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Economics –PT Shots

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TOPIC GENERAL STUDIES 3: ECONOMICS- ECONOMIC DEVELOPMENT- GOV POLICIES

JUNE 2020

1) AGRIDEX

National Commodity and Derivatives Exchange (NCDEX) announced the commencement of trading in the country's first agriculture futures index called AGRIDEX

• NCDEX AGRIDEX is India's first return based agricultural futures Index which tracks the performance of the ten liquid commodities (both kharif and rabi seasons) traded on NCDEX platform.

o Ten commodities include Castor seed, Chana, Coriander, Cotton Seed Oil cake, Guar Gum, Guar Seed, Jeera, Mustard Seed, Ref Soya oil and Soy bean.

o No group of related commodities may constitute more than 40% of the total weightage in the index in order to ensure diversification.

• It will facilitate the participants in hedging their commodity risk based on price anticipation of the products.

• It is based on the revised guidelines issued by the Securities and Exchange Board of India (SEBI), which allowed futures trading in commodity indices.

• NCDEX has partnered with National Stock Exchange (NSE) Indices, a leading Index service provider, to maintain and disseminate real-time NCDEX AGRIDEX values.

Futures

• These are a type of derivative instrument. o A derivative is an instrument whose value is derived from the value of one or more underlying assets, which can be commodities, precious metals, currency, bonds, stocks, stocks indices, etc.

o Common examples of derivative instruments are Forwards, Futures, Options and Swaps.

• In futures, there is an agreement to buy or sell a specified quantity of financial instrument or physical commodity in a designated future month at a price agreed upon by the buyer and seller.

About NCDEX

• It is the country's leading agricultural commodity exchange, which offers services across the entire value-chain of agricultural commodities.

• It offers a wide range of benchmark products across agriculture commodities.

• It brings buyers and sellers together through its electronic trading platform.

2) Why Moody's downgraded India's rating?

Moody's Investors Service ("Moody's") has downgraded the Government of India's foreign-currency and local-currency long-term issuer ratings to "Baa3" from "Baa2". It stated that the outlook remained "negative".

Implications: The latest downgrade reduces India to the lowest investment grade of ratings and brings Moody's ratings for the country in line with the other two main rating agencies in the world — Standard & Poor's (S&P) and Fitch. A rating downgrade means that bonds issued by the Indian governments are now "riskier" than before, because weaker economic growth and worsening fiscal health undermine a government's ability to pay back. When India's sovereign rating is downgraded, it becomes costlier for the Indian government as well as all Indian companies to raise funds because now the world sees such debt as a riskier proposition.

There are four main reasons why Moody's has taken the decision:

1. Weak implementation of economic reforms since 2017.
2. Relatively low economic growth over a sustained period.
3. A significant deterioration in the fiscal position of governments (central and state).
4. And the rising stress in India's financial sector.

What does "negative" outlook mean?

"The negative outlook reflects dominant, mutually reinforcing, downside risks from deeper stresses in the economy and financial system that could lead to a more severe and prolonged erosion in fiscal strength than Moody's currently projects". In particular, Moody's has highlighted persistent structural challenges to fast economic growth such as "weak infrastructure, rigidities in labor, land and product markets, and rising financial sector risks". In other words, a "negative" implies India could be rated down further.

What is Moody's outlook on economic growth, jobs and per capita income?

Moody's expects India's real GDP to contract by 4.0% in the current financial year. Thereafter it expects a sharp recovery in 2021-22. But over the longer term, it states "growth rates are likely to be materially lower than in the past".

Key observations made by Moody's: More than two years ago, in November 2017, Moody's had upgraded India's rating to "Baa2" with a "stable" outlook. At that time, it expected that "effective implementation of key reforms would strengthen the sovereign's credit profile" through a gradual but persistent improvement in economic, institutional and fiscal strength. But those hopes were belied. Since that upgrade in 2017, implementation of reforms has been "relatively weak and has not resulted in material credit improvements, indicating limited policy effectiveness," according to Moody's. The low effectiveness of policy and the resulting loss of growth momentum is evidenced in:

• The sharp deceleration in India's GDP growth rates- provisional estimates for 2019-20 were pegged at 4.2% — the lowest annual growth in a decade.

• Worsening government (both Centre and state-level) finances.

• Each year, the central government has failed to meet its fiscal deficit (essentially the total borrowings from the market) target. This has led to a steady accretion of total government debt.

