any statistics as "core statistics" and also determine the method to collect and disseminate the same.

Deflation

Deflation is a prolonged and widespread decline in prices that causes consumers and businesses to curb spending as they wait for prices to fall further. It is the opposite of inflation, when prices rise, and should not be confused with disinflation, which merely describes a slowdown in the rate of inflation. Deflation occurs when an economy's annual headline inflation indicator -- typically the consumer price index -- enters negative territory.

Deflation is hard to deal with because it is self-reinforcing. Put simply, unless it is stopped early, deflation can breed deflation, leading to what is known as a deflationary spiral. When an economy has fallen into deflation, demand from businesses and consumers to buy products falls because they expect to pay less later as prices fall. But as producers struggle to sell and go bankrupt, unemployment rises, reducing demand further. That causes deflation to become more pronounced.

It makes it more expensive to service existing debts. This is as true of governments, who have borrowed trillions of dollars globally to prop up the financial sector, as it is for consumers. As debt becomes more expensive to pay off, the risk of default and bankruptcy rises too, making banks more wary of lending. This reduces demand and further exacerbates the deflationary problem.

Remedy for remedy

- Tax cuts to boost demand from consumers and businesses
- Lowering central bank interest rates to encourage economic activity
- Printing more currency to boost money supply
- Capital injections into the banking system
- Increase government spending on projects that boost the return on private investment

India did not face the threat of deflation as demand has not dropped so much. Also, food scarcity meant food prices did not fall. In fact they rose.

India and Deflation

On the WPI, we faced disinflation- rate of growth of prices fell but not prices themselves till the first quarter of 2009. In the second quarter and later, there was 'deflation' on the WPI. This negative inflation is due to higher base as inflation peaked in July 2008 due to international energy and food price rises because of speculation.

But since late 2014, WPI was in persistent deflation zone till 2016.

Growth -Inflation Trade Off

With high growth, economy overheats. Overheating of the economy means demand overshoots supply and there is pressure on prices. As growth creates more employment, incomes and demand, prices rise.

As prices rise, the central bank intervenes and raises rates to cool investment and consumption demand and so price rise is moderated. Repo rate- the policy rate- is the tool along with CRR and OMOs available to the central bank as signals to the economy that it is ready to act to soften prices -partly because the poor suffer disproportionately and partly because inflation can derail the medium and long term growth.

Such intervention by the central bank has a dampening impact on growth as higher interest rates prevent easy borrowing and thus demand slackens.

We witnessed the same in India with CRR and repo rates going down from 2009 for one year and later till 2011 going up in response to inflation in the country. The primary goal of the RBI is to moderate and stabilize prices as the inflation targeting framework of 2015 February madates.

Thus, growth and inflation are intimately connected- one being traded for the other depending upon where the growth situation stands.

As prices stabilise, growth resumes and a new and higher base is set for the growth process. Growth and inflation do have a trade off but that is only in the short term. As Dr.C.Rangarajan says, growth is a marathon while overheating and slow down are temporary pauses to gain greater strength.

Further, unless the RBI raises the policy rates with inflation going up, there is a danger of banks failing to attract deposits as real interest rates become negative and savings may be diverted to unproductive assets like gold with serious consequences- inside and outside for the economy.

Government Steps To Control Inflation

The Government has taken a number of short term and medium term measures to improve domestic availability of essential commodities and moderate inflation. It has procured record food grains. Even after keeping the minimum buffer stock, there are enough food grains to intervene in the market to keep the prices at reasonable level. A Strategic Reserve of 5 million tonnes of wheat and rice has also been created to offload in the open market when prices are high. This is in addition to the buffer stock held by FCI every year.

The price situation is reviewed periodically at high-level meetings such as the Cabinet Committee on Prices (CCP).

Fiscal Measures

- Reduced import duties on food items
- Import duties are raised on gold etc to contain CAD and step rupee depreciation

Administrative Measures

- Ban on exports of food items
- Dehoarding

Monetary Measures

Repo rates were kept high to make credit dearer.

Other Measures Taken To Control Inflation

The measures taken by the Government along with decline in global oil and commodity prices have contributed towards achieving low inflation. The measures taken by Government include, advising states to allow free movement of fruits and vegetables by delisting them from the APMC Act, banning of export of all pulses (except *kabuli channa* and organic pulses and lentils upto certain quantity), zero import duty on pulses and onion, empowering States/UTs to impose stock limits in respect of onion, pulses, edible oil, and edible oilseeds under the Essential Commodities Act, modest increase in minimum support prices in last two years etc. The vigilant monetary policy stance by the RBI and adoption of a Monetary Policy Framework agreement between Government and RBI has also led to moderation in inflation by bringing in an element of certainty of action by the RBI.

Disinflation in India 2017: The Structural Basis

In 2017, the Economic Survey of GOI and inflation watchers have opined that there could be a paradigm shift in the inflationary situation in India as well as the world.

There is deceleration of rate of growth of prices in the country for some months. It is called deflation. There are structural reasons for it according to experts. Oil prices are low since 2014 and will never go back to the earlier levels. US crude exports are forecast to exceed that of most Organization of the Petroleum Exporting Countries (OPEC) members by 2020.

Because of Chinese growth slowing, pressure on metal prices is expected to continue.

Globalization and lower inflation may go together due to labour's declining pricing power as a result of the threat of globalization – either be competitive or close down. Investment and jobs may shift if labour unionises and becomes aggressive. Expansion of the global labour force due opening up of Asia and the former Soviet bloc almost doubled the effective labour force involved in world trade.

Robots are another threat to labour.

In India, there are other factors that point to lower inflation. The fiscal deficit has come down, the rupee has strengthened, the rains have been good and the government has successfully managed food prices.

MONEY MARKET AND CAPITAL MARKET IN INDIA: INSTRUMENTS AND DYNAMICS

There is need and demand for funds for a short period of time- less than one year. The need may be for a large amount but the period is short. The need is for working capital requirements, repayment of loans, consumption etc. That is the reason for a structured entity called money market. It is a part of the financial markets involved in short-term borrowing, lending, buying and selling with original maturities of one year or less. Trading in money markets is done over the counter. Over-the-counter (OTC) trading is done directly between two parties, without the supervision of an exchange.)

Money market can be defined as a market for short-term funds with maturities ranging from overnight to one year and includes financial instruments that are considered to be close substitutes of money. Money market transactions could be both secured (with collateral) and unsecured (clean, without collateral).

Banks and financial institutions (IDBI, LIC etc.) individuals, mutual funds, companies and government are the main lenders and borrowers. The informal market operates through small-scale money-lenders as well as others outside the RBI control.

Money market instruments broadly are: call money; bill market (both commercial bills and treasury bills) Certificates of Deposit (CD); Commercial paper (CP).

Call Money

Call/Notice money is money borrowed or lent for a very short period. If the period is more than one day and up to 14 days it is called 'Notice money' otherwise the amount is known as Call money'. No collateral security is required to cover these transactions and goodwill and reputation are the basis apart from the documents like promissory notes. The call market enables the bank and institutions to even out their day to day deficits and surpluses of money.

Commercial banks, both Indian and foreign, co-operative banks, Discount and Finance House of India Ltd.(DFHI), Securities trading corporation of India (STCI) participate as both lenders and borrowers and Life Insurance Corporation of India (LIC), Unit Trust of India(UTI), National Bank for Agriculture and Rural Development (NABARD)can participate only as lenders.

Interest rates in the call and notice money market are market determined.

A primary dealer is a firm that buys government securities directly from a government, with the intention of reselling them to others, thus acting as a market maker of government securities.

Government Securities

The Government securities comprise dated securities issued by the Government of India and state governments as also, treasury bills issued by the Government of India.Reserve Bank of India manages and services these securities through its public debt offices located in various places as an agent of the Government. T-Bills are a money market instrument.

Treasury Bills

Treasury bills (T-bills) are short-term investment opportunities, generally up to one year. They are thus useful in managing short-term liquidity. At present, the Government of India issues three types of treasury bills through auctions, namely, 91-day, 182-day and 364-day. There are no treasury bills issued by State Governments.Treasury bills are available for a minimum amount of Rs.25,000 and in multiples of Rs. 25,000. Treasury bills are issued at a discount and are redeemed at par. Treasury bills are also issued under the Market Stabilization Scheme (MSS).While 91-day T-bills are auctioned every week on Wednesdays, 182-day and 364-day T-bills are auctioned every alternate week on Wednesdays. They are available in primary and secondary market. Treasury bills are available for a minimum amount of Rs.25,000 and in multiples of Rs.25,000. Treasury bills are issued at a discount and are redeemed at par.Treasury bills are zero coupon securities and pay no interest. They are issued at a discount and redeemed at the face value at maturity. For example, a 91 day Treasury bill of Rs.100/- (face value) may be issued at say Rs.98.20, that is, at a discount of say, Rs.1.80 and would be redeemed at the face value of Rs.100/-. The return to the investors is the difference between the maturity value or the face value (that is Rs.100) and the issue price.The usual investors in these instruments are banks, insurance companies, FIs etc. T-bills auctions are held on ***the Negotiated Dealing System (NDS)*** and the members electronically submit their bids on the system.

Cash Management Bills (CMBs)

Government of India, in consultation with the Reserve Bank of India, has decided to issue a new short-term instrument, known as Cash Management Bills (CMBs), to meet the temporary mismatches in the cash flow of the Government. The CMBs have the generic character of T-bills but are issued for maturities less than 91 days. Like T-bills, they are also issued at a discount and redeemed at face value at maturity.

Inter Bank Term Money

Inter bank market for deposits of maturity beyond 14 days and upto three months is referred to as the term money market.

Certificates Of Deposit

Certificate of deposit (CD) is issued by scheduled commercial banks and Financial institutions (FI). Regional rural banks and Local area banks can not issue CDs.

CD is a negotiable promissory note, secure and short term (up to a year) in nature. A CD is issued at a discount to the face value, the discount rate being negotiated between the issuer and the investor. Minimum amount of a CD should be Rs.1 lakh. The maturity period of CDs issued by banks should be not less than 15 days and not more than one year. The FIs can issue CDs for a period not less than 1 year and not exceeding 3 years from the date of issue. CDs can be issued to individuals or firms.

Inter Corporate Deposits Market

Apart from CPs, corporates also have access to another market called the inter corporate deposits (ICD) market. An ICD is an unsecured loan extended by one corporate to another. Existing mainly as an avenue for low rated corporates, this market allows fund- surplus corporate to lend to other corporates.

Commercial Paper

It represents short term unsecured promissory notes issued by top rated corporates, primary dealers (PDs),satellite dealers (SDs) and the all-India financial institutions (FIs). CP can be issued for maturities between a minimum of 7 days and a maximum of up to one year from the date of issue. However, the maturity date of the CP should not go beyond the date up to which the credit rating of the issuer is valid. CP can be issued in denominations of Rs.5 lakh or multiples thereof.

The main features of these papers are:

- corporates having tangible net worth of not less than Rs.4 crore can issue them
- All CPs require credit rating from a credit rating agency
- Minimum amount invested by single investor is Rs. Five lakh or multiple thereof.
- CPs are issued at a discount to face value.

Ready Forward Contracts (Repos)

Repo is an abbreviation for Repurchase agreement, which involves a simultaneous "sale and purchas" agreement. When banks have any shortage of funds, they can borrow it from Reserve Bank of India or from other banks. The rate at which the RBI lends money to commercial banks on the basis of government securities is called repo rate.

Commercial Bills

Bills of exchange are negotiable instruments drawn by the seller (drawer) of the goods or services on the buyer (drawee) of the goods for the value of the goods delivered. These bills are called trade bills. These trade bills are called commercial bills when they are accepted by commercial banks for discounting. If the bill is payable at a future date and the seller needs money immediately, he may approach his bank for discounting the bill. The bank or any other discounting body takes a commission for it.

Discount and Finance House of India (DFHI)

It wet up in 1988 by RBI to strengthen the bill market. It has been established to deal in money market instruments in order to provide liquidity. Thus the task assigned to DFHI is to develop a secondary market in the existing money market instruments. The main objective of DFHI is to facilitate the smoothening of the short term liquidity imbalances by developing an active money market and integrating the various segments of the money market. At preset DFHI's activities are restricted to:

- Dealing in Treasury Bills
- Re-discounting short term commercial bills.
- Participating in the inert bank call money, notice money and term deposits and
- Dealing in Commercial Paper and Certificate of deposits.
- Government dated Securities

Libor

The London Interbank Offered Rate is the average interest rate estimated by leading banks in London that they would be charged for what they borrow from other banks. It is usually abbreviated to BBA Libor (for British Bankers' Association Libor). It is the primary benchmark, along with the Euribor, for short term interest rates around the world. Many financial institutions, mortgage lenders and credit card agencies set their own rates relative to it.

Mibor - Mumbai Inter-Bank Offer Rate

The Committee for the Development of the Debt Market that had studied and recommended the modalities for the development for a benchmark rate for the call money market. Accordingly, NSE had developed and launched the NSE Mumbai Inter-bank Bid Rate (MIBID) and NSE Mumbai Inter-bank Offer Rate (MIBOR) for the overnight money market in 1998. The **MIBID/MIBOR** rate is used as a bench mark rate for majority of deals.

Money Market Reforms

On the recommendations of the Sukhmoy Chakravarty Committee on the Review of the Working of the monetary system (1985) and the Narasimham Committee Report on the Working of the Financial System in India, 1991, The Reserve Bank of India initiated a series of money market reforms basically directed towards the efficient discharge of its objectives.

Reforms made in the Indian Money Market are

- Deregulation of the Interest Rate
- Money Market Mutual Fund (MMMFs) are allowed to sell units to corporates and individuals
- Discount and Finance House of India (DFHI) was set up in 1988 to impart liquidity in the money market. It was set up jointly by the RBI, Public sector Banks and Financial Institutions.
- Liquidity Adjustment Facility (LAF) LAF adjusts liquidity in the market through absorption and or injection of financial resources by the RBI.
- In order to impart transparency and efficiency in the money market transaction the electronic dealing system has been started. It is useful for the RBI to watchdog the money market.
- Establishment of the CCIL: The Clearing Corporation of India limited (CCIL) in 2001.
- Development of New Market Instruments like CMBs
- MSS since 2004 that came to great use in 2016 post-demonetisation.

Capital Market

It refers to market for funds with a maturity of 1 year and above called as term funds that include medium and long term funds. The demand for these funds comes from both the government for its investment purposes and also the private sector. Banks, public financial institutions like LIC and GIC; development financial institutions, mutual funds are the main participants in the market. The components of the capital market in India are the following:Government securities, industrial securities that include the shares and debentures of Indian companies- both the primary and secondary market, DFIs (IFCI, IDBI, State Financial Corporations (SFCs); UTI, ICICI (private sector) Financial intermediaries: merchant banks; mutual funds; leasing companies; venture capital companies and others.

G-Secs (Gilt Edged Securities)

A Government security is a tradable instrument issued by the Central Government or the State Governments through RBI. It acknowledges the Government's debt obligation. Such securities are short term (usually called treasury bills or Cash Management Bills with original maturities of less than one year) or long term (usually called Government bonds or dated securities with original maturity of one year or more). In India, the Central Government issues both, treasury bills and bonds (dated securities) while the State Governments issue only bonds or dated securities, which are called the State Development Loans (SDLs). Government securities carry zero risk of default and, hence, are called risk-free gilt-edged instruments. Government of India also issues savings instruments (Savings Bonds, National Saving Certificates (NSCs), etc.) or special securities (oil bonds, Food Corporation of India bonds, fertiliser bonds, power bonds, recapitalization bonds etc.). They may not be tradable and are, therefore, not eligible to be SLR securities. They are not issued through the RBI.

Dated Government securities are long term securities and carry a fixed or floating coupon (interest rate) which is paid on the face value, payable at fixed time periods (usually half-yearly). The tenor of dated securities can be up to 30 years. The G-Sec instrument is in the nature of a bond.

GOI Dated Security can be held by any person, firm, company, corporate body or institution, State Governments, Provident Funds and Trusts. Non-Resident Indians (NRIs, viz., Indian citizens and Individuals of Indian origin), Overseas corporate bodies predominantly owned by NRIs and Foreign Institutional Investors registered with SEBI and approved by Reserve Bank of India are also eligible to invest in the government stock. G-Sec are issued both in demat and physical form. The minimum investment in G-Secs is Rs 10,000. G-Secs could be of the following types:

Dated Securities: They have fixed maturity and fixed coupon rates payable half yearly and are identified by their year of maturity.

Floating Rate Bonds: They are bonds with variable interest rates with a fixed percentage over a benchmark rate. There may also be a cap and a floor rate attached, thereby fixing a maximum and minimum interest rate payable on it.

Capital Indexed Bonds: They are bonds where the interest rate is a fixed percentage over the inflation rate: WPI or CPI depending on the terms.

Reserve Bank of India sets limits to FPI investment in GOI securities, state development loans (SDLs) and corporate bonds.

