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Economics –PT Shots (MAY-2019)

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

May 2019

1. PREPAID PAYMENT INSTRUMENTS (PPIS)

Context: Reserve Bank of India (RBI) has imposed a monetary penalty on five Pre-Paid Payment Instrument (PPI) issuers for violating its regulatory guidelines under provisions of payment and settlement Systems act 2007.

Background:

• As per RBI directions, PPI issuers were required to complete the KYC process by February 28, 2019. PPIs or mobile wallets were mandated by the banking regulator in October 2017 to capture all information required under the know-your-customer (KYC) guidelines by end February.

What are PPIs?

• Prepaid payment instruments are those which facilitate purchase of goods and services against the value stored on such instruments. Value stored on them is paid by the holder using a medium (cash, debit card, credit card etc.).

• These are generally issued in the form of smart cards, mobile wallets, paper vouchers, internet accounts/wallets.

Features:

• Prepaid payment instruments (PPIs) come with a pre-loaded value and in some cases a pre-defined purpose of payment.

• They facilitate the purchase of goods and services as well as inter-personal remittance transactions such as sending money to a friend or a family member.

• These payment instruments are licensed and regulated by the Reserve Bank of India.

• There are three types of PPIs—closed system PPIs, semi-closed system PPIs and open system PPIs.

• The most common example of a closed system PPI is a brand-specific gift card. Such cards, physical or otherwise, can be used only at specific locations, and cannot be used to transfer funds from one account to another.

2. NON-PERFORMING ASSETS (NPAS)

• **Context**: Non-performing assets (NPAs) at commercial banks amounted to ₹10.3 trillion, or 11.2% of advances, in March 2018. Public sector banks (PSBs) accounted for ₹8.9 trillion, or 86%, of the total NPAs. The ratio of gross NPA to advances in PSBs was 14.6%. These are levels typically associated with a banking crisis.

What caused this?

• The credit boom of the years 2004-05 to 2008-09. In that period, commercial credit (or what is called 'nonfood credit') doubled. Indian firms borrowed furiously in order to avail of the growth opportunities they saw coming. Most of the investment went into infrastructure and related areas — telecom, power, roads, aviation, steel. Businessmen were overcome with exuberance, partly rational and partly irrational.

• Problems in acquiring land and getting environmental clearances, several projects got stalled.

• At the same time, with the onset of the global financial crisis in 2007-08 and the slowdown in growth after 2011-12, revenues fell well short of forecasts. Financing costs rose as policy rates were tightened in India in response to the crisis.

• The depreciation of the rupee meant higher outflows for companies that had borrowed in foreign currency.

• This combination of adverse factors made it difficult for companies to service their loans to Indian banks.

• The Reserve Bank of India (RBI), acting in the belief that NPAs were being under-stated, introduced tougher norms for NPA recognition under an Asset Quality Review.

Impact of higher NPAs:

• Higher provisions on the part of banks. Provisions rose to a level where banks, especially PSBs, started making losses. Their capital got eroded as a result. Without adequate capital, bank credit cannot grow. Gross NPAs/advances rose sharply.

Why high NPAs in public sector banks?

• PSBs had a higher exposure to the five most affected sectors — mining, iron and steel, textiles, infrastructure and aviation. These sectors accounted for 29% of advances and 53% of stressed advances at PSBs in December 2014.

What needs to be done?

• One immediate action that is required is resolving the NPAs.

• An alternative is to set up a Loan Resolution Authority, if necessary, through an Act of Parliament.

• The government must infuse at one go whatever additional capital is needed to recapitalise banks — providing such capital in multiple instalments is not helpful.

• Over the medium term, the RBI needs to develop better mechanisms for monitoring macro-prudential indicators.

• Actions needs to be taken to strengthen the functioning of banks in general and, more particularly, PSBs. Governance at PSBs, meaning the functioning of PSB boards, can certainly improve.

3. CPI INFLATION

Retail inflation rose to a six-month high of 2.92 per cent in April due to a spike in food prices, according to data the Central Statistics Office. CPI inflation in April is the highest since October 2018 when the rate was 3.38 per cent.

Why is CPI inflation rising?

• Rising prices in the food basket, as well as jump in fuel prices, are contributing to the rising inflation.

Concerns:

• Rating agency Crisil expects retail inflation to rise by 60 basis points to 4 per cent this fiscal from 3.4 per cent in 2018-19. Within CPI inflation, food inflation is expected to rise in the current year, as last two months witnessed rise in prices of many farm commodities, mainly due to drought in large parts of western and southern India, coupled with an early and harsher-than-usual summer.