3) Rising forex reserves and its importance

Amid pandemic, India's foreign exchange reserves are rising and are slated to hit the $500 billion mark soon. In the month of May, forex reserves jumped by $12.4 billion to an all-time high of $493.48 billion (around Rs 37.30 lakh crore) for the week ended May 29.

PT POINTERS: The level of foreign exchange reserves has steadily increased by 8,400 per cent from $5.8 billion as of March 1991 to the current level.

What are forex reserves?

Forex reserves are external assets in the form of gold, SDRs (special drawing rights of the IMF) and foreign currency assets (capital inflows to the capital markets, FDI and external commercial borrowings) accumulated by India and controlled by the Reserve Bank of India.

Why they are important?

1. Official foreign exchange reserves are held in support of a range of objectives like supporting and maintaining confidence in the policies for monetary and exchange rate management including the capacity to intervene in support of the national or union currency.

2. It will also limit external vulnerability by maintaining foreign currency liquidity to absorb shocks during times of crisis or when access to borrowing is curtailed.

Why are forex reserves rising despite the slowdown in the economy?

Rise in investment in foreign portfolio investors in Indian stocks and foreign direct investments (FDIs). Fall in crude oil prices has brought down the oil import bill, saving the precious foreign exchange. Overseas remittances and foreign travels have fallen steeply – down 61 per cent in April from $12.87 billion.

What's the significance of rising forex reserves?

The rising forex reserves give a lot of comfort to the government and the Reserve Bank of India in managing India's external and internal financial issues at a time when the economic growth is set to contract by 1.5 per cent in 2020-21. It's a big cushion in the event of any crisis on the economic front and enough to cover the import bill of the country for a year. The rising reserves have also helped the rupee to strengthen against the dollar. Reserves will provide a level of confidence to markets that a country can meet its external obligations, demonstrate the backing of domestic currency by external assets, assist the government in meeting its foreign exchange needs and external debt obligations and maintain a reserve for national disasters or emergencies.

Where are India's forex reserves kept?

The RBI Act, 1934 provides the overarching legal framework for deployment of reserves in different foreign currency assets and gold within the broad parameters of currencies, instruments, issuers and counterparties. As much as 64 per cent of the foreign currency reserves is held in the securities like Treasury bills of foreign countries, mainly the US. 28 per cent is deposited in foreign central banks. 7.4 per cent is also deposited in commercial banks abroad. India also held 653.01 tonnes of gold as of March 2020, with 360.71 tonnes being held overseas in safe custody with the Bank of England and the Bank for International Settlements, while the remaining gold is held domestically.

4) ANIMAL HUSBANDRY INFRASTRUCTURE DEVELOPMENT FUND

Cabinet Committee on Economic Affairs has recently approved the establishment of Animal Husbandry infrastructure Development Fund worth Rs. 15000 crores.

About Animal Husbandry Infrastructure Development Fund (AHIDF)

• AHIDF would facilitate investments in establishment of infrastructure for dairy and meat processing and value addition infrastructure and establishment of animal feed plant in the private sector.

• Eligible beneficiaries: Farmer Producer Organizations (FPOs), MSMEs, not-for-profit companies, Private Companies and individual entrepreneurs.

• Funding: Minimum 10% margin money to be contributed by beneficiary. The balance

90% would be the loan component to be made available by scheduled banks.

• Interest subvention: Government of India will provide 3% interest subvention to eligible beneficiaries.

o There will be 2 years moratorium period for principal loan amount and 6 years repayment period thereafter.

• Credit Guarantee Fund: Government of India would also set up Credit Guarantee Fund of Rs. 750 crores to be managed by NABARD. Credit guarantee would be provided to those sanctioned projects which are covered under MSME defined ceilings.

• Expected Benefits:

o **Investment**: AHIDF is expected to leverage around seven times private investment. It will ensure availability of capital to meet upfront investment, enhance overall returns and pay back for investors.

o **Employment generation:** AHIDF would help in direct and indirect livelihood creation for 35 lakh people.

o **Benefit for Farmers**: Almost 50-60% of final value of dairy output in India flows back to farmers. Thus, growth in this sector would directly impact farmer's income. Also, it would motivate farmers to invest more on inputs thereby driving higher productivity.

o It would promote exports of the processed and value-added commodities.

Animal Husbandry Sector Statistics in India

• During 2016-17, the value of output from livestock sector at current prices is about 31.25% of the value of output from agricultural and allied sector.

o India continues to be the largest producer of milk in the world, with per capita availability of milk 394 grams per day during 2018-19. (World per capita availability is 229 grams per day).