State Development Loan (SDL)

State Governments also raise loans from the market through the RBI. SDLs are dated securities issued through an auction similar to the auctions conducted for dated securities issued by the Central Government. Interest is serviced at half-yearly intervals and the principal is repaid on the maturity date. Like dated securities issued by the Central Government, SDLs issued by the State Governments qualify for SLR. They are also eligible as collaterals for borrowing through market repo as well as borrowing by eligible entities from the RBI under the Liquidity Adjustment Facility (LAF).

DFIs or Development Banks

Financial institutions assume a critical role in the provision of long term credit. A development finance institution (DFI) can be broadly categorised as All-India or State / regional level institutions depending on their geographical coverage of operation. Functionally, All-India institutions can be classified as

- term-lending institutions (IFCI Ltd., IDBI, IDFC Ltd., IIBI Ltd.) extending long-term finance to different industrial sectors
- refinancing institutions (NABARD, SIDBI, NHB) extending refinance to banking as well as non-banking intermediaries for finance to agriculture, SSIs and housing sector, respectively
- sector-specific / specialised institutions (EXIM Bank, TFCI Ltd., REC Ltd., HUDCO Ltd., IREDA Ltd., PFC Ltd., IRFC Ltd.)
- investment institutions (LIC, UTI, GIC, IFCI Venture Capital Funds Ltd., ICICI Venture Funds Management Co Ltd.). State / regional level institutions are various SFCs, SIDCs etc.

Historically, low-cost funds were made available to DFIs to ensure that the spread on their lending operations did not come under pressure. DFIs had access to soft window of Long Term Operation (LTO) funds from RBI at concessional rates.

(Industrial Development Bank of India (IDBI), IFCI Ltd., Industrial Investment Bank of India Ltd. (IIBI), Small Industries Development Bank of India (SIDBI), National Housing Bank (NHB), National Bank for Agriculture and Rural Development (NABARD), Export Import Bank of India (EXIM Bank), Tourism Finance Corporation of India Ltd. (TFCI), Life Insurance Corporation of India (LIC), General Insurance Corporation of India (GIC); Infrastructure Development Finance Company of India Ltd. (IDFC). All these institutions operate on all-India basis. Other institutions comprise Export Credit and Guarantee Corporation (ECGC) and Deposit Insurance and Credit Guarantee Corporation (DICGC). The state level institutions consist of state financial corporations (SFCs) and state industrial development corporations (SIDCs))

Merchant Banks / Investment Banks

MBs are those who manage and underwrite (Underwriting an issue means to guarantee to purchase any shares in a new issue(IPO) or rights issue not fully subscribed by the public.) new public issues floated by companies to raise funds from public. They advise corporate clients on fund raising. They are also called investment banks (I banks) .They deal only with corporates and not general public, essentially.

Lehman Brothers was a global financial services firm. Before declaring bankruptcy in 2008, Lehman was the fourth-largest investment bank in the US (behind Goldman Sachs, Morgan Stanley, and Merrill Lynch), doing business in investment banking, equity, trading (especially U.S. Treasury securities), research, investment management, private equity and private banking.

On September 15, 2008, the firm filed for bankruptcy protection following the massive exodus of most of its clients, drastic losses in its stock, and devaluation of its assets by credit rating agencies.

Collective Investment Schemes (CIS)

According to the Securities Laws (Amendment) Act 2014, a CIS is any scheme or arrangement which pools funds from investors and involves a corpus amount of ₹ 100crore or more. It is an arrangement where investors pool in their funds to derive some return on investment. The pool of funds is, in turn, used for purposes of the scheme or arrangement.CIS is governed by the Securities and Exchange Board of India (SEBI) Regulations.

While they are useful for the unbanked people, many CISs emerged as Ponzi schemes(fraud).

Alternative Investment Funds

AIFs is a newly created class of pooled-in investment vehicles for real estate, private equity and hedge funds. Angels are the new category introduced in 2013. AIFs are basically funds established or incorporated in India for the purpose of pooling in capital from Indian and foreign investors for investing as per a pre-decided policy. Sebi regulates them. It excludes Mutual funds or collective investment Schemes, family trusts, Employee Stock Option etc.

REITs

Securities and Exchange Board of India (SEBI) regulates Real Estate Investment Trusts (REITs). Like mutual funds, REITs will pool in money from investors and issue units in exchange.

Most of the money so collected is invested in commercial properties which are completed and generate income. The REIT will have to first get registered and raise funds through an initial public offer or IPO. Units of REITs will have to be compulsorily listed on exchanges and will be traded like securities. The minimum requirement for asset sizes permitted to be listed in India is Rs 500 crore. The minimum issue size of the initial public offer shouldn't be less than Rs 250 crore. Therefore, like stocks, investors will be able to buy units of REITs from both primary and secondary markets which are based on commercial real estate without actually having to buy those assets.

Mutual Funds

Mutual funds raise money from public and invest them in stock market securities; bonds etc. SEBI regulates mutual funds.

Hedge Fund

A hedge fund is like a mutual fund (MFs): both are investment vehicles which pool investors' money which invested as per the fund`s mandate and returns are distributed among unit holders for a commission. However, hedge funds use strategies far more complex than a typical MF which mostly focuses on generating returns through simple asset allocation. Hedge funds use various strategies such as long-short, derivatives, leverage and so on and aim to give return with minimum risk.SEBI (Securities and Exchange Board of India) regulates them under alternative investment fund (AIF) .

Venture Capital

Venture capital is money provided by financial institutions who invest in startups generally that have the potential to develop into significant economic contributors.

Angel Investors

An angel investor or angel (also known as a business angel or informal investor) is an affluent individual who provides capital for a business start-up, usually in exchange for convertible debt or ownership equity. They invest their own money unlike a venture capitalist who invests public money. They became popular after the web-based enterprises came up in the 1990's.With an aim to encourage entrepreneurship in the country by financing small start-ups, market regulator SEBI in 2013 notified norms for angel investors, who provide funding to companies at their initial stages. Angel investors are allowed to be registered as Alternative Investment Funds (AIFs) - a newly created class of pooled-in investment vehicles for real estate, private equity and hedge funds.

In order to ensure investment by angel funds is genuine, the Securities and Exchange Board of India (Sebi) has restricted investment by such funds between Rs. 50 lakh and Rs 5 crore. Among other norms included, angel funds can make investments only in those companies which are incorporated in India. These funds need to be invested in a firm for at least three years, can invest in companies not older than 3 years.Angel funds are required to have a corpus of at least Rs 10 crore and minimum investment by an investor should be Rs 25 lakh. The regulator also stipulated that the fund must not have any family connection with the investee company.

The new norms would help in encouraging entrepreneurship in the country by financing small start-ups at a stage where such start-up finds it difficult to obtain funds from traditional sources of funding such as banks, financial institutions among others.

In 2016, GOI introduced a start-up policy which can get a stimulus from the angels.

Private Equity

A company can sell some of its shares- in significant quantity, to a PE firm which obliges the PE to be a part of the management and make the company profitable in a few years or so after which the PE firm exits. The company may be listed or not. The placement of equity is private and not through an IPO. It generally has a lock in period during which they are not publicly traded on a stock exchange. Capital for private equity is raised primarily from institutional investors.

Hundi

Hundis were legal financial instruments that evolved in India. These were used in trade and credit transactions; they were used as remittance instruments for the purpose of transfer of funds from one place to another. In the pre-modern era, Hundis served as travellers cheques. They were also used as credit instruments for borrowing and as bills of exchange for trade transactions. Technically, a Hundi is an unconditional order in writing made by a person directing another to pay a certain sum of money to a person named in the order. Being a part of an informal system, hundis now have no legal status and were not covered under the Negotiable Instruments Act, 1881.

Chit Funds

A chit fund is an arrangement that a group of people arrive at to contribute money in a defined manner at periodic intervals into a pool. It is a kind of savings scheme.Such chit fund schemes may be conducted by organised financial institutions, or may be unorganised schemes conducted between friends or relatives. Chit funds played an important role in the financial development of people of south Indian state of Kerala, by providing easier access to credit. In Kerala, chitty (chit fund) is a common phenomenon practiced by all sections of the society. A company named Kerala State Financial Enterprise exists under the Kerala State Government, whose main business activity is the chitty. During the process of collection, any member can draw a lump sum through various ways like a lucky draw, an auction or a member can even fix a payout date based on a known expenditure. These schemes are very popular in tier II and III towns in India and even in rural India, because under-penetration of banking services, as they are a way of raising quick money or catering for sudden liquidity needs or even a planned expenditure. They thrive as bank loans are very cumbersome and many are not eligible. Chit funds are governed by state or central laws. There is a central Chit Funds Act of 1982, apart from a number of state chit fund Acts. There is an office of "Registrar of Chit Funds" in every state that monitors operations which are quite stringent.

Securities Laws (Amendment) Act, 2014 provides Securities and Exchange Board of India (SEBI) with new powers to effectively pursue fraudulent investment schemes, (ponzi schemes) and gives guidelines for the formation of special fast trial courts.

QIPs

QIPs are eligible under "Qualified Institutional Placement "(which includes public financial institutions, mutual funds, foreign institutional investors, venture capital funds and foreign ventur capital funds registered with the SEBI) to be sold shares/ fully convertible debentures/ partly convertible debentures or any securities which are convertible into or exchangeable with equity shares at a later date. Since the beginning of 2009, Indian companies are raising billions of dollars from the QIP route.

NBFC

NBFC means Non-banking financial company. A non-banking financial company (NBFC) is a company registered under the Companies Act, 1956 and is engaged in the business of loans and advances, housing finance, acquisition of shares/stock/bonds/debentures/securities issued by government or local authority or other securities of like marketable nature, leasing, hire-purchase, insurance business, chit business, but does not include any institution whose principal business is that of agriculture activity, industrial activity, ale/purchase/construction of immovable property. NBFCs are similar to banks; however they do not accept demand deposits.

Some microfinance companies are registered as NBFCs and are regulated by the RBI while other MFIs are either registered as money lenders or Societies. An RBI-appointed panel headed by Y H Malegam had recommended setting up of a special category of NBFCs operating in the micro finance sector in 2011.These are called Non Banking Financial Company-Micro Finance Institution (NBFC-MFI).

The Reserve Bank of India (RBI) introduced a new category called Non-Banking Financial Company-Factors. Factoring is the business of selling invoices (receivables) to a factoring company (Factor) at a discount. Consequently, the selling corporate can get cash quickly and avoid risk of collecting debt. Factoring can be of two types: domestic and export oriented, the latter being called forfaiting. Forfaiting is the purchasing of an exporter's receivables (the amount importers owe the exporter) at a discount by paying cash. The forfaiter, the purchaser of the receivables, becomes the entity to whom the importer is obliged to pay its debt.The factoring mechanism mostly assists smaller companies, which run relatively shorter fund flow cycle. Factoring bails them out by supporting their fund system instantly.

ECBs

ECB (External Commercial Borrowings) is an instrument used to facilitate the access to foreign money by Indian corporations and PSUs (Public Sector Undertakings). ECBs include commercial bank loans, buyers' credit, credit from official export credit agencies and commercial borrowings from the private sector window of Multilateral Financial Institutions such as International Finance Corporation (Washington), ADB and Investment by Foreign Institutional Investors (FIIs) in dedicated debt funds. ECBs cannot be used for investment in stock market or speculation in real estate. The DEA (Department of Economic Affairs), Ministry of Finance, Government of India along with Reserve Bank of India, monitors and regulates ECB guidelines and policies. External Commercial Borrowings provide an additional source of funds to Indian corporates and PSUs for financing expansion of existing capacity and as well as for fresh investment, to augment the resources available domestically. ECBs can be used for any purpose (rupee-related expenditure as well as imports) except for investment in stock market and speculation in real estate.Applicants are free to raise ECB from any internationally recognised source like banks, export credit agencies, suppliers of equipment, international capital markets etc. ECBs help diversify risk for the companies. Also, the interest rates are softer abroad. They help Indian companies with foreign funds.Country benefits as it has access to forex.

ECBs can be raised through two routes: Automatic Route and the Approval Route. The former does not require permit from the Regulator whereas the latter requires. RBI policy allows corporates registered under the Companies Act, 1956, except financial intermediaries such as banks, financial institutions (FIs), housing finance companies and Non-Banking Finance Companies (NBFCs) to access ECBs. NGOs engaged in micro-finance activities have been permitted to raise ECB up to certain limits. Financial institutions dealing exclusively with infrastructure or export finance such as IDFC, IL&FS, Power Finance Corporation, Power Trading Corporation, IRCON and EXIM Bank are considered on a case-by-case basis.

The priority end use of ECBs includes investment (such as import of capital goods, new projects, modernization/expansion of existing production units) in real sector - industrial sector including small and medium enterprises (SME) and infrastructure sector, power exploration, telecom, railways, roads & bridges, ports and exports.ECB Policy helps source loans cheap; domestic liquidity constraints are eased; country gets forex; rupee slide could be contained; infrastructure benefits.

Euro Issues

Indian companies are permitted to raise foreign currency resources through issue of Foreign Currency Convertible Bonds (FCCBs), ordinary equity shares through Global Depository Receipts (GDRs) to foreign investors i.e. institutional investors or individuals (including NRIs) residing abroad. That is, Euro-issues include Euro-convertible bonds and GDRs.

Stock Market

(Given as a separate chapter)

Credit Default Swap

It is a form of insurance against debt default. When an investor buys corporate (or government) bonds he/she faces the risks of default on the part of the issuing agent. The investor can insure its investment in such bonds against default through a third party. The investor pays a premium to the party providing insurance. In the event of default by the bond issuer, the insurer would step in and pay the investor. A CDS is just like insurance, which is bought by those who fear default.

Corporate Debt

Corporate debt is necessary for their investment, acquisitions etc.
The following are some of the different types of corporate debt securities issued:

- Non-Convertible Debentures
- Partly- Convertible Debentures
- Fully-Convertible Debentures (Convertible into Equity shares)
- Bonds

Infrastructure Debt Funds (IDFs)

IDFs are investment vehicles which can be sponsored by commercial banks and NBFCs in India in which domestic/offshore institutional investors, specially insurance and pension funds can invest through units and bonds issued by the IDFs. They can be set up either as a Trust or as a Company. A trust based IDF would normally be a Mutual Fund (MF), regulated by SEBI, while a company based IDF would normally be a NBFC regulated by the Reserve Bank. IDF-MFs can be sponsored by banks and NBFCs. Only banks and Infrastructure Finance companies can sponsor IDF-NBFCs. By 2017, while all IDF-NBFCs have asset base of over ₹ 9,000 crore, IDFs under the MF route (IIFCL, ILFS,) have assets of t about ₹ 2,000 crore.

FIIs Investment in Debt

FIIs can invest in government and corporate debt- primary and secondary market. These limits and the rules are relaxed from time to time depending on the needs of the economy. FII debt is rupee debt.

Take-out Financing

It came into effect in 2010. It is a method of providing finance for longer duration projects (for example, 15 years) by banks by sanctioning medium term loans (like 5-7 years). It is the understanding that the loan will be taken out of books of the financing bank within pre-fixed period, by another institution thus preventing any possible asset-liability mismatch.

Under this process, the institutions engaged in long term financing such as IDFC, agree to take out the loan from books of the banks financing such projects after the fixed time period when the project reaches certain previously defined milestones. On the basis of such understanding, the bank concerned agrees to provide a medium term loan- 5-7 years. At the end of the period, the bank could sell the loans to the institution and get it off its books. This ensures that the project gets long-term funding through various participants. Banks otherwise cannot lend for infrastructure as their deposits are for a short period and the loans are for a long period- asset liability mismatch.

External Sources of Finance For India

- Stock market(partly touched above under Euro issues) like ADRs and GDRs
- ECB(see above)
- IBRD and IFC
- Private equity
- Bilateral loans by Governments abroad
- Masala bonds(in rupee)

International Finance Corporation's (IFC) and Masala Bond

IFC floated the first ever global rupee bond in 2013. The first tranche of International Finance Corporation's (IFC) rupee bond saw unprecedented demand from global pension funds, banks, asset management companies and central banks. It paved the way for Indian corporates to raise cheaper funds as the currency risk will be borne by the investor.

STOCK MARKET- INDIA AND GENERAL

A stock exchange is an organization which provides a platform for trading shares- either physical or virtual. The origin of the stock market dates back to the year 1494, when the Amsterdam Stock Exchange was first set up. In a stock exchange, investors through stock brokers buy and sell shares and other financial products in a wide range of listed companies. A given company may list in one or more exchanges by meeting and maintaining the listing requirements of the stock exchange.

In financial terminology, stock is the capital raised by a corporation, through the sale of shares. In common parlance, stocks and shares are used interchangeably .A shareholder is any person or organization which owns one or more shares issued by a corporation. The aggregate value of a corporation's issued shares, at current market prices, is its market capitalization. Stock broker buys and sells for an investor as no one but the broker can do it.