What is the impact on interest rates?

• Despite rising CPI inflation, analysts expect the Reserve Bank of India to cut repo rate – the rate at which it lends short-term funds to banks – as inflation remains within the RBI's target of 4 per cent even as growth of the Indian economy has been slowing down.

What Is the Consumer Price Index (CPI)?

• The Consumer Price Index (CPI) is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as

transportation, food and medical care. It is calculated by taking price changes for each item in the predetermined basket of goods and averaging them.

• Changes in the CPI are used to assess price changes associated with the cost of living; the CPI is one of the most frequently used statistics for identifying periods of inflation or deflation.

Understanding Consumer Price Index (CPI):

• The CPI measures the average change in prices over time that consumers pay for a basket of goods and services, commonly known as inflation. Essentially it attempts to quantify the aggregate price level in an economy and thus measure the purchasing power of a country's unit of currency.

• The weighted average of the prices of goods and services that approximates an individual's consumption patterns is used to calculate CPI.

4. RBI RELEASES 'VISION 2021' FOR E-PAYMENT SYSTEM

The Reserve Bank of India (RBI) has released 'Payment and Settlement Systems in India: Vision 2019 – 2021', a vision document for safe, secure, quick and affordable e-payment system.

• The core theme of the vision document is 'Empowering Exceptional (E)payment Experience', that stresses on empowering every Indian to access a bunch of e-payment options safely and conveniently.

Highlights of Payment Systems Vision 2021:

• It has 36 specific action points and 12 specific outcomes.

• The main agenda of the vision document is the 'no-compromise' approach towards safety and security of payment systems.

• It outlined the measures that the central bank will undertake to foster innovation, cybersecurity, financial inclusion, customer protection, and competition.

The vision document aims to achieve "a 'highly digital' and 'cash-lite' society through Goal Posts (4Cs):

• Competition
• Cost effectiveness
• Convenience
• Confidence

Key focus areas:

• Boosting customer experience with robust grievance redressal
• Empowering e-payment service providers
• Enabling eco-system and infrastructure for the e-payment system
• Putting down forward-looking regulations
• Undertaking Risk-focused Supervision

Need:

• The RBI has highlighted the need for a self-regulatory organisation for the digital payment space, which can serve as a two-way communication channel between the players and the regulator.

• The number of digital transactions is expected to increase more than four times, from 20.69 billion in December 2018 to 87.07 billion in December 2021.

• The digital payment transaction turnover vis-à-vis gross domestic product (at current market prices) is expected to further increase to 10.37 per cent in 2019, 12.29 per cent in 2020, and 14.80 per cent in 2021.

Way ahead:

• The RBI will implement the approach highlighted in the Vision document during the period 2019 – 2021. RBI's efforts will focus towards facilitating the operation of efficient and price-attractive payment systems. However, there will be minimal intervention of the RBI in fixing charges for customers to avail of digital payments.

5. MASALA BONDS

Kerala Infrastructure Investment Fund Board issued Masala Bonds to raise funds from the overseas market.

What are Masala Bonds?

• Masala Bonds are rupee-denominated bonds i.e. the funds would be raised from overseas market in Indian rupees.

• Eligibility: Any corporate, body corporate and Indian bank is eligible to issue Rupee denominated bonds overseas.

Limitations:

• RBI mandates that the money raised through such bonds cannot be used for real estate activities other than for development of integrated township or affordable housing projects.

• It also can't be used for investing in capital markets, purchase of land and onlending to other entities for such activities as stated above.

Where can these bonds be issued and who can subscribe?

• The Rupee denominated bonds can only be issued in a country and subscribed by a resident of such country that is a member of financial action task force and whose securities market regulator is a member of International Organisation of Securities Commission.

• While residents of such countries can subscribe to the bonds, it can also be subscribed by multilateral and regional financial institutions where India is a member country.

What is the minimum maturity of such bonds?

• According to RBI, the minimum maturity period for Masala Bonds raised up to Rupee equivalent of USD 50 million in a financial year should be 3 years and for bonds raised above USD 50 million equivalent in INR per financial year should be 5 years.

• The conversion for such bonds will happen at the market rate on the date of settlement of transactions undertaken for issue and servicing of the bonds, including its redemption.

6. NEFT AND RTGS

• The RBI has proposed to examine the possibility of extending availability of National Electronic Funds Transfer (NEFT) round-the-clock on all the seven days of the week — 24×7 basis — to facilitate beyond the banking hour fund transfer. Besides, the central bank will also examine the possibility of extending the timings for Real Time Gross Settlement (RTGS) transactions.