• As per the latest and 20th Livestock census, the total livestock population is 535.78 million

5) REAL TIME MARKET IN ELECTRICITY

Recently, pan-India Real Time Market in electricity was launched.

About Real Time Market in electricity

• Real time market is organised market platform enabling buyers and sellers to meet their energy requirement closer to real time operation.

• Under this, auctions will be held 48 times a day, once every half an hour.

• It became operational on two platforms: Indian Energy Exchange (IEX) and Power Exchange India Limited (PXIL). • Power System Operation Corporation Limited (POSOCO) will route electricity from supply sources to consumption point with help of Regional Load Despatch Centres.

• To implement the Real Time Market as amendments were made to: Power Market regulations, Indian Electricity Grid Code (IEGC) Regulations, and Open Access in inter-state transmission regulations.

Benefits of Real Time Market in electricity

• Ensure optimal utilization of the surplus electricity as electricity producers, who may see generation more than their committed demand, can sell surplus energy in market.

• Manage diversity in the demand pattern, as electricity DISCOMS faced with sudden shortage of supply can purchase energy.

• Real Time Market would help to mitigate challenges to the grid management due to intermittent and variable nature of renewable energy generation (especially solar and wind energy). Thus, it can lead to integration of higher quantum of renewable energy resources into the grid.

• Shorter bidding time, faster scheduling, and defined processes will enable the participants to access resources throughout the all India grid for promoting competition.

• It will lead to cost optimisation of power purchase and serve consumers with reliable power supply.

• The concept of 'gate closure' ensures firmness in schedules during the hours of market operation. Gate closure implies the closure of the gate for trading in real-time market after which the bids submitted to the Power Exchange cannot be modified for a specified delivery period.

Power System Operation Corporation Limited (POSOCO)

• It is a wholly owned Government of India enterprise under the Ministry of Power.

• It facilitates competitive and efficient wholesale electricity markets and administer settlement systems.

• It consists of 5 Regional Load Despatch Centres and a National Load Despatch Centre (NLDC) to ensure integrated operation of the national power system with Reliability, Economy and Sustainability.

6) INDIAN GAS EXCHANGE (IGX)

India's first gas exchange — the Indian Gas Exchange (IGX) — was launched recently as wholly owned subsidiary of Indian Energy Exchange.

About IGX

• It is a digital trading platform that will allow buyers and sellers of natural gas to trade both in the spot market and in the forward market for imported natural gas across three hubs — Dahej and Hazira in Gujarat, and Kakinada in Andhra Pradesh.

• Imported Liquified Natural Gas (LNG) will be regassified and sold to buyers through the exchange, removing the requirement for buyers and sellers to find each other.

o The bidding is done in an anonymous manner, where the buyer and seller do not know their counterpart.

• The price of domestically produced natural gas is decided by the government and it will not be sold on the gas exchange.

o Domestic production of gas has been falling over the past two fiscals as current sources of natural gas have become less productive.

o Domestically produced natural gas currently accounts for less than half the country's natural gas consumption; imported LNG accounts for the other half. Hence, IGX encourages trading in imported LNG.

• The contracts traded at IGX are for compulsory specific physical delivery and settlement of the trade are subject to the condition that such contracts are non-transferable in nature.

Expected Benefits

• The exchange is expected to facilitate transparent price discovery in natural gas, and facilitate the growth of the share of natural gas in India's energy basket. o India has set a policy target of increasing the share of natural gas in India's energy basket from current 6.5% to 15% by 2030.

• Trading platform will also drive competition across the value-chain, leading to innovative business models and efficient cost-structures, thus supporting the overall affordability of gas.

Spot and Forward Market

• The spot market is a public financial market in which financial instruments or commodities are traded for immediate delivery.

• A forward market is an over-the-counter marketplace that sets the price of a financial instrument or asset for future delivery.

7) SOCIAL STOCK EXCHANGE

Expert panel setup by the Securities and Exchange Board of India (SEBI) has prepared draft norms for Social Stock Exchanges (SSE).

About Social Stock Exchanges (SSE)

• Social Stock Exchange (SSE) is an electronic fundraising platform that allows investors to buy shares in a social enterprise that has been vetted by the exchange.

• Social enterprises include is a revenue-generating business whose primary objective is to achieve a social objective, for example, providing healthcare or clean energy.

• Idea of a SSE for listing of social enterprise and voluntary organisations for raising capital as equity, debt or like a mutual fund was mooted in the Union Budget 2019-20.