Importance of Stock Exchanges

- For efficient working of the economy and for the smooth functioning of the corporate form of organization, the stock exchange is an essential institution.
- an efficient medium for raising long term. resources for business
- Help raise savings from the general public by the way of issue of equity / debt capital
- attract foreign currency
- exercise discipline on companies and make them profitable
- investment in backward regions for job generation
- another vehicle for investors' savings

Stock Exchanges in India

The first company that issued shares was the VOC or Dutch East India Company in the early 17th century (1602). India has over 25m shareholders today. Over 9,000 companies are listed on the stock exchanges, which are serviced by approximately 7,500 stockbrokers. The Indian capital market is significant in terms of the degree of development, volume of trading and its tremendous growth potential.

Stock exchanges provide an organised market for transactions in securities and other securities. There were more than 20 regional stock exchanges till recently but all of them shut down from 2012 when 012, when SEBI brought out new norms for RSEs, under which they needed to own a platform, with an annual trading of not less than ₹ 1,000 crore, to continue.Net worth of the exchange should not be less than ₹ 100 crore.

There are 5 stock exchanges in the country: BSE, National Stock Exchange (NSE), United Stock Exchange (USE), MCX Stock Exchange Ltd (MCX-SX) and India International Exchange (INX).

Bombay Stock Exchange (BSE)

BSE is Asia's first stock exchange is the world's 11th largest stock exchange with an overall market capitalization of $1.8 trillion (2017) More than 5500 companies are listed on the BSE.

BSE's popular equity index - the S&P BSE SENSEX (Formerly SENSEX) - is India's most widely tracked stock market benchmark index. It is traded internationally on the EUREX as well as leading exchanges of the BRICS nations (Brazil, Russia, China and South Africa).

One of the unique features in the BSE includes the automatic online trading system known as BOLT that ensures an efficient and transparent market for trading in equity, debt instruments and derivatives. In 2005, the status of the exchange changed from an Association of Persons (AoP) to a full fledged corporation under the BSE (Corporatization and Demutualization) Scheme, 2005 and its name was changed to The Bombay Stock Exchange Limited. It went for an IPO in 2017 and got listed on NSE.

National Stock Exchange (NSE)

It is stock exchange located in Mumbai, India. National Stock Exchange (NSE) was established in 1992 and started trading in 1994. It was recognised as a stock exchange in 1993. NSE has played a critical role in reforming the Indian securities market and in bringing transparency, efficiency and market integrity. NSE has a market capitalization of more than US$1.5 trillion, making it the world's 12th-largest stock exchange (2017). About 1600 companies are listed on it (2017).

NSE was set up by a group of leading Indian financial institutions at the behest of the government of India to bring transparency to the Indian capital market NSE was established with a diversified shareholding comprising domestic and global investors. The key domestic investors include Life Insurance Corporation of India, State Bank of India, IFCI Limited IDFC Limited and Stock Holding Corporation of India Limited. There are many domestic and global institutions and companies that hold stake in the exchange. Some of the domestic investors include LIC, GIC, State Bank of India and IDFC Ltd. Foreign investors include Citigroup.

The Standard & Poor's CRISIL NSE Index 50 or S&P CNX Nifty -Nifty 50 or simply Nifty is the leading index for large companies on the National Stock Exchange of India. The Nifty is a well diversified 50 stock index accounting for leading sectors of the economy .

The CNX Nifty Junior is an index for companies on the National Stock Exchange of India. It consists of 50 companies on the National Stock Exchange of India. It has the second tier of stocks in terms of market cap and don't make it into Nifty

Though a number of other exchanges exist, NSE and the Bombay Stock Exchange are the two most significant stock exchanges in India, and between them are responsible for the vast majority of share transactions. NSE's flagship index, the CNX NIFTY 50, is used extensively by investors in India and around the world to take exposure to the Indian equities market.

Metropolitan Stock Exchange of India (MSE)

It was earlier known as MCX-SX. It commenced operations in 2008.But became a full-fledged exchange with equity trading in 2013. It went for an IPO in 2012.

United Stock Exchange of India (USE)

The United Stock Exchange of India (USE) is an Indian stock exchange. It is the 4th pan India exchange launched for trading financial instruments in India. USE represents the commitment of 21 Indian public sector banks, private banks, international banks (Standard Chartered) and corporate houses to build an institution of repute.USE launched its operations in 2010 and deals in currency futures.

INX 2017

India International Exchange (INX) is India's first international stock exchange, opened in 2017. It is located at the International Financial Services Centre (IFSC), GIFT City in Gujarat. It is a wholly owned subsidiary of the Bombay Stock Exchange (BSE).

India INX is one of the world's most advanced technology platforms with a turn-around-time of 4 micro seconds which will operate for 22 hours a day, allowing international investors and NRIs to trade from anywhere across the globe. India INX offers equity, currency, commodity and interest rate derivatives and proposes to offer depository receipts and bonds once the infrastructure is in place.

Classification of companies listed in BSE

Group	Classification
A	Companies with large capital base, large shareholder base, and good growth record with regular dividends & greater volumes in secondary market.
B1	Relatively liquid scrips with good management & satisfactory growth prospects & volumes
F	Segment for Non-convertible debentures
G	Central and State Government Securities
Z	It comprises of companies not complying with clauses of the listing agreement and are not redressing the grievances of the investor.

Sensex

Sensex or Sensitive Index is a value-weighted index composed of 30 companies with the base 1978-1979 = 100. It consists of the 30 largest and most actively traded blue chip stocks (profit making), representative of various sectors, on the Bombay Stock Exchange. Inclusion of the company is basically on the basis of market capitalization. The 30 companies in the index are revised periodically- some are replaced by others and new sectors may find representation as the economy evolves. The Sensex is generally regarded a mirror or barometer of the Indian stock markets and economy.

Demutualization

Mutualization refers to ownership and management of the exchange being combined in the same hands- brokers elected by the broker community from among themselves. Brokers are the owners of the BSE. Demutualization is when management and ownership are separated. Ownership is divested from the brokers and the company becomes a public company. All stock exchanges are to be demutualised according to the Government law made in 2004. Demutualization, thus means that ownership, management and trading rights are separated in a stock exchange.

BSE SME and NSE Emerge

BSE and NSE in 2012 launched their SME exchange platforms to enable small and medium enterprises to raise funds and get listed as public entities. While BSE started its SME platform under the brand name of BSE SME Exchange NSE followed suit by announcing the launch its own platform 'Emerge'.The exchange provides an opportunity to small entrepreneurs to raise equity capital for growth and expansion. It will also provide immense opportunity for investors to identify and invest in good SMEs at early stage. The government has been taking a number of steps for SMEs to address challenges of globalisation, higher cost of funds, IT upgrade, infrastructure nstraints faced by SMEs.

SMEs have huge listing potential but so far there have been only debt-financing options, without any access to alternative equity options. There is a general lack of awareness among SMEs about equity capital, stock markets and funding options, other than banks.

Securities and Exchange Board of India (SEBI)

The capital markets in India are regulated by the Securities and Exchange Board of India. (SEBI) It was established in 1988 and given a statutory basis in 1992 on the basis of the Parliamentary Act- SEBI Act 1992 to regulate and develop capital market. SEBI regulates the working of stock exchanges and intermediaries such as stock brokers and merchant bankers, accords approval for mutual funds, and registers Foreign Institutional Investors who wish to trade in Indian stocks. Section 11(1) of the Sebi Act says that it shall be the duty of the Board to protect the interests of investors in securities.

SEBI promotes investor's education and training of intermediaries of securities markets. It prohibits fraudulent and unfair trade practices relating to securities markets, and insider trading in securities, with the imposition of monetary penalties, on erring market intermediaries. It also regulates substantial acquisition of shares and takeover of companies and calling for information from, carrying out inspection, conducting inquiries and audits of the stock exchanges and intermediaries and self regulatory organizations in the securities market. SEBI has its head office in Mumbai and its three regional offices in New Delhi, Calcutta and Chennai.

SEBI's powers were enhanced in 2002 - strengthen the SEBI's board, enlarge it to nine from six and appoint three full-time directors; given enhanced powers to conduct search and seizure etc.

SEBI and the Reforms

The Stock Exchange Scam of 1992 (Harshad Mehta) and the scam in 2000 (Ketan Parekh) led to led to various measures by the Government to protect the interests of the small investors. SEBI introduced reforms like improved transparency, computerisation, enactment against insider trading, restrictions on forward trading, introduction of T + 2 system of settlement etc. The restriction and elimination of forward or Contango trading, referred to in India as 'Badla' is a bold step to check speculation and manipulation of the market. Some more steps taken by SEBI to strengthen markets are:

- SEBI reconstituted governing boards of the stock exchanges, introduced capital adequacy norms for brokers, and makes rules for making client/broker relationship more transparent
- SEBI enforces corporate disclosures
- Enforces ban on insider trading
- Protects retail investors
- SEBI is empowered to register and regulate mutual funds.
- introducing a code of conduct for all credit rating agencies operating in India.
- Clause 49 of the listing agreement that SEBI introduced mandates that all listed companies should have half the Directors on the Board as Independent Directors
- Making it mandatory to have anchor investors

Securities Laws (Amendment) Act 2014

Securities Laws (Amendment) Act 2014 is a legislation in India which provided the securiti market regulator Securities and Exchange Board of India (SEBI) with new powers to effectively pursue fraudulent investment schemes, especially ponzi schemes. It also provides guidelines for the formation of special fast trial courts.

SEBI's Role As Protector of Investors

Investors are the pillar of the financial and securities market. They determine the level of activity in the market. They put the money in funds, stocks, etc. to help grow the market and thus, the economy. It thus very important to protect the interests of the investors. Investor protection involves prevention of malpractices. Securities and Exchange Board of India (SEBI) is responsible for regulations of the Mutual Funds and safeguard the interests of the investors.

SEBI has taken measures to ensure the investor protection from time to time. It has published various directives, conducted many investor awareness programmes, set up Investor Protection Fund (IPF) to compensate the investors. Other measures are as follows:

- Stock Exchange and other securities market business regulation.
- Registering and regulating the intermediaries of the business like brokers, portfolio managers, merchant bankers, etc.
- Recording and monitoring the work of credit rating agencies, etc.
- Registering investment schemes like Mutual fund & venture capital funds, and regulating their functioning.
- Keeping a check on frauds and unfair trading methods related to the securities market.
- Observing and regulating major transactions and take-over of the companies.
- Carry out investor awareness and education programme.
- Inspecting and auditing the exchanges (SEs)
- Assessment of fees and other charges.
- Banning insider trading
- Strengthening of corporate governance in the listed companies

Investor protection measures by SEBI follows the slogan 'An informed investor is a safe investor'. SEBI launched the Securities Market Awareness Campaign which covers major subjects like portfolio management, Mutual Funds, tax provisions, Investor Protection Fund, Investors' Grievance Redressal.

Capital Market Reforms

Since 1991 when the Government launched economic reforms, the following measures were taken

- SEBI given statutory status- that is Act of Parliament
- Electronic trade
- Rolling settlement to reduce speculation
- FIIs are permitted since 1992
- setting up of clearing houses
- settlement guarantee funds at all stock exchanges
- compulsory dematerialization of share certificates so as to remove problems associated with paper trading; and speed up the transfer
- clause 49 of the listing agreement for corporate governance
- restrictions on PNs
- platform for msme
- law in 2014 strengthen SEBI
- merger of FMC with SEBI

Essentially, the government is involved in providing the regulator, SEBI, with more teeth to prevent and take action against market frauds, take steps to boost retail participation into equities and provide for a viable fund-raising option for SME s – as also provide short-term gains by tweaking tax structures in favour of the asset class.

Primary Market

The primary market is that part of the capital markets that deals with the issuance of new securities directly by the company to the investors (Companies, governments or public sector institutions can obtain funding through the sale of a new stock or bond issue. In the case of a new stock issue, this sale is called an initial public offering (IPO). If the company already issued shares and is going to the market again with a new issue, it is called Follow on Public Offer (FPO).

Sebi made some far reaching reforms in favour of the retail investor in August 2012- allowed electronic bidding (e-IPO) for cost effective bidding; and made the rule that retail applicant will be allotted some shares compulsorily.

Secondary Market

The secondary market is the financial market for trading of securities that have already been issued in an initial public offering. Once a newly issued stock is listed on a stock exchange, investors and speculators can trade on the exchange as there are buyers and sellers.

Types of Shares

There are essentially two types of shares: common stock and preferred stock.

Preferred stock is generally issued to banks by the companies though retail investors are also eligible for them. They are preferred for the following reasons:

- In terms of dividend payment, generally, they are given dividends even if the common stock holders are not
- When the company is to be closed, preference stock holders are given money first from the proceeds of the sale of the assets of the companies.
- They may have enhanced voting rights such as the ability to veto mergers or acquisitions or the right of first refusal when new shares are issued (i.e. the holder of the preferred stock can buy as much as they want before the stock is offered to others).

Derivatives

Derivative is a financial instrument. It derives from an underlying asset- securities, shares, debt instruments, commodities etc.. The price of the derivative is directly dependent upon the valu. of the underlying asset in the present and the projected future trends. Futures and options are the two classes of derivatives.

Futures

Futures are financial instruments based on a physical underlying (commodity, equities etc.). A futures contract is an agreement between two parties to buy or sell an asset at a certain time in the future for a certain price.

Futures are part of a class of securities called derivatives, so named because such securities deri- their value from the worth of an underlying investment. Futures are different from forwards as the former are traded on exchange while the later may be merely a signed contract between two parties.

Options are a class of futures where the buyer or seller has the option whether to buy or not – put option is the right but not the obligation to sell. Call option is right but not the obligation to buy.

Buyback of Shares

Buyback of shares is the process of a company's repurchase of stock it has issued at a price that is usually higher than the market price. In the case of stocks, this reduces the number of shares outstanding, giving each remaining shareholder a larger percentage ownership of the company. This is usually considered a sign that the company's management is optimistic about the future and believes that the current share price is undervalued. The company also should have reserves to do so.

Reasons for buybacks include

- putting unused cash to use
- raising earnings per share
- reducing the number of shareholders to reduce the cost for servicing them, etc.

Shares bought back need to be cancelled and thus the total equity shrinks and the shareholders benefit. Buyback price is more than the market prices. Companies can buy back with the reserves but can not borrow to buyback. It is allowed in India since 1998. The government has encouraged cash—surplus PSUs to go for share buybacks to meet its disinvestment target. For the current 2017—18 fiscal, it has set a target of raising Rs 72,500 crore through minority sales, strategic disinvestments as well as through listing of state—owned insurance companies. GOI benefited from the buyback operations of Coal India Ltd (CIL) and Engineers India Ltd in 2017.

Anchor Investor

Anchor investors or cornerstone investors (as they are called globally) are institutional investors like sovereign wealth funds, mutual funds and pension funds that are invited to subscribe for shares ahead of the IPO to boost the popularity of the issue and provide confidence to potential IPO investors. The benefit for institutional investors applying in anchor quota is that they get guaranteed allotment. Allotment to investors applying in an IPO depends on the number of times the issue gets subscribed. Anchor investors, however, cannot sell their shares for a period of 30 days from the date of allotment as against IPO investors who are allowed to sell on listing day.

Commodity Exchanges

Commodity exchanges are institutions which provide a platform for trading in 'commodity futures' just as how stock markets provide space for trading in equities and their derivatives. They thus play a critical role in price discovery where several buyers and sellers interact and determine the most efficient price for the product. Indian commodity exchanges offer trading in 'commodity futures' in a number of commodities. Presently, the regulator, SEBI allows futures trading in over 120 commodities.

Currently 6 national exchanges, viz. Multi Commodity Exchange, Mumbai (MCX), National Commodity and Derivatives Exchange, Mumbai (NCDEX), National Multi Commodity Exchange, Ahmedabad (NMCE), Indian Commodity Exchange Ltd., Mumbai (ICEX), ACE Derivatives and Commodity Exchange, Mumbai (ACE) and Universal Commodity Exchange Ltd., Navi Mumbai (UCX), operate forward trading in 113 commodities. Besides, there are 11 Commodity specific exchanges recognized for regulating trading in various commodities approved by the Commission under the Forward Contracts (Regulation) Act, 1952.

The commodities traded at these Exchanges comprise the following:

- Edible oilseeds complexes like Mustardseed, Cottonseed, Soybean oil etc.
- Food grains – Wheat, Gram, Bajra, Maize etc.
- Metals – Gold, Silver, Copper, Zinc etc.
- Spices – Turmeric, Pepper, Jeera etc.
- Fibres – Cotton, Jute etc.
- Others – Sugar, Gur, Rubber, Natural Gas, Crude Oil etc.

Out of 17 recognized Exchanges, MCX, NCDEX, NMCE, ACE, UCX and ICEX, contribute 99% of the total value of the commodities traded. Out of the 113 commodities, regulated by the FMC, in terms of value of trade, Gold, Crude oil, Silver, Copper, Natural Gas, Lead, Soy Oil, Zinc, Soybean and Castorseed are the prominently traded commodities.