What is NEFT?

• NEFT is an electronic funds transfer system maintained by the Reserve Bank of India (RBI). Started in November 2005, the setup was established and maintained by Institute for Development and Research in Banking Technology (IDRBT).

• NEFT enables bank customers in India to transfer funds between any two NEFT-enabled bank accounts on a one-to-one basis. It is done via electronic messages.

• Unlike Real-time gross settlement (RTGS), fund transfers through the NEFT system do not occur in real-time basis.

What is RTGS?

• RTGS are specialist funds transfer systems where the transfer of money or securities takes place from one bank to any other bank on a "real time" and on a "gross" basis.

• Settlement in "real time" means a payment transaction is not subjected to any waiting period, with transactions being settled as soon as they are processed.

7. CHIEF RISK OFFICER (CRO) FOR NBFCS

The RBI has asked the non-banking financial companies (NBFCs) with assets of more than ₹5,000 crore to appoint a chief risk officer (CRO).

Roles of Chief Risk Officer (CRO):

• The primary role of the risk officer will be identification, measurement and mitigation of risks.

• All credit products (retail or wholesale) shall be vetted by the CRO from the angle of inherent and control risks.

• The CRO's role in deciding credit proposals shall be limited to being an adviser.

Reporting by CRO:

• RBI has mandated that the CRO shall report directly to the MD and CEO or the risk management committee (RMC) of the board.

• Moreover, in case the CRO reports to the MD and CEO, the risk management committee or the board shall meet the CRO in the absence of the MD and CEO, at least on a quarterly basis.

• The CRO shall not have any reporting relationship with the business verticals of the NBFC and shall not be given any business targets.

Appointment and Transfer:

• The CRO shall be a senior official in the hierarchy of an NBFC and shall possess adequate professional qualification or experience in the area of risk management.

• The CRO shall be appointed for a fixed tenure with the approval of the board.

• There shall not be any 'dual hatting' i.e. the CRO shall not be given any other responsibility.

• The CRO can be transferred or removed from his post before completion of the tenure only with the approval of the board.

• And such premature transfer or removal shall be reported to the department of non-banking supervision of the regional office of RBI under whose jurisdiction the NBFC is registered.

Need:

• With the increasing role of NBFCs in direct credit intermediation, there is a need for NBFCs to augment risk management practices. Ongoing rating downgrades of non-banks which has raised fears of another liquidity crisis.

8. SERVICES TRADE RESTRICTIVENESS INDEX

Union Commerce ministry has found problems with the current method of Services Trade Restrictiveness Index (STRI) which ranks countries based on their services trade policies, indicating the outcomes are biased and counter-intuitive.

• The 2018 edition covers a total of 45 economies (36 OECD and the rest non-OECD) and 22 sectors.

About STRI:

• Launched in 2014 and computed by the Organisation for Economic Cooperation and Development (OECD). The database is based on regulations currently in force.

• Uses and significance: It helps to identify which policy measures restrict trade. It provides policy makers and negotiators with information and measurement tools to improve domestic policy environment, negotiate international agreements and open up international trade in services. It can also help governments identify best practice and then focus their domestic reform efforts on priority sectors and measures.

• Scores: STRI indices take the value from 0 to 1, where 0 is completely open and 1 is completely closed.

Issues and concerns raised by India:

• Design issues that render STRI impractical for use. For example, the index seems to show the Indian services sector as one of the most restrictive, particularly in policy areas like foreign entry. This seems surprising as since 1991, the one area that has seen maximum liberalisation in India is FDI.
• Theoretical and empirical inconsistencies in the OECD methodology. For example, change in regulatory measures in one policy area can lead to dramatic changes in the STRI in another policy area which is not very useful for policy purposes.
• Developed country bias: The data seems to have been generated by rather arbitrary procedures and reflects a developed country bias.

9. NEED OF MANUFACTURING POLICY

Concerns:

• India still has no manufacturing policy. Focusing (as "Make in India" does) on increasing foreign direct investment and ease of doing business, important though they may be, does not constitute an industrial policy.
Significance of the Manufacturing sector:
• Manufacturing is an engine of economic growth because it offers economies of scale, embodies technological progress and generates forward and backward linkages that create positive spillover effects in the economy.
• No major country managed to reduce poverty or sustain growth without manufacturing driving economic growth. This is because productivity levels in industry (and manufacturing) are much higher than in either agriculture or services.