• Later, SEBI constituted panel to suggest norms for SSEs.

• The most prominent SSEs in the world are in UK, Canada, USA, South Africa, Singapore and Mauritius.

Benefits of Social Stock Exchange (SSE)

• This will unlock funds from donors, philanthropic foundations, Corporate Social Responsibility (CSR) spenders and impact investors for social development. As per Brookings India, currently only 57% of the social enterprises have access to debt and equity, which is barrier to growth and sustainability.

• Listing of social enterprises on an SSE would also improve visibility of social enterprises in the eyes of large investors and philanthropic organisations. Also, SSEs will provide investors a better understanding of social sector for routing their investment.

• Banks, NBFCs and other investors can also raise capital from SSE to participate in the growth journey of the social enterprises and thereby deepen their impact.

• SSE will help to improve essential social services and important social sectors like education, health, agriculture and clean energy by channelling greater capital to them.

• SSE is expected to unlock large pools of social capital, and encourage blended finance structures so that conventional capital can partner with social capital to address the urgent challenges of COVID-19. Challenges in setting up SSE

• There is no consensus about what is and isn't a social enterprise. Prof Muhammad Yunus definition of social business can be adopted which who defined it as "a non-loss, non-dividend paying company which is created and designed to address a social problem."

• Valuing social initiatives, welfare and non-profits organisations is difficult, because there is no set benchmark, no uniform structures to set minimum thresholds to enable their listing.

• Apart from equity capital, social enterprises need debt particularly to meet working capital requirements, but only handful of private impact investors provide debt to early-stage social enterprises.

• India has more than 2 million social enterprises (non-profits, for-profits and hybrid model), which needs careful planning while designing a social stock exchange.

Way forward

• Social impact assessment can be adopted as way to assess social initiatives, welfare and non-profits organisations.

• Bringing policy and regulatory reforms to support investors and facilitating research and development for small social enterprises.

• Educating market participants about the valuation metrics weighing both on social and financial returns.

• Transparency and accountability can be achieved by online platform, similar to NITI Aayog's Darpan portal, which provides platform for interface between Voluntary organisations/ NGOs and Government Ministries.

8) Garib Kalyan Rojgar Abhiyaan launched

Prime Minister Narendra Modi launched the mega 'Garib Kalyan Rojgar Abhiyaan' aimed to boost livelihood opportunities in rural India amid the ongoing Covid-19 crisis.

Highlights of the scheme:

• The first priority of the scheme is to meet the immediate requirement of workers who have gone back to their districts by providing them with livelihood opportunities.

• The focus is also on rural citizens.

• It is a focused campaign of 125 days across 116 districts in six states to work in mission mode.

• Public works worth 50,000 crore rupees to be carried out under the scheme.

• It includes focused implementation of 25 different types of work to provide employment and to create durable infrastructure.

• The villages will join this programme through the common service centres and Krishi Vigyan Kendras. **Implementation of the scheme:** The scheme will be a coordinated effort by 12 different ministries including rural development, Panchayati Raj, Road transport and highways, mines, drinking water and sanitation, environment, railways, petroleum and natural gas, new and renewable energy, border Roads, Telecom and agriculture.

Why these 6 districts were chosen?

Post-COVID-19 lockdown, maximum migrant workers have returned to these six states.

• These districts are estimated to cover about 2/3 of such migrant workers.

• The chosen districts include 27 aspirational districts.

Significance of the scheme:

The jobs selected in the campaign will enable proper utilisation of the strength and skill of people. It will also enable the government to convert Covid crisis into an opportunity. The campaign will contribute towards provision of modern facilities, such as internet connectivity, laying of optic fibre cables, to increase internet speed in villages, so that children in villages are able to study and learn like those in cities

9) What is a rights issue?

Many companies including Reliance Industries Limited, Mahindra finance, Tata Power, Shriram Transport Finance among others plan to raise funds (aggregating to over Rs 10,000 crore) through rights issue amidst the Covid-19 pandemic.

What is rights issue?

It is an offering of shares made to existing shareholders in proportion to their existing shareholding.

• Companies often offer shares in a rights issue at a discount on the market price.

• Rights issues are used by companies seeking to raise capital without increasing debt.

• Shareholders are not obliged to purchase shares offered in a rights issue.

Why are companies going for rights issue in current times?