FMC Was Merged Into SEBI 2015

Forward Markets Commission (FMC) that was headquartered at Mumbai was a regulatory authority, which was overseen by the Ministry of Consumer Affairs and Public Distribution, Govt. of India. It was merged with the Securities and Exchange Board of in 2015. The Forward Contracts Regulation Act (FCRA) stands repealed, and the regulation of the commodity derivatives market shifts to Sebi under the Securities Contracts Regulation Act (SCRA), 1956. SCRA is a stronger law, and gives more powers to Sebi than FCRA offered to FMC. It means that commodity markets will now be better regulated, with more stringent processes — and will thus evoke greater confidence after the NSEL crisis. The FMC only regulated the exchanges and had no direct control over brokers. SEBI has a far superior surveillance, risk-monitoring and enforcement mechanism that will give more confidence to investors, and may help businesses grow.

Mutual Fund

Mutual fund – a financial intermediary that mops up money from a group of investors, to invest in capital market so as to generate returns for the investors. Mutual fund does it for a fees. There are two types of MFs.

Open-ended Funds

Open-ended or open mutual funds issue shares (units) to the investors directly at any time. The price of share is based on the fund's net asset value. Open funds have no time duration, and can be purchased or redeemed at any time on demand, but not on the stock market.

Closed-ended Fund

It is a collective investment scheme issued by a fund. Only a fixed number of shares (units) are issued in an initial public offering which may be called New Fund Offering (NFO). They trade on an exchange. Share prices are determined not by the total net asset value (NAV), but by investor demand. Once the offering closes, new shares are rarely issued. They can be traded only on the secondary market (stock exchanges). Shares are not normally redeemable until the fund liquidates. On the other hand, an open-end fund where the fund company creates new shares and can redeem existing shares.

Foreign Portfolio Investor (FPI)

In 2012, SEBI had constituted a "Committee on Rationalization of Investment Routes and Monitoring of Foreign Portfolio Investments" under the chairmanship of Shri K. M. Chandrasekhar with a view to rationalize/harmonize various foreign portfolio investment routes and to establish a unified, simple regulatory framework. Based on the committee report, in 2014, new FPI Regime came into effect from.

Highlights are:

- Portfolio Investment by any single investor or investor group cannot exceed 10% of the equity of an Indian company, beyond which it will now be treated as FDI.
- FIIs, Sub-Accounts and QFIs are merged together to form the new investor class, namely Foreign Portfolio Investors, with an aggregate investment limit of 24% which can be raised by the Company up to the applicable sectoral cap.
- Non-Resident Indians (NRIs) and Foreign Venture Capital Investors (FVCI) are excluded from the purview of this definition.
- FPIs are not allowed to invest in unlisted shares. However, all existing investments made by the FIIs/Sub-accounts/QFIs are grandfathered (Classroom).
- FPIs are permitted to invest in Government Securities with a minimum residual maturity of one year. It means, FPIs have been prohibited from investing in T-Bills.

FIIs

Foreign Institutional Investor (FII) means an institution established or incorporated outside India which proposes to make investment in securities in India. They are registered as FIIs with the SEBI (FII). FIIs are allowed to subscribe to new securities or trade in already issued securities FII are a part of "Foreign Portfolio Investor" (FPI) along with the other two: Sub Accounts and Qualified Foreign Investors.

FIIs invest huge sums of money in financial assets - debt and shares- of companies and in other countries- a country different from the one where they are incorporated. They include banks, insurance companies, retirement or pension funds, hedge funds and mutual funds.FIIs are allowed to invest in the primary and secondary capital markets in India through the portfolio investment scheme (PIS). The ceiling for overall investment for FIIs varies from company to company. Besides buying equities from the market, FIIs have participated in Qualified Institutional Placements (QIPs), directly from the promoters requiring huge capital. SEBI prescribes norms to register FIIs and also to regulate FII investments.

Reasons for FIIs having India as a favourite destination

- growing economy
- corporate profits are high
- government policies are encouraging
- compared to other countries, India has brighter prospects

FII investment is referred to as hot money for the reason that it can leave the country at the same speed at which it comes in.

QFIs

A QFI is an individual, group or association resident in a foreign country that is compliant with Financial Action Task Force (FATF) standards. Till 2012, they were investing in India through the FIIs registered with the SEBI. From 2012, they are allowed to invest in India directly for which Sebi and RBI have made the necessary rules.They are a part of FPI from 2014.They can invest in corporate debt, equities and mutual funds.Its aim is to widen the class of investors, attract more foreign funds and reduce market volatility and deepen the Indian capital market.

Government relaxed the eligibility condition to allow investors from Gulf Cooperation Council (GCC) and also the European Commission to invest in Indian debt if they meet the local rules. A resident of IOSCO can also be a QFI.

Difference Between FDI and FII

FDI invest in setting up firms to produce goods and services. That is why it is called "direct" institution. FII on the other hand buys financial assets for profits. In order to remove the ambiguity that prevails on what is Foreign Direct Investment (FDI) and what is Foreign Institutional Investment (FII), it was decided to follow the international practice and lay down a broad principle that, where an investor has a stake of 10 percent or less in a company, it will be treated as FII and, where an investor has a stake of more than 10 percent, it will be treated as FDI.

IOSCO

The International Organization of Securities Commissions (IOSCO) is an association of organisations that regulate the world's securities and futures markets.

Members are typically the Securities Commission or the main financial regulator from each country. IOSCO has members from over 100 different countries, who regulate more than 90 percent of the world's securities markets. The organisations role is to assist its members to promote high standards of regulation and act as a forum for national regulators to cooperate with each other and other international organisations. India is a member.

IOSCO is has a permanent secretariat based in Madrid.

Sustainable Stock Exchanges (SSE)

The Sustainable Stock Exchanges (SSE) initiative is a project of the United Nations (UN) co-organized by the United Nations Conference on Trade and Development (UNCTAD), the United Nations Global Compact, the United Nations Environment Programme Finance Initiative (UNEP-FI) and the UN supported Principles for Responsible Investment (PRI).

Other key stakeholders include the World Federation of Exchanges (WFE), and the International Organization of Securities Commissions (IOSCO). The SSE provides a multi-stakeholder learning platform for stock exchanges, investors, regulators, and companies to adopt best practices in promoting corporate sustainability. In collaboration with investors, regulators, and companies, they strive to encourage sustainable investment.

FATF

The Financial Action Task Force (on Money Laundering) (FATF) is an intergovernmental organization founded in 1989.The purpose of the FATF is to develop policies to combat money laundering and terrorism financing. The FATF Secretariat is housed at the headquarters of the OECD in Paris.FATF is responsible for setting global standards on anti-money laundering (AML) and combating financing of terrorism (CFT).

Following its inclusion in 2010, India and its tax enforcement authorities — the Financial Intelligence Unit, the Enforcement Directorate, the Central Economic Intelligence Bureau and the Directorate of Revenue Intelligence — would be able to exchange vital information from member-countries on money laundering and terrorist financing activities.

Global Depository Receipts (GDR)

Indian companies are allowed to raise equity capital in the international market through the issue of Global Depository Receipt (GDRs). GDRs are designated in dollars/euros or any other foreign currency.

The proceeds of the GDRs can be used for financing capital goods imports, capital expenditure including domestic purchase/installation of plant, equipment and building and investment in software development, prepayment or scheduled repayment of earlier external borrowings, and equity investment in JVs in India. GDRs are listed on London SE or Louxembourg or elsewhere. They are also called euroissues in a general sense.

ADRs

American depository receipts are like shares. They are issued to US retail and institutional investors. They are entitled like the shares to bonus, stock split and dividend. They are listed either on Nasdaq or NYSE.Like GDRs, they help raise equity capital in forex for various benefits like expansion, acquisition etc.ADR route is taken as non-USA companies are not allowed to list on the US stock exchanges by issuing shares.

Similarly with Indian Depository Receipts (IDRs).

Participatory Notes

Participatory notes are instruments used by foreign investors for making investments in the stock markets. In India, foreign institutional investors (FIIs) who are Sebi-registered use these instruments for facilitating the participation of overseas funds like hedge funds and others who are not registered with the Sebi and thus are not directly eligible for investing in Indian stocks.

Any entity investing in participatory notes is not required to register with SEBI (Securities and Exchange Board of India), whereas all FIIs have to compulsorily get registered. Participatory notes are popular because they provide a high degree of anonymity, which enables large hedge funds to carry out their operations without disclosing their identity and the source of funds. KYC (know your customer norms are not applied here).

Since the source of funds is not revealed, the PNs are potentially unsafe. Therefore, SEBI in 2007 October imposed certain conditions like limits on the PNs that a single FII can issue etc. SEBI wants the PN holders to register with the SEBI and invest directly as India is a long term growth story. Sebi policy paid off with the number of FIIs registering with the regulator going over time to about 2000(2017) .

The SEBI action aims at ensuring that the quality of flows into stock markets and Indian forex market is clean.

Clearing House

An organisation which registers, monitors, matches and guarantees the trades of its members and carries out the final settlement of all futures transactions. The National Securities Clearing Corporation is the clearing house for the NSE.

Equity

Common stock and preferred stock that is, shares issued by the company.Also, funds provided to a business by the sale of stock.

Share

Share is a certificate representing ownership of the company that issued it. Shares can yield dividends and entitle the holder to vote at general meetings. The company may be listed on a stock exchange. Shares are also known as stock or equity.

Bond

A debt instrument issued for a period of more than one year with the purpose of raising capital by borrowing.

Debenture

Debt not secured by a specific asset of the corporation, but issued against the issuer's general credit- that is, it is unsecured debt. Investment earns an interest for the debenture holder. The following are various types of debentures

- convertible debentures can be converted into equity at a future date
- Non-convertible debentures will not be converted
- Partly convertible debentures will have some part converted into shares.

Bear

Bear is an investor who believes that market will go down.

Bull

Bull is an investor who believes that the market will go up-optimistic

Bear Market

A sustained period falling stock prices usually preceding or accompanied by a period of poor economic performance known as a recession. of

Bull Market

A stock market that is characterized by rising prices over a long period of time. The time span is not precise, but it represents a period of investor optimism, lower interest rates and economic growth. The opposite of a bear market.

Gilt

Gilt is a bond issued by the government. It is issued by the Central Bank of a country on behalf of the government. In India, Reserve Bank of India issues the treasury bills or gilts. Gilt Edged Market is the market for government securities.

Blue Chip

Blue chip shares are the shares of the companies that are the most valuable. Companies that are profit making; usually dividend –paying and are liquid in the market- that is there is almost always in demand on the market.

Midcap Company

Generally, companies with a market capitalization that is very high are called large caps and the next rung below is mid cap and the bottom one is small cap companies. Limits are not statutorily laid dwn and vary from institution to institution.

Retail Investor

A retail investor is in the Indian securities is one whose subscription to securities is of a value less than Rs. 2 lakh regardless of individual's existing shareholding in the market or what his present networth is. Sebi allows price discount for retail investors and company discount participating in initial public offers and follow-on offers. This discount is offered to attract retail investors into the market and broad base ownership.

Negotiated Dealing System

Negotiated Dealing System (NDS) is an electronic platform for facilitating dealing in Government Securities and Money Market Instruments.

Short Selling

The sale of a security made by an investor who does not own the security. The short sale is made in expectation of a decline in the price of a security, which would allow the investor to then purchase the shares at a lower price in order to deliver the securities earlier sold short.

Market Capitalization

Price per share multiplied by the total number of shares outstanding; also the market's total valuation of a public company.

Insider Trading

Insider trading occurs when any one with information related to strategic and price-influencing information purchases or sells stocks so as to make speculative profits. SEBI is formulating rules which are tougher for the insider trading.

Depository

A depository holds securities (like shares, debentures, bonds, Government Securities, units etc.) of investors in electronic form. Besides holding securities, a depository also provides services related to transactions in securities. Benefits of a depository are reduction in paperwork involved in transfer of securities; reduction in transaction cost.

National Securities Depository Limited (NSDL)

In the depository system, securities are held in depository accounts, which is more or less similar to holding funds in bank accounts. Transfer of ownership of securities is done through simple account transfers. The enactment of Depositories Act in 1996 paved the way for establishment of NSDL, the first depository in India.

NSDL offers facilities like dematerialisation i.e., converting physical share certificates to electronic form; rematerialisation i.e., conversion of securities in demat form into physical certificates etc.

Nasdaq

Nasdaq stands for the National Association of Securities Dealers Automated Quotation System. Unlike the New York Stock Exchange where trades take place on an exchange, Nasdaq is an electronic stock market that uses a computerized system to provide brokers and dealers with price quotes. It is an electronic stock market- first in the world- run by the National Association of Securities Dealers. Many of the stocks traded through Nasdaq are in the technology sector.

Dow Jones Index

The New York Stock Exchange (NYSE) index, which reflects the movement of the world's first stock market. It is composed of the 32 most traded stocks of the NYSE. Currently there are three Dow Jones Indices: The Dow Jones Industrial Average (DJIA). The Dow Jones Transport Average (DJTA) and finally DJUA (Dow Jones Utility Average).

In recent years, broader indices such as the Standard & Poor's 500 (for large companies), the Russell 2000 (for smaller companies) and the Wilshire 5000 (for an especially broad measure) have gained currency, in part due to the rising popularity of index investing.

Important Indices In The World

Market index is a number to indicate the average movement of prices of a securities market. It usually tracks select stocks.

- American Dow Jones Industrial Average and S&P 500 Index
- British FTSE 100: It is a share index of the 100 most highly capitalised companies listed on the London Stock Exchange. The index began in 1984 with a base level of 1000.The index is maintained by the FTSE Group, an independent company which originated as a joint venture between the Financial Times and the London Stock Exchange.
- French CAC 40
- German DAX
- Ibex for Spain
- Japanese Nikkei
- Australian All Ordinaries

- Hong Kong Hang Seng Index
- South Korea's Kospi
- Straits Times Index (STI) of Singapore
- Bovespa Index
- RTS Index (RTSI) is an index of 50 Russian stocks that trade on the RTS Stock Exchange in Moscow
- SSE (Shenzhen Stock Exchange) Composite Index- China
- SSE (Shanghai Stock Exchange) Composite index-China

Ponzi Scheme Or Pyramid Scheme

A Ponzi scheme is a fraudulent investment operation that pays high returns to investors and promises higher returns to those who join the scheme later. The payments are done from investors own money or money paid by subsequent investors rather than from any actual profit earned. The scheme is named after Charles Ponzi, who became notorious for using the technique after emigrating from Italy to the United States in 1903.

Decoupling

It means that a nation's economy may have an autonomous logic and need not be entirely dependent on the global economy. For example, if the world goes into a recession, all counties need not have their stock markets collapse beyond a point. India, for example grew at 6.7% (2008-09) while the USA and the west were contracting. Reflecting the economic realities, equity markets also perform autonomously after a point. It is called decoupling- that is, isolation from the rest.China is more integrated with the world as its economy is driven by exports. However, even China is decoupled as it has a lot of domestic consumption driving its growth.

Clause 49

Clause 49 of the Listing Agreement to the Indian stock exchange came into effect in 2005. It has been formulated for the improvement of corporate governance in all listed companies as it mandates that there should be certain independent directors on the Board of a Company.

Shariah Index

Asia's oldest stock exchange, the Bombay Stock Exchange (BSE), launched its Shariah index in December 2010. The index has 50 stocks selected from the BSE-500 bracket. Infrastructure, capital goods, IT, telecom and pharmaceuticals shares will form a large chunk of the 'BSE Tasis Shariah-50 Index', as the new index is known.

The new index attracts investments from Arab and European countries, where Shariah funds are already popular. Shariah, the religious law of the followers of Islam, has strictures regarding finance and commercial activities permitted for believers. Arab investors only invest in a portfolio of 'clean' stocks. They do not invest in stocks of companies dealing in alcohol, conventional financial services (banking and insurance), entertainment (cinemas and hotels), tobacco, pork meat, defence and weapons.

BRICS Cooperation Among Exchanges

In 2011 seven major stock exchanges in Brazil, Russia, India, China and South Africa announced plans to cross-list derivatives on their benchmark indexes. The five founding members of the BRICS Exchanges Alliance began cross-listing benchmark equity index derivatives on each others trading platforms from 2012. The five exchanges, BOVESPA from Brazil, MICEX from Russia, BSE from India, Hong Kong Exchanges and Clearing Limited (HKEx) from China, and JSE Limited from South Africa, announced the formation of the alliance In this initial stage of implementation, the exchanges aim to expand their product offerings beyond their home markets and give investors of each exchange exposure to the dynamic, emerging, and increasingly important BRICS economies.

Power Exchanges

A power exchange created within the regulatory framework is an institution that is responsible for conducting auctions in a non-discriminatory fashion to sell power at competitive market prices. CERC has permitted trading of Electricity through Power Exchange with effect from June 2008. Currently, two exchanges viz. Indian Energy Exchange (IEX) and Power Exchange of India Limited (PXIL) are in operation in India which facilitate an automated on-line platform for physical day-ahead contracts. It is the core of an electricity market which is a system for effecting purchases, through bids to buy and sell. It would bring about efficiency as well as liquidity as power companies bought and sold electricity.