Need of the hour:

• There is a need for government intervention in the case of market failures. Specific instances of market failure require a government-driven industrial policy: deficiencies in capital markets, usually as a result of information asymmetries; lack of adequate investments inhibiting exploitation of scale economies; imperfect information with respect to firm-level investments in learning and training; and lack of information and coordination between technologically interdependent investments. These are good reasons why an economy-wide planning mechanism is needed in India.

Why have an industrial policy in India now?

• There is the need to coordinate complementary investments when there are significant economies of scale and capital market imperfections.
• Industrial policies are needed to address learning externalities such as subsidies for industrial training.
• The state can play the role of organiser of domestic firms into cartels in their negotiations with foreign firms or governments — a role particularly relevant in the 21st century after the big business revolution of the 1990s.
• The role of industrial policy is not only to prevent coordination failures (i.e. ensure complementary investments) but also avoid competing investments in a capital-scarce environment.
• An industrial policy can ensure that the industrial capacity installed is as close to the minimum efficient scale as possible.
• When structural change is needed, industrial policy can facilitate that process. In a fast-changing market, losing firms will block structural changes that are socially beneficial but make their own assets worthless. East Asian governments prevented such firms from undermining structural

change, with moves such as orderly capacity-scrapping between competing firms and retraining programmes to limit such resistance.

10. FALL ARMYWORM

• **Why in News?**

First reported in India last year, the Fall Armyworm (FAW) or Spodoptera frugiperda has become a major problem for farmers this year, with the pest hitting the production of the crop.

Concerns:

• More than 50% of the country, including Mizoram, has reported cases of FAW infestation this year.

• Ahead of the new kharif season, FAW poses a serious challenge before farmers due to lack of knowledge about the pest and lack of clarity on how to tackle it.

• If these problems are not addressed urgently, vast tracts of crops can be laid to waste by this pest.

What is FAW?

• A native of the tropical and sub-tropical regions of the Americas, FAW was first detected in the African continent in 2016. Since then, it has spread to other countries such as China, Thailand, Malaysia and Sri Lanka.

• In India: It was reported in India for the first-time last year, when it affected crops in Karnataka. Within a span of only six months, almost 50 per cent of the country, including Mizoram, Maharashtra, Karnataka, Tamil Nadu, Andhra Pradesh, Chhattisgarh, Madhya Pradesh, Gujarat and West Bengal, has reported FAW infestations.

Life cycle:

• In its 45-day-long lifecycle, the female moth of this pest lays around 1,5002,000 eggs on the top of leaves. In the roughly 30-day larval stage, the caterpillar goes through six stages of development or instars.

• This is the most dangerous part of the lifecycle as the caterpillar feeds on leaves, whorls, stalks and flowers of crop plants. Once this stage is completed, the growing moth pupates in the soil — for 8-9 days in summer and 20-30 days in cold weather. The nocturnal egg-laying adults live for about 10 days, during which they migrate long distances.

What makes FAW dangerous?

• It is the polyphagous (ability to feed on different kinds of food) nature of the caterpillar and the ability of the adult moth to fly more than 100 km per night. • Given its ability to feed on multiple crops — nearly 80 different crops ranging from maize to sugarcane — FAW can attack multiple crops.

• Similarly, it can spread across large tracts of land as it can fly over large distances. This explains the quick spread of the pest across India.

How FAW affects output?

• Till date, India has reported FAW infestation on maize, sorghum (jowar) and sugarcane crops. Maize has been the worst affected as most maize-growing states in southern India have been affected by the pest.

• FAW infestation and drought has led to a shortfall of nearly 5 lakh tonnes in output, prompting the central government to allow import of maize under concessional duty. Maize is the third most important cereal crop grown in the country and the infestation, if not checked in time, can wreak havoc.

What needs to be done?

• Most entomologists have suggested the Integrated Pest Management system to control the pest. This would involve constant surveillance of the pest during its vegetative growth phase and taking measures like mechanically destroying the egg masses and using pheromone traps to catch the insects.

• Pheromone traps are devices which are used to attract male insects by luring them with female pheromones. Farmers should also be discouraged from taking up staggered sowing, as this would allow the pest to have multiple reservations for growth.

11. FUND FOR RURAL AGRICULTURAL START-UPS

NABARD has announced Rs 700-crore venture capital fund for rural agricultural start-ups.

Key facts:

• This project was launched by Nab ventures, an auxiliary unit of NABARD.

• NABARD proposed amount of Rs 500 crore with an option to retain oversubscriptions of Rs 200 crore.

• NABARD has given an anchor commitment for the fund, which will be investing across startups engaged in agriculture, food and rural development space.

Significance and benefits of the fund:

• The fund will have a high impact as it will provide a boost to investment ecosystem in the core areas of agriculture, food and improvement of rural livelihoods.