For a rights issue, there is no requirement of shareholders' meeting and an approval from the board of directors is sufficient and adequate. Therefore, the turnaround time for raising this capital is short and is much suited for the current situation unlike other forms that require shareholders' approval and may take some time to fructify. Thus the rights issue are a more efficient mechanism of raising capital.

What were the temporary relaxations provided in the wake of Covid-19 by SEBI?

Sebi reduced the eligibility requirement of average market capitalization of public shareholding from Rs 250 crore to Rs 100 crore for a fast track rights issuance. It also reduced the minimum subscription requirement from 90 per cent to 75 per cent of the issue size. Also, listed entities raising funds upto Rs 25 crores (erstwhile limit was Rs 10 crores) through a rights issue are now not required to file draft offer document with SEBI.

10) Housing Finance Companies

The Reserve Bank of India (RBI) has proposed stringent norms for housing finance companies. Proposed norms include:

1. At least 50% of net assets should be in the nature of 'qualifying assets' for HFCs, of which at least 75% should be towards individual housing loans.
2. Such HFCs which do not fulfil the criteria will be treated as NBFC – Investment and Credit Companies (NBFC-ICCs) and will be required to approach the RBI for conversion of their Certificate of Registration from HFC to NBFC-ICC.
3. The NBFC-ICCs which want to continue as HFCs would have to follow a roadmap to make 75% of their assets individual housing loans.
4. The target has been set at 60% by March 31, 2022, 70% by March 31, 2023, and 75% by March 31, 2024. 5. It has also proposed a minimum net-owned fund (NOF) of ₹20 crore as compared to ₹10 crore now. Existing HFCs would have to reach ₹15 crore within a year and ₹20 crore within two years.

What are qualifying assets?

The RBI defined 'qualifying assets' as loans to individuals or a group of individuals, including co-operative societies, for construction/purchase of new dwelling units, loans to individuals for renovation of existing dwelling units, lending to builders for construction of residential dwelling units.

Regulatory oversight:

• A housing finance company is considered a non-banking financial company (NBFC) under the RBI's regulations.

• A company is treated as an NBFC if its financial assets are more than 50% of its total assets and income from financial assets is more than 50% of the gross income.

11) BILATERAL INVESTMENT TREATY (BIT)

As India attempts to attract investments, there have been calls to review India's model Bilateral Investment Treaty (BIT) 2016.

About Bilateral Investment Treaty (BIT)

• Bilateral investment treaties (BITs) are treaties between two countries aimed at protecting investments made by investors of both countries.

• These treaties impose conditions on the regulatory behaviour of the host state and limit interference with the rights of the foreign investor.

• Some of these conditions include,

o Restricting host state from expropriating (take property from owner) investments, barring for public interest with adequate compensation;

o Imposing obligations on host states to accord Fair and Equitable Treatment (FET) to foreign investment.

o Allowing for transfer of funds subject to conditions given in the treaty.

o Allowing individual investors to bring cases against host states if the latter's sovereign regulatory measures are not consistent with the BIT.

• There is International Centre for Settlement of Disputes (ICSID) under investor-state dispute settlement (ISDS) mechanism for dispute redressal between international investors.

India and BIT

• India started signing BITs in early 1990s and signed the first BIT with the United Kingdom (UK) in 1994, since then India has signed BITs with 84 countries.

• BITs have been one the major drivers of FDI inflows into India. Total FDI to India has increased from $4,029 million in 2000-2001 to $43,478 in 2016-17.

• However, a penalty awarded by an Investor-State Dispute Settlement (ISDS) tribunal in the White Industries case in 2011, and subsequent ISDS notices served against India in a wide variety of cases involving regulatory measures led to a review of the BITs.

• Thus, India adopted new model BIT in 2016, moving somewhat to a protectionist approach concerning foreign investments. This model BIT is to serve as a framework for the renegotiation of India's BITs worldwide.

• Since its adoption, India has unilaterally terminated 66-odd BITs between 2016 and 2019. Since then, India has signed just three treaties, none of which is in force yet.

Key features and concerns in India model BIT 2016

• Definition of Investment in the Model BIT has moved away from a broad asset-based definition of investment to an enterprise-based definition where an enterprise is taken together with its assets.

o **Concerns**: Definition contains vague criteria such as the requirement of enterprises to satisfy 'certain duration' of existence without specifying how much, or, investments having 'significance for development' without specifying what amounts to 'significant' contribution.

o It heavily narrows down the definition of "investment" needed to qualify for BIT protection.