Why Is The Indian Stock Market Doing So Well (2017)

The Nifty rose to a historic high of 10,425, while the S&P BSE Sensex hit a lifetime high of 33,530 on November 1st, 2017 posting the highest returns in the calendar year till then. The reasons are: loose monetary policy of foreign countries like Japan, EU that makes money cheap for the FPIs to invest abroad. Domestic savings are flowing to mutual funds. It is happening because the macro economic data is encouraging. The current account deficit and fiscal deficit are under control. Retail inflation is low. The government is focusing on ease of doing business and implementing crucial reforms such as the Goods and Services Tax (GST); RERA etc. These factors could boost growth. India jumped 30 places to 100 in the World Bank's ease of doing business rankings 2018, driven by reforms in access to credit, power supplies and protection of minority investors. It augurs very well for investment.

TAXATION

Tax is a payment compulsorily collected from individuals or firms by government. A direct tax is levied on the income or profits of an individual or a company respectively. The word 'direct' is used to denote the fact that the burden of tax falls on the individual or the company paying the tax and can not be passed on to anybody else. For example, income tax, corporate tax, wealth tax etc. An 'indirect' tax is levied on manufacturing and sale of goods or services. It is called 'indirect' because the real burden of such a tax is not borne by the individual or firm paying it but is passed on to the consumer. Excise duty, customs duty, sales tax etc. are the examples.

Importance of taxation for the Government, economy and society

Taxation has revenue and non-revenue aims. The revenue it fetches helps government in meeting its growth goals through investment. Taxes provide funds that can accomplish

- Provision of public goods
- national defense
- enforcement of law and order
- redistribution of wealth through progressive taxation system
- economic infrastructure — roads, ports etc
- social welfare
- social infrastructure like education, health etc
- social security measures like pensions for the elderly, unemployment benefits
- To modernize the economic system like GST
- Promote savings
- Promote small scale industries
- Boost exports by making exports free of the GST burden
- Enforce good civic fiscal behavior through carrots and sticks as in the Income Declaration Scheme (IDS) 2016 and Pradhan Mantri Garib Kalyan Yojana, 2016 (PMGKY)

Taxation in India

India has an elaborate federal Constitutional scheme for imposition, collection and appropriation of taxes. The central government levies direct taxes such as personal income tax and corporate tax, and indirect taxes like customs and excise duties and service tax. In 2017, however, excise duties and service tax were integrated into the Goods and Services Tax (GST) for most products. States are a part of GST though they have some residuary power to levy Value added tax (VAT) on goods like petroleum products, tax on liquor etc. States also have the power to levy direct taxes like tax on agricultural income.

Since 1991, the tax system in India has undergone substantial rationalization- reduced rates and slabs and better administration. Tax system has been simplified also to boost "Ease of doing business."

Some of the tax reforms made till 2017 are:

- Broadening the tax base to include services, fringe benefits, stock market transactions etc
- Reduction in customs and excise duties. Peak customs rate is today 10% which is imposed on 90 per cent of non-agricultural industrial goods

- Lowering of corporate tax rates to 25% over a four year period from 2015
- Wealth tax was abolished in the Union Budget (2016-2017) and integrated into the income tax of the Rs.1 cr slab
- Rationalizing the personal income tax rates and slabs starting from 1997 'dream budget'
- GST from 2017
- Use of technology for quicker processes
- Simpler procedures for greater compliance
- Safe harbor rules on transfer pricing
- Revamping the double tax avoidance treaties with many countries like Mauritius to prevent Base erosion and profit shifting (BEPS)
- Clear General anti-avoidance rules (GAAR)
- Stringent action against black money holders through disclosure schemes which have very little amnesty component(Income Disclosure Scheme (IDS) 2016 and severe monetary penalty as in Pradhan Mantri Garib Kalyan Yojana, 2016 (PMGKY) so that they pay adequate tax

Direct and Indirect Tax Ratio

Total tax revenue of the Government of India includes both direct & indirect taxes. Direct taxes include personal income tax and corporation tax mainly while indirect taxes comprise of GST and Customs duties. Direct taxes come from the well off as it is a progressive tax where the richer a person/firm, the more it has to pay. It has equity built into it. Direct taxes like income tax are also 'automatic stabilisers' – when the economy grows, there is inflation, wages rice, people move into higher tax brackets and pay more taxes which reduces their spend on goods and services thus stabilizing prices. They help in stabilising economic cycles without explicit government action.

Indirect taxes on the other hand largely do not differentiate between the rich and the poor though there is a progressive element there as well as there are exemptions and there is a hierarchy of slabs. But on most essential goods, there is tax and the poor pay it. Indirect taxes also contribute to inflation and may dent savings and demand. Thus, they are relatively anti growth. In India, the relative contribution has been evolving as follows as mentioned in the Reserve Bank of India (RBI) Handbook of Statistics on Indian Economy released in September 2017:

In 1985-86, the indirect tax revenue was more than 4 times that of the direct tax revenue. The share of indirect taxes in the total tax revenue was 83% compared to the 17% share of direct taxes in 1985-86. In 30 years since then, the share of both has more or less become equal. In 2016-17, share of direct taxes was 48% in the total tax revenue compared to the 52% share of indirect taxes. In the 8 years between 2007-08 and 2014-15, the share of direct taxes in the total tax revenue was more than the share of indirect taxes. In 2009-10, the share of direct taxes was close to 60%, the highest ever till date. Starting again in 2015-16, the share of indirect taxes has overtaken the share of direct taxes.

In this context, it should be noted that when the overall tax collections of both the Centre and the States are taken into account, nearly two-third of total tax collected is accounted for by indirect taxes, implying that the tax structure in the country continues to be regressive.

While collections from direct taxes have risen in absolute terms, their contribution to India's total tax revenue has fallen in percentage terms. Also, direct taxes have been growing at a slower pace than indirect taxes.

The reason for the surge in indirect taxes is two fold: service tax base increased and also the rate-being 18% under the GST regime since 2017. Also, with the dramatic drop in the international crude prices since 2015, GOI found an opportunity and need to increase the excise duties on petroleum products steeply.

Tax to GDP ratio

When the economy grows, there is greater personal prosperity, corporate profits and consumption of goods and services. All of them add to tax collections and thus the Tax: GDP ratio increases. GOI's gross tax collections (total amount that it collects which includes the share of States and UTs) are estimated at 11.3% of GDP for FY2018. When we add the taxes and duties of States and local bodies, India's tax-to-GDP ratio becomes 16.6%. Gross tax collections will statistically come down from 2017-18 as states are collecting their own GST. In 2015, tax revenue (including social contributions) in the EU-28 stood at 40.0 % of GDP, and accounted for around 89 % of total government revenue. In comparison, the combined tax to GDP ratio in other BRICS countries was higher - Brazil (35.6%), South Africa (28.8%), Russia (23%), and China (19.4%).Some countries, like Sweden, have a high tax-to-GDP ratio (as high as 54%). USA's is 25.4%. France has a tax to GDP ratio of 45% while Denmark as is pegged at 48.6%. Among the BRIC countries, Brazil has a tax to GDP ratio of 33.4% while Russia is at 34.8%. But experts say that most developed countries have a higher per capita income and therefore the ability to pay higher taxes.

The relatively low ratio in India is because we are a developing country; there is a large informal sector; agricultural income is exempt; there are so many other tax exemptions (tax expenditure); parallel economy; and also, tax machinery is not sufficiently capacity-built.

Low ratio handicaps the state from spending on social social sector and infrastructure. India spends on an average about 3.4 percentage points less vis-a-vis comparable countries on health and education Economic Survey 2015-16 said that India needs to increase its tax-GDP ratio, and spend more on health and education. When tax revenues grow at a slower rate than the GDP of a country, the tax-to-GDP ratio drops.

Since 2016-17, formalization of economy has become the focus with demonetization and GST. There are more people filing tax returns; more digital payments; those evading tax earlier can not do so any more as the government relies on big data garnered from demonetization. GST makes compliance higher due to input tax set off.

Due to demonetization, as many as 1.26 crore new taxpayers were added in 2016-17. The I-T department launched Operation Clean Money to clamp down on unaccounted money funnelled into bank accounts, post-demonetisation.

Number of Tax Payers 2017

In India a large section of people come from agriculture, BPL and small enterprises who are not liable to pay tax as their income falls below the exemption limit. Due to Tax Deduction at Source

(TDS), many more people are paying tax even though many of them may not be filing their tax returns. That is, not everyone who pays tax files returns. The government added 9.1 million new taxpayers in 2016-17.This is expected to significantly boost the government's tax revenue. India had only 55.9 million individual return filers at the end of 2015-16.

Not everyone who pays files returns pays tax. Many file returns to show that they have no taxable income.

Broadening Tax Base

Tax base encompasses all that is taxed- incomes, profits, manufacture, sale, import etc. While vertical equity demands that rich are taxed harder and luxury goods as well, horizontal equity demands that all transactions except the very essential ones be taxed. The more the actions that are taxed, the larger the base. Since 1991, government has been broadening the base starting from 1994 when the service tax was introduced. Following have been the steps

- STT
- CTT
- Fringe benefit tax
- MAT
- GAAR
- Limitation of benefit clause in the DTAAs
- Demonetization
- Transfer pricing and APAs
- GST
- Expanding the coverage of provisions relating to Tax Deduction at Source (TDS) to more transactions
- Quoting of permanent account number made compulsory for many transactions so more people can be brought into tax net

Tax Amnesty Schemes

There may be people who do not comply with the tax laws. That is they evade taxes. Governments make amnesty schemes for them come clean by paying taxes at the current rates or any other rate which is beneficial to the assesse even as the government collects tax revenue that can be used for the socio-economic development of the country. It is called tax amnesty scheme. Those who comply with such a scheme are not taken up criminally. Dome schemes do not have any penalty. Some have it, the latter being disclosure schemes essentially where the amnesty part if minimal (not being criminally proceeded against). The schemes that were launched in 2016 are mainly disclosure schemes: IDS 2016 and PMGKY.

IDS 2016

Income Declaration Scheme, 2016 was an amnesty scheme that was as a part of the 2016 Union budget to unearth black money and bring it back into the system. Lasting from 1 June to 30 September, the scheme provided an opportunity to income tax and wealth tax defaulters to avoid litigation and become compliant by declaring their assets, paying the tax on them and a penalty of 45% thereafter.

Pradhan Mantri Garib Kalyan Yojana, 2016 (PMGKY)

It is an amnesty scheme launched by the Government of India in December 2016 on the lines of the Income declaration scheme, 2016 (IDS) launched earlier in the year. A part of the Taxation Laws (Second Amendment) Act, 2016, the scheme provides an opportunity to declare unaccounted wealth and black money in a confidential manner and avoid prosecution after paying tax, interest and a fine of 50% on the undisclosed income. An additional 25% of the undisclosed income is invested in the scheme which can be refunded after four years, without any interest.Valid from December 16, 2016 to May, 2017, the scheme can only be availed to declare income in the form of cash or bank deposits in Indian bank accounts and not in the form of jewellery, stock, immovable property, or deposits in overseas accounts.

While the rationale is appealing for the amnesty schemes, they carry a moral hazard: those who do not pay continue not to pay and those who did, may be de-motivated.

Operation Clean Money 1 and 2

Income Tax Department (ITD) initiated Operation Clean Money in January 2017. Initial phase of the operation involves e-verification of large cash deposits made during 9th November to 30th December 2016. Data analytics were used for comparing the demonetisation data with information in ITD databases. In the first batch, around 18 lakh persons have been identified in whose case, cash transactions do not appear to be in line with the tax payer's profile. Operation Clean Money I began on January 31 and ended on February 15.As part of the first phase of Operation Clean Money, the CBDT had identified 17.92 lakh persons for e-verification of large cash deposits.

In the second phase of 'Operation Clean Money' launched in April 2017 with an aim to detect black money generation post demonetisation, the I-T department used information received under the Statement of Financial Transactions (SFT) from banks to identify additional cases: persons whose tax profiles were found to be inconsistent with the cash deposits made by them during the demonetisation period.

Direct Taxes Code (DTC)

The Direct Taxes Code (DTC) is a proposal by the Government of India (GOI) to simplify the direct tax laws in India. DTC aims to introduce new provisions and revise, consolidate and simplify the structure of direct tax laws in India into a single legislation. DTC will I replace the Income-tax Act, 1961 and other direct tax legislations. DTC 2010 was introduced in the Indian Parliament in 2010 but it lapsed with the dissolution of the 15th Lok Sabha in 2014. However, without the DTC, many changes have been brought about in the direct tax regime in the country in the three years till 2017:

1. Wealth tax was abolished
2. Union Budget 16-17, GOI presented a plan to reduce the corporate tax rate from 30% to 25% in four years to make India's tax rates globally competitive
3. Reduction in corporate tax rate for MSMEs to 25% from 30% to make them competitive
4. General Anti Avoidance Rules (GAAR)
5. Place of Effective Management (POEM) rule as a test to determine residency for tax purposes
6. Changes in DTAAs

In the 2017 Rajaswa Gyan Sangam, PM mentioned the need to overhaul the direct taxes framework.

Inverted Duty Structure

Normally, there should be lower tax on raw material so that it can be imported and value added to produce the final product that can be sold at home or exported. That helps "Make in India". It also promotes exports. On the other hand, higher import duty on the raw materials and intermediates than on the finished product is called inverted duty structure. It puts the domestic manufacturers at a disadvantage making them uncompetitive within the domestic market and in global markets.

India levies one of the highest duties on import of raw materials and one of the lowest duties on import of finished rubber goods.This inverted duty structure is leading to a surge in import of finished goods. Of the total import of finished goods, 80-90 per cent is avoidable as domestic rubber manufacturing units have the capability to meet the demand, but low import duties on rubber products especially under FTAs (free trade agreements) have led to indiscriminate imports in the country.

Reducing the customs duty on raw material for the pharmaceutical, electronic and automobile sectors is important for the same reason.

Such anomalies discourage value-addition by domestic manufacturers and encouraged imports.

FTAs may lead to inverted duty structure with duties for final products being lower from FTA partners compared to duties for the raw materials imported from non-FTA countries. This acts as a disincentive to local manufacturing which is not competitive against FTA imports because of the inverted duty structure phenomenon.

Tax Expenditure

Tax expenditure refers to revenue forgone as a result of exemptions and concessions (direct and indirect tax). It was introduced for the first time in 2006-07 Union Budget. The revenue foregone due to tax incentives in 2015-16 is estimated at nearly 6 lakh crore. Such exemptions have been justified for promoting balanced regional growth; dispersal of industries; neutralisation of disadvantages on account of location; and incentives to priority sectors, including infrastructure. They are also given to the middle class to build houses; senior citizens for their relief; women for buying houses etc.

Since the amount is large and so many of the incentives may have lost their utility and need, it is suggested that some should be dropped. They should be subject to a sunset clause, as tax exemptions often create pressure groups for their perpetuation. While some may be justified as they enhance investment and generate more taxes for the government, others are not.

Such exemptions and concessions can distort resource allocation and stunt productivity. They also result in a multiplicity of rates, legal complexities, classification disputes, litigation etc. If these exemptions are rationalized, they can help the government spend more on social and infrastructure and help reduce the fiscal deficit.

However, some such incentives are necessary. For example, the 2016 Start Up policy that gives breaks for such firms.

Tax Havens

A tax haven is a country or territory where certain taxes are levied at a low rate or not at all. Individuals and/or corporate entities can find it attractive to move themselves to areas with reduced or nil taxation levels. This creates a situation of tax competition among governments. The important features of a tax haven arte:

- nil or nominal taxes;
- lack of effective exchange of tax information with foreign tax authorities, that is, personal finance information is not shared with other countries
- no requirement for a substantive local presence; and

Bermuda, Panama, Ireland, Singapore, the Cayman Islands, Monaco, Luxembourg and Hong Kong are among 45 territories blacklisted by the Organisation for Economic Co-operation and Development and threatened with punitive financial retaliation for being tax havens.

Panama and Pradise Papers

The Panama Papers are 11.5 million leaked documents that detail financial and attorney–client information for more than 214,488 offshore entities that contain personal financial information about wealthy individuals and public officials dealing in shell corporations that were used for illegal purposes, including fraud, tax evasion, and evading international sanctions.

The Paradise Papers is a set of 13.4 million confidential electronic documents relating to offshore investment. The documents originate from the offshore law firm Appleby. They contain the names of more than 120,000 people and companies who put their legal and illegal money in funds based in Cayman Islands and Bermuda - tax havens.

Tobin Tax

James Tobin, an economist, proposed in 1972 a worldwide tax on all foreign exchange transactions- when foreign capital enters a country and when it leaves. The aim is to check speculative flows. Long term investment – generally FDI, will not suffer as it does not invest for speculative (short term) reasons like FIIs.