• **Most Favoured Nation (MFN):** MFN provision in BIT aims to create a level-playing field for all foreign investors by prohibiting the host state from discriminating against investors from different countries. o India's model BIT completely excludes the MFN clause to prevent foreign investors from taking advantage of provisions in other BITs by 'borrowing' them through the MFN clause.

o Concern: Not having an MFN provision in the BIT means exposing foreign investment to the risk of discriminatory treatment, which could offer preferential treatment to one foreign investor over other.

• **Fair and Equitable Treatment (FET):** It means that the foreign investor is protected against unacceptable measures of the host state by rules of international law which are independent of those of the host state.

o The 2016 Model BIT does not contain an FET provision because ISDS tribunals often interpret this provision too broadly. Instead, it contains a provision entitled 'Treatment of Investments' that prohibits country from subjecting foreign investments to measures that constitute a violation of customary international law. o Concern: It narrows down the scope of protection available to foreign investors because of ambiguity in regarding how such breach will it be determined.

• I**SDS Mechanism:** In 2016 Model BIT, India has qualified its consent to ISDS by requiring that a foreign investor should first exhaust local remedies at least for a period of five years before commencing international arbitration.

o **Concern:** According to the 'Ease of Doing Business 2020' report, India currently ranks 163 out of 190 countries in ease of enforcing contracts, and it takes 1,445 days and 31% of the claim value for dispute resolution. This reduces confidence in foreign investors.

Way forward

• As per studies, there is evidence that BIT regime in India has played an important role in attracting foreign investment. Thus, having a balanced BIT regime would help foreign investors to do business easier in India without due regulatory interventions to safeguard their investment.

• India is not just an importer but also an exporter of capital, hence protectionist provisions under BIT may be reciprocated in host state and reduce protection for Indian companies abroad.

• Significance of BITs for foreign investors in India also assumes importance due to larger goals of India for good governance and strengthening of rule of law.

• India's desire to increase foreign investment inflows, especially under projects like Make in India and liberalisation policies needs to adopt a more balanced approach in the BIT model.

• Also, to meet objective of making domestic firms competitive and mobile in the value chain, as envisaged in the Atmanirbhar Bharat package, there is need for favourable decisions on FDIs.

• Now, global companies are moving their investments away from China, thus, there is an opportunity to review the BIT model from protectionist approach to a more pragmatic one.

12) SUSPENSION OF INSOLVENCY AND BANKRUPTCY CODE (IBC)

Recently, an ordinance was approved to amend the IBC so as to provide relief for corporates as the pandemic and subsequent lockdown had significantly impacted economic activities.

About the ordinance

• Section 10A has been introduced thereby suspending Sections 7, 9 and 10 of the IBC.

o It states that no application shall ever be filed for initiation of corporate insolvency resolution process of a corporate debtor for any default arising on or after 25th March, 2020 for a period of six months which could be extended up to a year.

o While sections 7 and 9 provide for initiation of insolvency proceedings by financial creditors and operational creditors, respectively, section 10 is for initiation of insolvency resolution proceedings by a corporate applicant. **Rationale of the move**

• Economic stress because of COVID-19: Industries are grappling with supply chain breakdown, slowdown in demand, unavailability of labour and inability to complete contracts. Moreover, service sectors such as hospitality or aviation are facing reluctance of the customers in indulging in such activities. The by-product of this slowdown will be increased stress and default by debt-laden Indian corporates.

• **Tough IBC regime:** Under the IBC, an entity can seek insolvency proceedings against a company even if the repayment (of more than 1 crore) is delayed by just one day. The approach of Creditor-in-Control regime and strict time frame of resolution has created an environment where corporate debtors try to avoid IBC as they may lose control over management otherwise.

• **Concern on value recovery:** Of the total 221 resolved cases under IBC, just 44 per cent amount of debt has been recovered since the inception of the law in 2016. Moreover, for every one case resolved, four cases end up in liquidation, where the recovery falls down sharply to 15-25%. This means that creditors have to undergo large haircuts on their loans.

• **Huge litigation pressure on judiciary:** judicial system would not have been able to handle a huge influx of cases triggered by economic downturn.

Concerns regarding suspension of IBC

• Ballooning of liabilities without resolution: when creditors and even corporate applicant itself can not initiate the insolvency proceedings, it may restrict the exit of a business and lock-up its assets, thereby further deteriorating their value and leading to losses.