Tobin justified the tax on two grounds: First, it would reduce exchange rate volatility and improve macroeconomic performance. Second, the tax could bring in revenue to support for development efforts or exchange rate stabilization.

The defining characteristic of a Tobin tax is that the tax is levied twice-, once when one acquires foreign exchange, and again when one sells the foreign exchange.

The south East Asian currency crisis (1997) is partly attributed to the 'dynamics of hot money'(portfolio investments or FII flows). That gave further justification for the Tobin tax.

Tobin tax can be imposed only if all the countries accept the proposition. Otherwise, FIIs can go to countries where the tax is not imposed.

India does not prefer it as we need foreign inflows as we are a CAD country and don't have surplus.

In the EMU, there is a proposal to see a microtax levied at 0.1% on share and bond transactions, and 0.01% on deals involving complex securities such as derivatives. It is called the Financial Transaction Tax. The FTT, or "Tobin tax" as it is also known is a "Robin Hood tax", - collected from speculators and used for rescuing the financial system when there is such a need. India has a similar tax though not for the same purpose- securities transaction tax (STT) and commodities transaction tax (2015)

Due to currency volatility and stock market stocks in China in 2015-16, there is a proposal that Tobin tax be imposed. China may be able to afford such a tax as FII exposure is limited in China and it has huge surpluses of forex reserves.

India can not afford Tobin tax as we need foreign currency. We need to contain volatility by other means encouraging FDI and relatively limiting FPI though FPI is also very important for liquidity in capital market.

Pigovian Tax

The Pigovian tax is imposed on transactions that have a negative externality. For example, pollution. Externality means impact of one person's actions on the well being of an outsider (bystander or third party). For example, the seller and consumer of cigarettes together will harm the third person with pollution. Also, exhaust fumes from automobiles. Positive externality refers to a good effect on the third party. For example, restoration of historic buildings, research into new technologies, libraries etc. Carbon tax is one example in the context of the need to discourage fossil fuels and encourage renewable sources due to climate change threat. Supreme Court in 2015 imposed an 'Environment Compensation Charge' (ECC) on commercial vehicles entering Delhi.

Carbon tax (called Clean Environment Cess from 2017) is levied in India since 2010 at the rate which is Rs.400 per tonne on Coal, Lignite and Peat in order to finance and promote clean environment initiatives, funding research in the area of clean environment or for any such related purposes.It is imposed on coal produced in India or imported into India. This is in line with the principle of "polluter pays".

In many countries carbon taxes are levied also on other fossil fuels like petroleum, natural gas etc.

Base Erosion and Profit Shifting (BEPS)

BEPS refers to tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity. It means, a company shifts its headquarters to a jurisdiction like Mauritius or Ireland where tax rates are low only to avoid taxes. Although some of the schemes used are illegal, most are not. It is a huge loss of tax revenue to the governments of the countries where these companies actually carry out their economic activity. This undermines the fairness and integrity of tax systems because businesses that operate across borders can use BEPS to gain a competitive advantage over enterprises that operate at a domestic level. Moreover, when taxpayers see multinational corporations legally avoiding income tax, it undermines voluntary compliance by all taxpayers.

BEPS is of major significance for developing countries like India due to their significant reliance on corporate income tax, particularly from multinational enterprises. India suffers from BEPS due to double taxation avoidance agreements (DTAA) being misused, transfer pricing issues etc. India modified its DTAA with Mauritius to tackle the BEPS issues.

Tax abuse not only weakens efforts to fight poverty but also weakens the fiscal base needed for sustainable economic development.

OECD has a BEPS inclusive framework in which many countries are participants including India. It consists of measures ranging from common approaches which will facilitate the convergence of national practices, and best practices.The Inclusive Framework on BEPS brings together over 100 countries and jurisdictions to collaborate on the implementation of the OECD/ G20 Base Erosion and Profit Shifting (BEPS) Package.

United States Foreign Account Tax Compliance Act (FATCA) is a similar example. The Foreign Account Tax Compliance Act (FATCA) is a 2010 United States federal law requiring all non-U.S. ('foreign') financial institutions (FFIs) to search their records for customers from U.S. and to report the assets and identities of such persons to the U.S. government. India agrees with it.

Transfer Pricing and APA

Transfer pricing is the setting of the price for goods and services sold between related legal entities within an enterprise. For example, if a subsidiary company sells goods to a parent company or vice versa , the price of those goods paid by the parent to the subsidiary or the opposite is the transfer price.The Indian Transfer Pricing Code prescribes that income arising from international transactions or specified domestic transactions between associated enterprises should be computed having regard to the arm's-length price. An arm's-length price for a transaction is what the price of that transaction would be on the open market. The need for the Code is because of the profit shifting practices followed by the MNCs. For example, an MNC has a subsidiary in India and elsewhere. It sources from and supplies to the subsidiaries in all the countries. The goods and services are same but the prices are shown differently depending upon the tax rates in the countries. The corporate tax rates are high in India. Therefore, the price of goods sold by the MNC to Indian subsidiary is shown higher in India to show less profit and thus less tax outgo. Thus, transfer pricing is generally done in a way as to show high profit in countries where the corporate tax rate is low and low profits/losses where the rate is high. Therefore, transfer pricing norms existing today need to be rationalised so that the tax revenues that are due to the government are not eroded. Tax evasion and money laundering has to be checked by tightening the transfer pricing regime.The solution is advance pricing agreements (APA).

An APA refers to an agreement between the taxpayer and the tax authorities on the pricing of an existing or proposed transaction between related parties. Any taxpayer can file an application for an APA, along with details of the transaction and the proposed pricing for such transaction. The APA programme enables the taxpayers and the revenue authorities to interact, negotiate and come to a conclusion on the pricing of the transaction in question. If the taxpayer and the revenue authorities agree to a particular price, they may enter into an agreement, which would be valid for a period of five years. If, however, for some reason, they do not reach a consensus, they may not sign the agreement.It helps avoid disputes with the tax authorities over transfer pricing. The APA scheme, which was introduced in 2012, tries to provide certainty to taxpayers in transfer pricing by specifying the method of pricing and setting the prices of international transactions in advance. It applies to foreign MNCs and Indian MNCs.

Double Taxation Avoidance Agreement (DTAA)

Double taxation is the levying of tax by two or more jurisdictions on the same declared income (in the case of income taxes), asset (in the case of capital taxes), or financial transaction (in the case of sales taxes). Double taxation is avoided by DTAAs where countries affected enter into a tax treaty which sets out rules to avoid double taxation.

A DTAA is a tax treaty signed between two or more countries. Its objective is that tax-payers in these countries can avoid being taxed twice for the same income. A DTAA applies in cases where a tax-payer resides in one country and earns income in another. It is both fair as well boosts investment and growth.DTAAs also provide for concessional rates of tax in some cases.

For instance, interest on NRI bank deposits attract 30 per cent TDS (tax deduction at source) normally. But under the DTAAs that India has signed with several countries, tax is deducted at only 10 to 15 per cent. Many of India's DTAAs also have lower tax rates for royalty, fee for technical services, etc.

Favourable tax treatment for capital gains under certain DTAAs such as the one with Mauritius have encouraged a lot of foreign investment into India. Mauritius accounted for $93.65 billion or one-third of the total FDI flows into India between 2000 and 2016. It has also remained a favoured route for foreign portfolio investors. But the problem is DTAAs led to round tripping: India money goes out to come back through the DTAA countries to avoid paying taxes. Even foreign companies which are not DTAA companies route their investments through the DTAA jurisdictions only for tax avoidance purposes. They are called "mailbox companies." This leads to loss of tax revenue for the country.

2016 India-Mauritius Protocol

In 2016, India and Mauritius signed a Protocol to amend the 1982 India-Mauritius Double Taxation Avoidance Agreement (DTAA) It will have an impact on the India-Singapore DTAA as the capital gains tax exemption provided therein is linked to the benefits available under the 1982 IndiaMauritius DTAA. The 2016 protocol says that India has the right to tax the capital gains in India for investments coming from Mauritius from 2017. Investments made before 1 April 2017 have been grandfathered (continue to enjoy the benefits) and will not be subject to capital gains taxation in India. Where such capital gains arise during the transition period from 1 April 2017 to 31 March 2019, the tax rate will be limited to 50% of the domestic tax rate of India. However, the benefit of 50% reduction in tax rate during the transition period shall be subject to the Limitation of Benefits Article. Taxation in India at full domestic tax rate will take place from financial year 2019-20 onwards.

Limitation of benefits

DTAAs may contain an article intended to prevent "treaty shopping," which is the inappropriate use of tax treaties by residents of third states. These limitation on benefits articles deny the benefits of the tax treaty to residents that do not meet certain tests.

They are aimed against any attempts of round-tripping and money laundering activities.The LOB clause limits treaty benefits to those who meet certain conditions including those related to business, residency and investment commitments of the entity seeking benefit of a Double Taxation Avoidance Agreement (DTAA).

India-Mauritius Limitation of Benefits (LOB): The benefit of 50% reduction in tax rate during the transition period from 1st April, 2017 to 31st March, 2019 shall be subject to LOB Article, whereby a resident of Mauritius (including a shell / conduit company) will not be entitled to benefits of 50% reduction in tax rate, if it fails the main purpose test and bonafide business test. A resident is deemed to be a shell / conduit company, if its total expenditure on operations in Mauritius is less than Rs. 2,700,000 in the immediately preceding 12 months.

This LOB clause will have the effect of bringing substance to companies which want to be tax resident in Mauritius.

POEM

To determine the residential status of foreign companies, the Finance Act 2015 introduced the concept of place of effective management or POEM. If a company's place of effective management is India, it will be treated as an Indian resident and its global income will be taxable in India. The aim of POEM is not to attack Indian multi-nationals which are doing business outside India. But it is to target shell companies set up for retaining income outside India although effective control and management of affairs is located in India.

General Anti Avoidance Rules (GAAR)

General anti-avoidance rule (GAAR) is an anti-tax avoidance Rule of India. It came into operation from 1 April 2017-assessment year 2018-19. It allows tax officials to deny tax benefits, if a deal is found without any commercial purpose other than tax avoidance. Thus, it seeks to prevent tax evasion in the guise of tax planning. There are firms and individuals who either minimize tax payment or completely avoid it by taking advantage of the rules in the book. But government says that it is not acceptable as the entire event is planned only to avoid taxes as was done by the Vodafone when it signed the deal outside the country with Hutch and put up a corporate veil for the operation just to avoid paying taxes. Even while on the face of it, it is legal, GOI applied the doctrine of "look through" and not "look at" and ordered them to pay tax as tax avoidance in this case is tax evasion. There were no clear rules for the GOI order and there was a demand that there be clear GAAR rules. As a result GOI made the rules framed by the Department of Revenue under the Ministry of Finance. It applies to transactions made specifically to avoid taxes as detailed above. Investments made up to March 31, 2017 shall not be subjected to GAAR. It is to be applied on those claiming tax benefit of over Rs 3 crore.

GAAR was first proposed in 2010, targeting transactions made specifically to avoid taxes by companies such as Vodafone and Hutchison Essar. It applies to a company in case of abuse of treaty for gaining undue tax benefit.The rules are aimed at improving transparency in tax matters and help curb tax evasion.

The proposal to apply GAAR will be vetted first by the Principal Commissioner/Commissioner of I-T and at the second stage by an Approving Panel headed by a judge of High Court.

Adequate procedural safeguards are in place to ensure that GAAR is invoked in a uniform, fair and rational manner.

Tax Information Exchange Agreements (TIEA)

The purpose of Tax Information Exchange Agreements (TIEA) is to promote international co-operation in tax matters through exchange of information.

They provide for the exchange of information relating to a specific criminal or civil tax matter under investigation.In simple terms, the tax departments of one State may assist that of the other State, with information which may be utilized in collecting the due share of taxes of the latter State, as per its laws and procedure, India has TIEAs with many countries.

The objective of agreement is to promote international cooperation in tax matters through exchange of information. The nature of information varies from agreement to agreement. In 2016, after the Panama Papers' expose, Panama had said that it was ready to share information with India on tax evaders named in the Panama Papers, but this was possible only after the two countries signed a TIEA.The Indian government is now strongly pursuing a tax information exchange agreement (TIEA) with Panama, official sources said.

According to the Panama Papers' expose in April 2016, at least 500 Indians are reportedly said to have held offshore accounts/equity interest in offshore entities in tax havens.

In 2016, Panama signed the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (MAC), which is now seen as "gold standard" for co-operation in tax administration. However, under the MAC, Panama is not taking up information exchange obligations automatically, but on request. The commitment to automatic exchange remains only with those countries with which Panama decides to do so bilaterally, Panama Government had said in 2016.

The MAC is the most comprehensive multilateral instrument available for all forms of tax co-operation to tackle tax evasion and avoidance, and guarantees extensive safeguards for the protection of taxpayers' rights. Already 98 other countries, including India, and jurisdictions have joined the Convention.

Panama has been the one of the most popular domicile for the anonymous shell companies controlled by the powerful.

Service Tax

Service tax was first imposed in 1994. In the Seventh Schedule to the Constitution, under Article 246, the item relating to "taxes on services" was not specifically mentioned in any entry either in the Union List or in the State List. However, Entry 97 of the Union List empowers Parliament to make laws in respect of any other matter not enumerated in List II (State List) or List III (Concurrent List), including any tax not mentioned in either of those lists. Since "taxes on services" is not there in any of the lists, service tax was levied by the Central Government in exercise of the powers under Entry 97 of the Union List.

The 88th amendment to the Constitution (2004) inserted in the Union List (List I) entry No. 92C — 'taxes on services'. The amendment was never notified and so it never came into effect. 101st Constitution Amendment Act 2016 that introduced GST deleted Art.92C as services are a part of GST for which there is an entirely new regime put in place from 2017.

Goods and Services Tax (GST)

Goods and Services Tax is a comprehensive, multi-stage, destination-based tax that will be levied on every value addition. It absorbs many indirect taxes and duties into a single consolidated tax. It is levied on the supply of goods and services. It provides set off for tax paid on inputs which removes cascading (tax on tax) effect as there is deduction or credit mechanism for taxes paid for the inputs. The tax is levied on the value added and on consumption only. Total burden of the tax is exclusively borne by the domestic consumer. Exports are not subject to GST.

The term multi stage requires elaboration. Each final commodity is the result of value addition from raw material stage to the final sale to the consumer which goes through many stages which also involve not only physical value addition but also by way of storage, distribution and sale. At every stage tax is paid and under GST that is returned (credited) when it is shown that value is further added and the good resold.

Destination based means that goods are taxed where they are sold to the consumer and not where they are made. That is, if goods are made in Gujarat and sold in Telangana, they are taxed in Telangana where the consumer pays it. The manufacturing state gains by its prosperity which creates creates a big market for its own goods and services within its geography. Its apprehensions about losses are take care of by the central government commitment to compensate and also by a portion of the IGST that the centre levies and shares with it.
Both Centre and States will simultaneously levy GST across the value chain. Centre would levy and collect Central Goods and Services Tax (CGST), and States would levy and collect the State Goods and Services Tax (SGST) on all transactions within a State.

The Centre would levy and collect the Integrated Goods and Services Tax (IGST) on all inter-State supply of goods and services. There will be seamless flow of input tax credit from one State to another. Proceeds of IGST will be apportioned among the States.

With the 101 CAA 2016 being in place, the centre passed laws to levy CGST and IGST. Similarly, all states will have to pass a simple law on SGST. These laws will specify the rates of the GST to be levied, the goods and services that will be included, the threshold of the turnover of businesses to be included, etc.

India introduced VAT (earlier name was sales tax) at the state level in 2005. In 2002 union excise duties were renamed Central Vat (Cenvat). But when states called their sales tax Vat, centre reverted to the earlier name of excise duty to prevent confusion. The earliest form of Vat was however taken in 1986 in the form of Modvat- modified VAT that included set off for a few commodities only and was confined to excise duties only.

Need for GST

Pre-GST, India had a plethora of taxes at the central and state level making it a cumbersome system. States had different rates. Lack of uniformity of rates created confusion and deterred investment. Apart from the cumbersomeness, it lacked rationality. Tax is collected by the government in general to continue to provide public and special goods. Where there is value addition, there should be tax. But when there is tax on tax, it violates rationality of taxation and also is against growth, price stability, allocative efficiency of financial resources etc. It is called cascading effect as the tax base for further taxation is irrationally higher.

Thus, GST is needed to forge a common domestic market, removing multiplicity of taxes, eliminating the cascading effect of tax on tax, making the prices of the Indian products competitive and, above all, benefiting the end consumers by attracting investment of scale.

Eliminating a multiplicity of existing indirect taxes would simplify the tax structure, broaden the tax base as there is incentive to pay taxes due to the attraction of input tax credits and thus create tax buoyancy to enable government to consolidate the fiscal system and provide for greater resources for social sector.

By lowering business costs and transaction costs, it would boost economic growth and increase exports and bring India in line with practices in many developed economies. Reducing production costs would make exporters more competitive.

Black money and evasion will reduce as GST is transparent. Also because all taxable businesses have to register with the government and thus become formal. Alcohol, petroleum,real estate and electricity do not come under GST.

GST and Revenue Neutral Rate

An important issue in the Goods and Services Tax was the rates of central and state GSTs to be levied. Tax rates should be "revenue neutral". This implies that the rates set under the new GST regime are such that they get the same revenue as the pre-GST regime. That is, the rates are not meant to lead to revenue loss or gain. However, over time the revenue productivity is expected to increase due to better compliance; higher levels of administrative efficiency; and increased productivity of the economy due to its rationality and transparency.

Estimation of revenue-neutral rate requires consensus on the exemption list, number of tax rates to be levied and the list of goods and services to be included in different rate categories.

There are three terms in this filed: Standard rate is what applies to most goods and services. Fitment rate is the rate that applies to a class of goods and services which is the tax bracket in which they fall. Revenue neutral rate is the rate that brings the same revenue as the pre-GST regime.

GST and Fiscal Autonomy Issues

Constitutional amendments are required to enable the Centre and the states to impose tax on the same base of goods and services. Currently, the states cannot impose tax on services. They also can not impose tax on manufacturing of goods. Centre cannot levy tax sales tax.

States feel that their fiscal autonomy is being eroded for the following reasons:

- they are surrendering the power to tax sales
- they can not change rates according to their fiscal needs
- all states can not have the same rates as it violates respect for federal diversity
- centre may not compensate the states fully

The position of states is rejected on the other points for the following reasons

- centre is also surrendering and sharing its powers regarding service tax and union excise duties

- states are free to tax sin goods like liquor and also the petroleum products

It is said that like VAT, GST would also increase the revenue of the states as they will have powers to impose tax on services which are growing at a rapid pace.

Thus, there is mutual surrender of powers to a uniform national taxation system where both gain. Apprehensions of loss of fiscal autonomy by states and central dominance is misplaced. This is a quintessential case of cooperative federalism and is an example of pooled sovereignty.

Constitution (101st) Amendment Act, 2016

The Act seeks to amend the Constitution to introduce the goods and services tax (GST). Consequently, the GST subsumes various central indirect taxes including the Central excise duty, additional excise duties, service tax, additional customs duty (CVD) and special additional duty of customs (SAD), etc. It also subsumes state Value Added Tax (VAT)/sales tax, central sales tax, entertainment tax, octroi and entry tax, purchase tax and luxury tax, etc.

Central and State government powers for GST: It inserts a new Article 246A in the Constitution to give the central and state governments parallel power to make laws on the taxation of goods and services.

Integrated GST (IGST): However, only the centre may levy and collect GST on supplies in the course of inter-state trade or commerce and imports. The tax collected would be divided between the centre and the states in a manner to be provided by Parliament, by law, on the recommendations of the GST Council.

GST Council: The President must constitute a Goods and Services Tax Council within sixty days of this Act coming into force. GST council examines issues relating to goods, services tax and make recommendations to the Union and the States on parameters like rates, exemption list and threshold limits. The Council shall function under the Chairmanship of the Union Finance Minister and will have the Union Minister of State in charge of Revenue or Finance as member, along with the Minister in-charge of Finance or Taxation or any other Minister nominated by each State Government.

Composition of the GST Council

The GST Council is to consist of the following three members:

(a) the Union Finance Minister (as Chairman),
(b) the Union Minister of State in charge of Revenue or Finance, and
(c) the Minister in charge of Finance or Taxation or any other, nominated by each state government.

Functions of the GST Council

These include making recommendations on:

- taxes, cess and surcharges levied by the centre, states and local bodies which may be subsumed in the GST;
- goods and services which may be subjected to or exempted from GST;
- model GST laws, principles of levy, apportionment of IGST and principles that govern the place of supply;

- the threshold limit of turnover below which goods and services may be exempted from GST;
- rates including floor rates with bands of GST;
- special rates to raise additional resources during any natural calamity;
- special provision with respect to Arunachal Pradesh, Jammu and Kashmir, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura, Himachal Pradesh and Uttarakhand; and
- Any other matters relating to the goods and services tax, as the Council may decide.

The Goods and Service Tax Council shall recommend the date on which the goods and service tax be levied on petroleum crude, high speed diesel, motor spirit (commonly known as petrol), natural gas and aviation turbine fuel.

Resolution of disputes: The GST Council may decide upon the modalities for the resolution of disputes arising out of its recommendations.

Compensation to states: Parliament shall, by law, provide for compensation to states for any loss of revenues, for a period which may extend to five years. This would be based on the recommendations of the GST Council. This implies that (i) Parliament must provide compensation; and (ii) compensation cannot be provided for more than five years, but allows Parliament to decide a shorter time period.

Goods And Services Tax (GST) And The Changes It Makes In The Fiscal Federal Scheme of Division Of Powers

GST shows the Centre and States working together on a sustained basis to incrementally but irreversibly transforming the domestic indirect tax landscape in a manner to make the country a common market for more investment and prosperity. Both the centre and states had to forego some of their earlier constitutional powers for the historic compromise: The Centre left its exclusive power to tax manufacture of goods (i.e. Excise) and provision of services (i.e. Service Tax), and the States gave up their exclusive power to tax sale of goods (sales tax / VAT). Both the Centre and the States agreed to share their powers to achieve uniformity.

The Constitution of India has been amended accordingly- 101 CAA 2016. In the early part of the last decade, initially Empowered Committee of State Finance Ministers and later the GST Council became useful. Under the GST regime, the Centre & States will act on the recommendations of the GST Council. The participation of all States and Centre in the framing of GST laws has led to Harmonisation of GST laws across the country.

Main Constitutional changes

1. Art.246A *(explained separately)*
2. GST Constitution Amendment Act omits Entry 92 and 92C from the Union List and Entry 52 and 55 of the State List of the Seventh Schedule.
   - 92 of Union list – Taxes on the sale or purchase of newspapers and on advertisements published therein.
   - 92C of Union List – Taxes on services
   - 52 of State List – Taxes on the entry of goods into a local area

- 55 of State List – Taxes on advertisements other than advertisements published in the newspapers and advertisements broadcast by radio or television.

Rationale for Art.246A

The Seventh Schedule to the Constitution classifies all areas under three lists for the purpose of making laws: the Union List, which enumerates subjects under the sole purview of Parliament; the State List, which has items to be legislated by state legislatures; and the Concurrent List, which has subjects that can be legislated upon by both Parliament and state legislatures. In case of Concurrent List subjects, if there is a contradiction on any specific provision in laws made by Parliament and a state legislature, the central law will override the state law.

Currently, the power to impose some of the taxes is distributed among the three Lists: Union list of the Constitution (e.g., excise duty) while that for some others are in the State List (e.g., sale tax). Therefore, the Constitution needs to be amended to enable the enactment of a uniform law. When we consider the amendments possible, many ways may be suggested. We need to see each one of them and see why they are not acceptable. One simple method is to move the power to impose all these taxes to the Union List. The Centre can then levy the tax, and a method of redistributing the tax to states can be formulated, by the FC. This is the process used in the case of central taxes such as income tax, which are then pooled and redistributed according to the recommendation of the Finance Commission. However, this methodology has some major drawbacks. States have no say in the rate of tax that is levied under this process, and may be unwilling to give up this power. Also, there is a risk that the state in which the transactions occur and where tax is collected may not get their proportional share of the tax pool at the time of redistribution. This will reduce the incentive for states to formulate policies that lead to higher economic activity as they might not benefit from the potential increase in tax revenue. Another choice would be to move the power to impose GST to the Concurrent List.

However, this move would have the same drawbacks discussed above because Parliament will have the power to make laws that override any law made by state legislatures. A third approach was adopted in the 101 CAA 2017 after extensive consultation with the Empowered Committee of State Finance Ministers. The Act removes several of these taxes from the three Lists and creates a new Article (Art.246A) of the Constitution to deal with GST. Both Parliament and state legislatures will have the power to make law, but unlike the Concurrent List items, Parliament will not have the power to make a law that overrides a state law. This applies to all goods and services other than six items: petroleum crude, diesel, petrol, natural gas, aviation turbine fuel and alcohol for human consumption. In case of inter-state commerce, Parliament will make law, the central government will collect the tax, and the tax collected will be apportioned between the centre and states according to law made by Parliament.

This formulation could lead to non-uniform taxes across states defeating a key objective of a national GST. In order to address this possibility, the Bill creates a GST Council composed of the union finance minister and the minister of state in charge of revenue, and finance ministers of all states which will determine the GST rates by consensus.

How GST scores over the pre-GST regime

Multiplicity of Taxes: Presently, the Constitution empowers the Central Government to levy excise duty on manufacturing and service tax on the supply of services. Further, it empowers the State

Governments to levy sales tax or value added tax (VAT) on the sale of goods. This exclusive division of fiscal powers has led to a multiplicity of indirect taxes in the country. In addition, central sales tax (CST) is levied on inter-State sale of goods by the Central Government, but collected and retained by the exporting States. Further, many States levy an entry tax on the entry of goods in local areas. Taxes by Union Government, State Governments and the local governments have resulted in difficulties and harassment to the tax payer. He has to contact several authorities and maintain separate records for each of them.

Complex: The taxes are levied by central government as well as state government. So, a person has to maintain accounts which will comply all the applicable laws. This multiplicity of taxes at the State and Central levels has resulted in a complex indirect tax structure in the country that is ridden with hidden costs for the trade and industry.

Cascading effects of taxes: In current indirect tax structure in India, there is cascading of taxes due to 'tax on tax'. No credit of excise duty and service tax paid at the stage of manufacture is available to the traders while paying the State level sales tax or VAT, and vice versa. Further, no credit of State taxes paid in one State can be availed in other States. Hence, the prices of goods and services get artificially inflated to the extent of this 'tax on tax'.

Multiple Compliance: A business person might have to comply with multiple compliance in terms of indirect taxes in India.

IGST

IGST is a part of Goods and Service Tax (GST)

IGST means Integrated Goods and Service Tax. IGST is charged when movement of goods and services from one state to another. For example, if goods are moved from Tamil Nadu to Telangana, IGST is levied on such goods. Under the GST regime, an Integrated GST (IGST) would be levied and collected by the Centre on inter-State supply of goods and services. Under Article 269A of the Constitution, the GST on supplies in the course of inter State trade or commerce shall be levied and collected by the Government of India and such tax shall be apportioned between the Union and the States in the manner as may be provided by Parliament by law on the recommendations of the Goods and Services Tax Council.

Dual GST

India adopted a dual GST model, meaning that taxation is administered by both the Union and State Governments. India is a federal country where both the Centre and the States have been assigned the powers to levy and collect taxes through appropriate legislation. Both the levels of Government have distinct responsibilities to perform according to the division of powers prescribed in the Constitution for which they need to raise resources. A dual GST will, therefore, be in keeping with the Constitutional requirement of fiscal federalism. It satisfies the urge for autonomy by both the Centre and States. Dual GST threw up the challenge of taxpayers interface with tax administration and thus cross-empowerment was worked out.

GST and Cross-empowerment

The cross-empowerment model allows taxpayers to restrict their interaction to a single tax authority for central GST, state GST and integrated or IGST. Central and state GST are two components of a single GST levied on intra-state sales, while IGST will apply to inter-state sales. The division of GST taxpayers between the centre and states will be done horizontally with states getting to administer and control 90% of the asseesses below Rs 1.5 crore annual turnover, and the remaining 10% coming under the Centre. The Centre and states will share control of assessees with annual turnover of over Rs 1.5 crore in 50:50 ratio and thus each tax payer will be assessed only once and by only one authority.

Anti-profiteering clause of GST

Section 171 of the CGST Act (and the corresponding provisions of the state GST Acts) creates the obligation on businesses to pass on to the recipients any reduction in the rate of tax or the benefit of input tax credit by way of a commensurate reduction in prices. For example, in November 2017, the 23rd meeting of the GST Council reduced rates on many goods and services. If the firms do not pass it on, they are liable for penal action.

These rules prevent entities from making excessive profits by not passing such reliefs. Since the GST, along with the input tax credit, is eventually expected to bring down prices, a National Anti-profiteering Authority (NAA) is to be set up to ensure that the benefits that accrue to entities due to reduction in costs is passed on to the consumers. Also, entities that hike rates inordinately, citing GST as the reason, will be checked by this body.

NAA will investigate the complaints, the procedure to be followed in investigations and the powers given to the authority.

Once the registered entity, which has profiteered illegally, is identified, it can be asked to — one, reduce prices if it has hiked prices too much and, two, if price reduction due to GST rate relief has not been passed on to customers, to return to the customer the sum equivalent to the price reduction along with 18 per cent interest from the date the higher sum was collected. The authority can impose penalty on the profiteer or cancel its registration.

The rules however do not lay down the formula based on which the extent of profiteering can be determined. This task has been left to the NAA.

Many countries that have adopted GST such as Singapore and Australia witnessed a spurt in inflation after implementation. This clause is relevant thus.

GSTN

Goods and Services Tax Network, (GSTN) is a Section 8 (under new companies Act, not for profit companies are governed under section 8), non-Government, private limited company. It was incorporated in 2013. The Government of India holds 24.5% equity in GSTN and all States of the Indian Union, including NCT of Delhi and Puducherry, and the Empowered Committee of State Finance Ministers (EC), together hold another 24.5%. Balance 51% equity is with non-Government financial institutions. 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). The Authorised Capital of the company is Rs. Ten crore.

Besides, GST being a destination based tax, the inter- state trade of goods and services (IGST) would need a robust settlement mechanism amongst the States and the Centre. This is possible only when there is a strong IT Infrastructure and Service backbone which enables capture, processing and exchange of information amongst the stakeholders (including taxpayers, States and Central Governments, Accounting Offices, Banks and RBI).

GST And Petro-Products

Petroleum products are not included in the GST. That is taxes paid on them are not returned eventually. They are not eligible for set off. States have refused the central government's appeal to bring petroleum products under the ambit of Goods and Services Tax (GST).

Taxes constitute more than 50% of the price consumers pay for petrol and diesel. States, which charge VAT are reluctant to move away from the present tax regime unless the Centre promises special annual grants. Different states have different rates of VAT.It's the GST Council, the highest decision-making body of the indirect tax regime, that has the final word on the inclusion of petroleum productsFor the states, moving to the GST for petroleum products could amount to a "loss" in revenue. While the Centre collects Rs.21.48 as excise duty, states charge value added tax (or VAT, which varies from state to state, ranging between 25% and 48%) along with 25p as pollution cess with a surcharge. In 2016-17, the combined revenue collected from the petroleum sector was Rs.463,089 crore, according to figures available with the ministry of petroleum and natural gas. Of this, states' share was Rs.189,587 crore.

Under GST, even if petrol and diesel are charged at the highest slab of 28%, states, which get a substantial chunk of their revenue from the sector, will stand to lose considering they will only get 14% of it — much lower than the present rate of VAT. States say that taking the autonomy of taxing petroleum products away from the states will hurt their exchequer. States have freedom to change the VAT on petrol and diesel. But under the GST, this flexibility will go.

With highest VAT and the surcharge in the country, Maharashtra government earns over Rs.20,000 crore a year from taxes on petrol and diesel. Centre also does not want to integrate petroproducts into GST as that will erode its fiscal resources. The Centre has been under pressure from the opposition as well as consumers for the steady surge in fuel prices.

Jammu and Kashmir and GST

Unlike in the case of the rest of India, the power to levy state taxes in J&K are not part of the Constitution of India's 7th schedule. Instead, it is part of the J&K Constitution.

Hence, the 101st Constitution amendment, laying the GST framework, is not applicable to the Himalayan state. It applies to J and K only when their legislature passes it. The resolution passed by the state assembly recently adopting GST was to address this issue and facilitate adoption of GST.

It will be very beneficial for state of Jammu and Kashmir and the estimate is that tax revenue will increase .Importing states like J&K stand to benefit from the GST as there will be no cascading effect of taxes, resulting in fall in prices of commodities. It will also benefit as its goods will be cheaper for trade in Indian market due to the input tax credit they enjoy like others. The entire market of India can be tapped. In case of revenue loss, there is compensation for 5 years also.

GST Benefits Small Entrepreneurs And Small Traders

The pre-GST threshold prescribed in different State VAT Acts below which VAT is not applicable varies from State to State. It was Rs. 5 lakhs for a majority of bigger States and a lower threshold for others. A uniform State GST threshold across States is desirable. Under the provisions of the GST, traders with an annual turnover less than 20 lakh are exempt for the Goods and Services Tax. This raising of threshold will protect the interest of small traders. A Composition scheme for small traders and businesses has also been introduced under GST. Both these features of GST will adequately protect the interests of small traders and small scale industries.

Threshold exemption is built into a tax regime to keep small traders out of tax net. This has three-fold objectives:

a. It is difficult to administer small traders and cost of administering of such traders is very high in comparison to the tax paid by them.

b. The compliance cost and compliance effort would be saved for such small traders.

c. Small traders get relative advantage over large enterprises on account of lower tax incidence.