• Use of alternative debt resolution mechanisms: suspension will negate the two states objectives of faster resolutions and value maximization under IBC and creditors will be forced to turn to older adhoc mechanisms (see box) to address defaults. o Diversion from IBC to other methods may alternatively result in myriad recovery cases and enforcement of security cases being filed, thereby burdening the courts further.

• Mounting NPAs: in the absence of any definite and timely resolution, NPAs of banking sector may rise which may lead to increment in lending rates, hamper the investment and credit cycle and lower investor confidence. This will hamper the potential growth of economy in long run.

• Higher provisioning norms for Banks: Prudential Framework for Resolution of Stressed Assets by RBI requires the lenders to undertake a prima facie review of the debtor upon the occurrence of a default. It provides a system of disincentives in the form of additional provisioning for delay in implementation of resolution plan or initiation of insolvency proceedings.

• Potential of misuse: as proceedings under IBC can never be filed for default occurring in the suspension period, so:

o Promoters of companies that have the capacity to repay dues could force a default during this period and never be held accountable under the IBC.

o While only pandemic-related cases should get the benefit of this reprieve, it will be tough to pinpoint this as the reason for the non-servicing of loans.

o It can adversely affect operational creditors, such as vendors and suppliers, as they would not be able to file insolvency proceedings that may lead to artificial delays in payments accrued to them by corporate debtors.

• No suspension against personal guarantors of a company: if directors or promoters of a company have provided personal guarantees to its lenders, they may still be taken to the insolvency court under IBC.

• The ordinance does not grant any relief to such applicants whose resolution plans recently got approved. Their ability to implement the said plans will be directly impacted by such disruptions going forward.

Way Forward

India will do well by addressing the above concerns. Further, other countries are flattening the bankruptcy curve by adopting methods like:

• In Germany, two conditions have to be satisfied by the corporate debtor for a suspension. First, the reason for insolvency must be based on the effects of the pandemic. Also, under scrutiny would be the prospects of restructuring the company.

• The United Kingdom has allowed for a much shorter moratorium without the creditor approval.

• In Singapore, to get the benefit of the moratorium, corporate debtors have to prove they were unable to perform a contract because of COVID-19 pandemic. Finally, in view of the suspension of the IBC, the government must do the necessary reforms to create an alternative framework. In the absence of this, financial health of companies may deteriorate leading to valuedestruction which should not be an unwanted consequence of this move.

13) MONETIZATION OF DEFICIT

Some economists including former RBI governor C Rangarajan have suggested that the government should monetize the deficit.

What is meant by Monetization of Deficit?

If the expenditure of the government exceeds its income, the government is said to have incurred a fiscal deficit. This deficit financing has to be done either by borrowing from the market or monetisation of deficit through RBI.

• In simple words, monetization of fiscal deficits involves the financing of such extra expenses with money, instead of debt to be repaid at some future dates. So, it is a form of "non-debt financing". As a result, under monetization, there is no increase in net (not gross) public debt.

• It can occur only through one of two modalities:

o Direct Monetization (DM): Under this method, RBI prints new currency and purchases government bonds directly from the primary market (from the government) using this currency. As a result, this supports the spending needs of the government.

✓ For instance, debt would originate if treasury were to simply borrow the money from the RBI therefore this would not constitute true monetization of the deficits.

o Indirect monetization (IM): In this method, deficits are monetized as the government issues bonds in the primary market and the RBI purchases an equivalent amount of government bonds from the secondary market in the form of Open Market Operations (OMOs).

✓ This modality replicates the same effects of the first if the central bank commits to the following actions:

i) hold the purchased bonds in perpetuity,

ii) roll over all the purchased bonds that reach maturity, and

iii) return to government the interests earned on the purchased bonds.

Historical context on Monetization of deficit

• Monetisation of deficit was in practice in India till 1997, whereby the central bank automatically monetised government deficit through the issuance of ad-hoc treasury bills.

o Treasury bills are money market instruments, are short term debt instruments issued by the Government of India and are presently issued in three tenors (91, 182 and 364 days).

• In 1994 and 1997, two agreements were signed between the government and RBI to completely phase out funding through ad-hoc treasury bills. Later on, with the enactment of Fiscal Responsibility and Budget

Management (FRBM) Act, 2003, RBI was completely barred from subscribing to the primary issuances of the government.

• The FRBM Act as amended in 2017 contained an escape clause which permits monetisation of the deficit under special circumstances.

What warranted such a step now?

As India battles the impact of the Covid-19 pandemic, economic indicators like tax revenue, government expenditure, household savings, demand as well as supply are adversely hit.