In its working however, the GST troubled the small businessmen for which remedies were announced in October and November 2017. Composition Scheme is an important feature of GST to protect the interests of small traders and small scale industries. Small and new taxpayers generally find it difficult to comply with so many rules. Hence, the government has introduced the concept of Composition Scheme. Now there is an option for small and new taxpayer to opt for Composition scheme and have lesser compliance burden. Also, a taxpayer opting for composition scheme has to pay tax at a nominal rate. A taxpayer whose turnover is below Rs 1 crore can opt for Composition Scheme. In case of North-Eastern states and Himachal Pradesh, the limit is now Rs 75 lakh.

HSN Code in GST

Harmonized System of Nomenclature, or HSN, was conceived and developed by the World Customs Organization (WCO) with the vision of classifying goods from all over the World in a systematic and logical manner. It is a six digit uniform code that classifies more than 5,000 products and is accepted worldwide. These set of defined rules is used for taxation purposes in identifying the rate of tax applicable to a product in a country. It is also used to determine the quantum of product exported or imported in and out of a country. It is a crucial feature to analyze the movement of goods across the World. It is a combination of different sections, further drilled down to chapters, which are further classified into headings and sub-headings. The resultant figure is the six-digit code. HSN is widespread and is adopted in more than 200 countries, covering a 98% of goods in the World. It is by far, the best logical system of classification and identification adopted in International Trade. It has helped in reducing efforts and costs related to complex procedures of International Trade. HSN (Harmonized System of Nomenclature) is a 6-digit code for identifying the applicable rate of GST on different products as per GST rules.

Components of GST

There are 3 types of taxes under GST: CGST, SGST & IGST.

- **CGST:** Collected by the Central Government on an intra-state sale (Eg: Within Andhra Pradesh)
- **SGST:** Collected by the State Government on an intra-state sale (Eg: Within Andhra Pradesh)
- **IGST:** Collected by the Central Government for inter-state sale (Eg: Andhra Pradesh to Kerala)

Tax slabs under the GST 2017

The government has categorised items in five major slabs for different goods and services - 0%, 5%, 12%, 18% and 28%.

Goods and Services Tax (Compensation to States) Act, 2017

The Goods and Services Tax (GST) is a transformational and historic reform whose effects are exppected to be positive but it is untested and so has generated anxieties among the states that they may incur losses. That made them bargain hard for compensation from centre in case of losses. It is a destination-based tax, so is viewed as being to the advantage of the consuming states and to the detriment of the producing states like Maharashtra, Tamil Nadu, Gujarat, Haryana, and Karnataka. These latter wanted a suitable compensation formula.States demanded full compensation for five years and the Centre agreed.

Government needs extra revenue to compensate the states, and so the GST Council decided to impose additional cesses for five years on certain goods over and above the highest tax bracket of 28%. These goods on which cess will be levied include tobacco products, coal, motor vehicles, which include all types of cars, personal aircraft, and yachts.

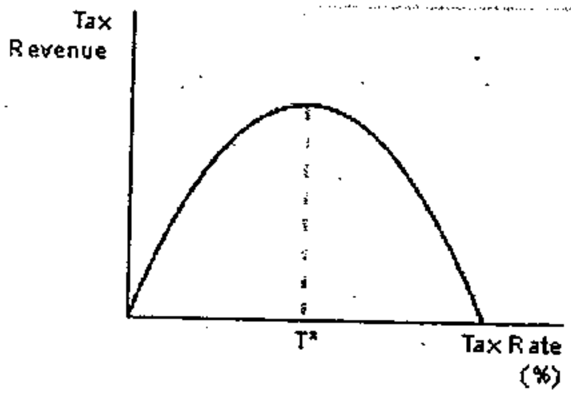
These additional cesses, however, will be removed after five years and the states incurring losses would have to find alternative sources of revenue.

The percentage of the additional cess changes from good to good.Both intra-state and inter-state supplies of goods or services would attract GST cess over and above the applicable CGST, SGST, and IGST rates.

Clean Environment Cess of GOI , India's carbon tax which was a source of funding clean energy projects and to combat climate change and which was collected -Rs. 400 a tonne on domestic and imported coal- to make up the National Clean Energy Fund, will go into the GST Compensation Fund, according to Goods & Services (Compensation to States) Act, 2017, in a schedule.

Laffer Curve

Developed by Arthur Laffer, this curve shows the relationship between tax rates and tax revenue collected by governments. The chart below shows the Laffer Curve:



The Laffer curve has been debated in the country since 1997-1998 Budget reduced rates and slabs in the income tax regime in the country.

Source and spend of rupee

Where does the rupee come from?

- 19% of the rupee comes from corporation tax
- 16% from Income Tax
- 9% from Customs duty
- 14% from Excise duty
- 10% from Service tax and other taxes
- 10% Non-tax revenue
- 3% Non-debt capital receipts
- 19% from borrowing and other liabilities

How is the rupee spent?

- 11% of the rupee goes to Central plan
- 18% on Interest
- 9% on Defence
- 10% on Subsidies
- 5% on other Non-Plan Expenditure
- 24% on States' shares
- 13% on Non Plan Grants
- 10% Plan assistance to state and Union territories

Minimum Alternative Tax (MAT)

Normally, a company is liable to pay tax on the income computed in accordance with the provisions of the Income Tax Act, but the profit and loss account of the company is prepared as per provisions of the Companies Act. There were large number of companies who show book profits as per their profit and loss account (according to the Companies Act) but do not pay any tax by showing no taxable income as per provisions of the Income Tax act. Although the companies show book profits and may even declare dividends to the shareholders, they do not pay any income tax. These companies are popularly known as Zero Tax companies. In order to bring such companies under the income tax act net, MAT was introduced in 1996. They are required to pay MAT at 18.5% of the book profit.

Book profit is profit which is notional: when assets appreciate, their value in the book goes up but the same is not realized as they are not sold. It is also called unrealized gain or unrealized profit or paper gain or paper profit.

Rajaswa Gyan Sangam

The Central Board of Direct Taxes (CBDT) and the Central Board of Excise & Customs (CBEC) have been holding annual Conferences of senior officers for a number of years. In 2016, for the first time, a joint Conference of the two Boards was held under the umbrella of "Rajaswa Gyan Sangam" which was inaugurated by the Hon'ble Prime Minister. Same was held in 2017 too.

The objective of the Conference is to enable a two-way communication between the policy-makers and the senior officers in the field offices with a view to increase revenue collection and facilitate effective implementation of law and policies. Issues arising in implementation of policies and strategies to achieve targets in core functional areas are discussed. Such issues *inter alia* include HR issues, Litigation Management, Strategies for Revenue Maximisation, Tax Evasion, Taxpayer Services, GST and Reforms and Modernisation.

Tax Reforms in India

Since the beginning of the last decade as a part of the economic reforms programme, the taxation system in the country has been subjected to consistent and comprehensive reform.

The need for the tax reforms arises from the fact that

- tax resources must maximised
- international competitiveness must be imparted to the Indian economy
- transaction costs must be reduced
- the high-cost nature of Indian economy needs to be corrected so that compliance increases,equity improves and investment flows

On the direct tax front, the reforms are the following:

- Reduction and rationalization of rates
- Simplification of procedures
- Strengthening of e-administration
- Widening of the tax base
- Exemptions are gradually being withdrawn.
- Corporate tax reforms since 2015
- Wealth tax abolished in 2015 and many more as seen above

Indirect Taxes

- Reduction in the peak tariff rates- 10% is the peak customs duty today
- The number of slabs has come down drastically
- GST etc

Some Terms

Dividend Distribution tax

Companies giving dividend have to pay tax on the amount distributed as dividend.

Withholding tax

It means withholding of tax from certain payments including interest, salaries paid to employees, professional fee, payments to contractors etc at the time of making the payment. It is the same as TDS.

Capital gains tax

It is the tax on the gains made from buying and selling assets like land, shares etc.

If the gain is made in the assets held for over three year (one year for shares) , it is called long term capital gain and taxed. For shares, there is no long term capital gains tax. Short term capital gains tax is always more to encourage investment as distinct from speculation.

Presumptive Tax

Presumptive tax the estimated income method of assessment for certain categories of businesses is prevalent in several countries. Presumptive taxation involves the use of indirect means to ascertain tax liability which differs from the usual rules based on the taxpayer's accounts. It is used to indicate that there is a legal presumption that the taxpayer's income taxable to a certain extent.

The reason for the presumptive tax may be that in a number of businesses the assessees do not maintain books of accounts or the books of accounts maintained are irregular and incomplete. It was introduced in India in the early nineties for traders but was withdrawn as the success rate was low.

Wealth Tax

When income accumulates into wealth, it gets taxed after a point. Wealth tax is levied only in respect of specified non-productive assets such as residential houses, urban land, jewellery, bullion, motor cars etc. Union Budget 2015-16 abolished wealth tax and instead levied an additional surcharge of 2 per cent on individuals with taxable income of Rs 1 crore and above.

Securities Transaction Tax

Introduced in the Union Budget 2004-2005, it is a tax on the value of all the transactions of purchase of securities that take place in a recognised stock exchange of India. It is meant to make up revenue loss from the abolition of long term capital gains tax.

Commodities Transaction Tax

Commodities transaction tax (CTT) is a tax similar to Securities Transaction Tax (STT). CTT aims at discouraging excessive speculation

Fringe Benefit Tax (FBT)

Fringe benefits are usually enjoyed collectively by the employees and cannot be attributed to individual employees singly. They are taxed in the hands of the employer who may or not pass it on to the employee. Examples are transport services for workers and staff, gym, club, etc.

The rationale for levying a FBT on the employer lies in the inherent difficulty in isolating the 'personal element' where there is collective enjoyment of such benefits and attributing the same directly to the employee. This is so especially where the expenditure incurred by the employer is ostensibly for purposes of the business but includes, in partial measure, a benefit of a personal nature. Consequent to abolition of fringe benefit tax in 2009, certain benefits taxed earlier as fringe benefits in the hands of the employer would now be taxable as perquisites in the hands of the employees.

Perquisites

Perquisites are benefits in addition to normal salary to which employee has a right by virtue of his employment. To put it simply or 'perks' as they are called colloquially, are benefits generally in cash/kind, received by an employee by virtue of his employment.

Perks are taxable as a part of salary as per the India income tax laws and includes:

- the value of rent-free accommodation
- the value of any concession in the matter of rent respecting any accommodation provided etc
- car
- club membership
- travel

Tax-incidence: It shows the entity on whom tax is imposed. It is different from the tax burden as the latter refers to the one who actually bears it- the consumer in the case of indirect taxes. For direct taxes, both fall on the same entity. Tax on petrol is paid by te consumer while the seller is officially responsible to deposit with the government.

Tax Base: The value of goods, services and incomes on which tax is imposed. When we speak of the tax base being broadened, they mean a wider range of goods, services, income, etc. has been made subject to a tax. In the case of income tax, the tax base is taxable income. Some kinds of income are excluded from the definition of taxable income, such as savings. For sales tax, the tax base is the value/volume of items that are subject to tax; essential goods, for example, are not part of the tax base.

Tax Shelters: Any technique which allows one to legally reduce or avoid tax liabilities. It is a way in which the taxpayer can invest his income in a particular kind of investment that gives tax concessions.

Tax planning, avoidance and tax evasion: There are provisions in the law that allows one to save and invest in a manner that leads to reduction in taxable income. If these provisions are used for reducing tax liability, it is called tax avoidance. It is lawful to take all available tax deductions. It is the same as tax planning for tax mitigation.

Tax evasion, on the other hand, is a punishable offence. Tax evasion involves failing to report income, or improperly claiming deductions that are not authorized. It creates black money.

But as mentioned earlier in the chapter, certain types of tax avoidance can be considered evasion as in the case of Vodafone.

Hidden taxes: are taxes that are concealed in the price of articles that one buys. Hidden taxes are also referred to as implicit taxes. The most well-known form of the hidden tax is the indirect tax. Examples of hidden taxes are import duties.

Consumption tax

A consumption tax is a tax on spending on goods and services. The tax base of such a tax is the money spent on consumption. Consumption taxes are indirect, such as a sales tax or a value added tax.

Proportional, progressive and regressive tax

An important feature of tax systems is whether they are proportional tax (the tax as a percentage of income is constant over all income levels), progressive tax (the tax as a percentage of income rises as income rises), or regressive tax (the tax as a percentage of income falls as income rises). Progressive taxes reduce the tax incidence on people with smaller incomes, as they shift the incidence disproportionately to those with higher incomes.

Specific duty: Weight or quantity or number is the basis for taxation.

Ad Valorem- A Latin term meaning "according to worth," referring to taxes levied on the basis of value. Taxes on real estate and personal property are ad valorem. Luxury goods are taxed higher even if they weigh the same or number the same as ordinary goods.

Compound duties are a combination of value and other factors based on which tax is imposed.
Excise Duty: Excise duty is a tax on manufacture and is levied on the manufacture of goods within the country.

Customs Duty: When goods are imported or exported, customs duty is imposed and collected by the Union Government. Peak customs duty today is 10%.

Negative income tax: Subsidy is a negative income tax. It is a taxation system where income subsidies are given to persons or families that are below the poverty line. The government sends financial aid to a person who files an income tax return reporting an income below a certain level. It is advocated by economist Milton Friedman in 1962.

Tax Buoyancy: It refers to the percentage change in tax revenue with the growth of national income. That is, growth-based increase in tax collections.

Tax Elasticity: Tax elasticity is defined as the percentage change in tax revenue in response to the change in tax rate and the extension of coverage. Buoyancy, on the other hand is the response to economic growth when the base increases but there is no change in the rate.

Tax Stability: It means no frequent changes and continuity of policy in a predictable and transparent manner. Although revenue from different taxes varies from year to year, revenue stability is desirable because it makes it easier for a government to build a credible spending and borrowing plan for the year ahead. Taxes whose revenue is relatively stable contribute to overall revenue stability. Market players also can plan better.

Receipt Budget, 2017-2018

ABSTRACT OF RECEIPTS

(In ₹ crores)

REVENUE RECEIPTS	2015-2016 Actuals	2016-2017 Budget Estimates	2016-2017 Revised Estimates	2017-2018 Budget Estimates
1. Tax Revenue				
Gross Tax Revenue	1455648.11	1630887.81	1703242.94	1911579.46
Corporation Tax	453228.33	493923.55	493923.50	538744.73
Taxes on Income	287637.12	353173.68	353173.70	441255.27
Wealth Tax	1079.26	...	...	...
Customs	210338.00	230000.00	217000.00	245000.00
Union Excise Duties	288072.89	318669.50	387368.58	406900.00
Service Tax	211414.25	231000.00	247500.00	275000.00
Taxes on Union Territories	3878.28	4121.08	4277.16	4679.46
Less - NCCD transferred to the National Calamity Contigency Fund/National Disaster Response Fund	6136.39	6450.00	6450.00	10000.00
Less - State's share	506192.86	570336.59	608000.31	674565.45
Centre's Net Tax Revenue	943318.76	1054101.22	1088792.63	1227014.01
2. Non-Tax Revenue				
Interest receipts	25378.32	29620.43	18149.03	19020.73
Dividend and Profits	112127.15	123780.05	153222.38	142430.49
Other Non Tax Revenue	112662.67	168181.29	161997.07	125788.20
Receipts of Union Territories	1536.27	1339.33	1401.81	1517.65
Total Non Tax Revenue	251706.41	322921.10	334770.29	288757.07
Total Revenue Receipts	1195025.17	1377022.32	1423562.92	1515771.08
3. Capital Receipts				
A. Non-debt Receipts				
1. Recoveries of loans and advances@	30834.75	10634.31	11070.86	11932.25
2. Miscellaneous Capital Receipts	42131.69	56500.00	45500.00	72500.00
Total	*72966.44*	*67134.31*	*56570.86*	*84432.25*
B. Debt Receipts*				
3. Market Loans	404049.95	425180.87	347218.54	348226.40
4. Short term borrowings	50692.71	16648.64	18629.59	2002.00
5. External Assistance (Net)	12748.34	19094.42	14873.00	15789.00
6. Securities issued against Small Savings	52464.96	22107.91	90376.57	100157.16
7. State Provident Fund (Net)	11858.33	12000.00	13000.00	14000.00
8. Switching/Buy Back of Securities	...	...	...	...
9. Other Receipts (Net)	-12201.90	25876.70	9648.40	53512.69
Total	519612.39	520708.74	494046.10	533687.25
Total Capital Receipts (A+B)	592578.83	587843.05	550616.96	618119.50
4. Draw-Down of Cash Balance	13170.07	13195.08	40227.10	12844.26
Total Receipts (1+2+3+4)	1774433.93	1961670.29	1933962.78	2121046.38
Receipts under MSS (Net)	...	20000.00	...	...
@ excludes recoveries of short-term loans and advances from States, loans to Government servants, etc.	11035.05	11861.04	50615.00	51375.01

* The receipts are net of payment