• Combined fiscal deficit of the central and the state governments could cross 10% of the GDP during this year which was about 7-7.5% last year.

• To meet this deficit, usually government has to borrow. However, these borrowings increase government debt and negatively impacts debt-to-GDP ratio which is already worsening because of growth slowdown and possible contraction because of COVID-19 lockdown. o India's debt-to-GDP ratio is likely to increase to 84% in FY21 from an already high level of 72% as per rating agencies like Moody's and Fitch.

Conclusion

In this pandemic situation, at a time when demand and inflation are already low and unemployment is high, monetization is not likely to create negative effects as it does in normal situations. It has the possibility to set off virtuous cycle of liquidity easing, leading to a reduced level of insolvency and also a positive impact on the economy which will reduce debt-to-GDP ratio. Moreover, it is suggested that past fiscal profligacy should not stop deficit monetisation and the decision should be based on present ground situation. Apart from that, the government could look at innovative ways to shore up tax revenues- like selling land banks or by stimulating demand by cutting GST and income-tax rates. Also, government would do well by prioritizing its expenditure.

14) Consolidated notification on MSME classification and registration

The Micro Small and Medium Enterprises (MSME) Ministry has issued consolidated notification for classification and registration of MSMEs to be effected from July 1. This notification would supercede all earlier notifications with regard to classification or registration of MSMEs.

As per the latest notification:

1. An MSME would hereafter been referred to as Udyam and the registration process as Udyam Registration.
2. The Registration can be filed online based on self-declaration. Uploading of documents, papers or certificate as proof would not be necessary henceforth.
3. The basic criteria for MSME classification would be on investment in plant, machinery and equipment and turnover.
4. Export of goods or services or both would be excluded while calculating the turnover of any enterprise and investment calculation linked to the IT return of the previous year.
5. Champions Control Room across the country have been made legally responsible for facilitating entrepreneurs in registration and thereafter. As per the latest classification:

1. Micro enterprises would be those with investments not exceeding Rs one crore and turnover of Rs 5 crore.
2. Small enterprises would be those with investment up to Rs 10 crore and turnover of up to Rs 50 crore.
3. Medium enterprises - as those with investments not exceeding Rs 50 crore and

turnover of Rs 250 crore. **Significance and implications of these measures:**

The measures would completely change the way MSMEs work, ensure they compete globally besides resulting in newer enterprises entering the fray. With the stimulus, these enterprises will be in a position to lead to a fast V-shaped recovery the moment the pandemic is brought under control.

Significance of MSMEs:

With around 63.4 million units throughout the geographical expanse of the country, MSMEs contribute around 6.11% of the manufacturing GDP and 24.63% of the GDP from service activities as well as 33.4% of India's manufacturing output. They have been able to provide employment to around 120 million persons and contribute around 45% of the overall exports from India. About 20% of the MSMEs are based out of rural areas, which indicates the deployment of significant rural workforce in the MSME sector.

PT POINTER: International MSME Day was observed on 27 June under the theme "COVID-19: The Great Lockdown and its impact on Small Business."

15) Urban, multi-State cooperative banks to come under RBI supervision

To ensure that depositors are protected, the Centre has decided to bring all urban and multi-State cooperative banks under the direct supervision of the Reserve Bank of India (RBI). The Union Cabinet has approved an ordinance to this effect.

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How were these banks regulated so far?

Currently, these banks come under dual regulation of the RBI and the Registrar of Co-operative Societies.

• The role of registrar of cooperative societies includes incorporation, registration, management, audit, supersession of board and liquidation.

• RBI is responsible for regulatory functions such maintaining cash reserve and capital adequacy, among others. Co-operative banks are registered under the States Cooperative Societies Act. They come under the regulatory ambit of the Reserve Bank of India (RBI) under two laws, namely, the Banking Regulations Act, 1949, and the Banking Laws (Co-operative Societies) Act, 1955.

What necessitated this?

This comes after several instances of fraud and serious financial irregularities, including the major scam at the Punjab and Maharashtra Co-operative (PMC) Bank last year. In September, the RBI was forced to supersede the PMC Bank's board and impose strict restrictions. Implications of the latest move: Empower the RBI to regulate all urban and multi-state co-operative banks on the lines of commercial banks. It will also provide more security to depositors.

• There are 1482 urban co-operatives banks and 58 multi-state co-operative banks.

• These banks have a depositor base of 8.6 crores, who have saved a huge amount of Rs. 4.84 lakh crore with these banks.

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God bless…
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