About NABARD:

• It is an apex development and specialized bank established on 12 July 1982 by an act by the parliament of India.

• Its main focus is to uplift rural India by increasing the credit flow for elevation of agriculture & rural non-farm sector.

• It was established based on the recommendations of the Committee set up by the Reserve Bank of India (RBI) under the chairmanship of Shri B. Sivaraman.

• It replaced the Agricultural Credit Department (ACD) and Rural Planning and Credit Cell (RPCC) of Reserve Bank of India, and Agricultural Refinance and Development Corporation (ARDC).

• It has been accredited with "matters concerning policy, planning and operations in the field of credit for agriculture and other economic activities in rural areas in India".

• The Reserve Bank of India (RBI) recently sold its entire stakes in the National Bank for Agriculture & Rural Development (NABARD) and National Housing Bank. The decision to divest its entire stake was taken based on the recommendations of the second Narasimham Committee. The government now holds a 100 per cent stake in both NHB and NABARD.

12. PRADHAN MANTRI FASAL BIMA YOJANA (PMFBY)

Out of ₹1,400 crore earmarked annually for the north-eastern States under the Centre's flagship Pradhan Mantri Fasal Bima Yojana, only ₹8 crore — or just over half a per cent — was actually spent last year, according to the Agriculture Ministry. Four north-eastern States — Arunachal Pradesh, Nagaland, Manipur and Mizoram — are not covered under the scheme at all.

Issues with the implementation of the scheme:

• Farmers in seven States and four Union Territories nationwide will not be covered by the scheme in this kharif or summer season, for which sowing begins next month.

• Some large States like Bihar and West Bengal have withdrawn from PMFBY to set up their own State-level schemes and Punjab has never participated in the scheme, while UTs like Delhi and Chandigarh are largely urban spaces.

• However, States in the Northeast, as well as the Union Territory of Daman and Diu, face challenges such as the lack of interest by insurance companies and the lack of State budgetary resources to pay their share of the premium.

• This lack of coverage has left thousands of maize farmers devastated by losses from the fall armyworm pest there without any hope of insurance.

• Insurance companies have been reluctant to bid for these States, as the administrative costs are high. There are no proper land records. Historic yield data is not available for these States, particularly at the gram panchayat and block level.

Challenges at present:

• Insufficient reach and the issue of penetration.

• Data constraints: With just around 45% of the claims made by farmers over the last three crop seasons data for the last rabi season is not available paid by the insurance companies.

• Low payout of claims: The reason for the very low payout of claims is that only few state governments are paying their share of the premiums on time and till they do, the central government doesn't pay its share either. Till they get the premium, insurance companies simply sit on the claims.

• Gaps in assessment of crop loss: There is hardly any use of modern technology in assessing crop damages. There is lack of trained outsourced agencies, scope of corruption during implementation and the non-utilisation of technologies like smart phones and drones to improve reliability of such sampling

• Less number of notified crops than can avail insurance, Inadequate and delayed claim payment.

• High actuarial premium rates: Insurance companie charged high actuarial premium rates. If states delay notifications, or payment of premiums, or crop cutting data, companies cannot pay compensation to the farmers in time.

• Poor capacity to deliver: There has been no concerted effort by the state government and insurance companies to build awareness of farmers on PMFBY. Insurance companies have failed to set-up infrastructure for proper Implementation of PMFBY. PMBY is not beneficial for farmers in vulnerable regions as factors like low indemnity levels, low threshold yields, low sum insured and default on loans make it a poor scheme to safeguard against extreme weather events.

About PMFBY:

• In April, 2016, the government of India had launched Pradhan Mantri Fasal Bima Yojana (PMFBY) after rolling back the earlier insurance schemes viz. National Agriculture Insurance Scheme (NAIS), Weather-based Crop Insurance scheme and Modified National Agricultural Insurance Scheme (MNAIS).

• Premium: It envisages a uniform premium of only 2% to be paid by farmers for Kharif crops, and 1.5% for Rabi crops. The premium for annual commercial and horticultural crops will be 5%.

• The scheme is mandatory for farmers who have taken institutional loans from banks. It's optional for farmers who have not taken institutional credit.

Objectives:

• Providing financial support to farmers suffering crop loss/damage arising out of unforeseen events.

• Stabilizing the income of farmers to ensure their continuance in farming.

• Encouraging farmers to adopt innovative and modern agricultural practices.

• Ensuring flow of credit to the agriculture sector which contributes to food security, crop diversification and enhancing growth and competitiveness of agriculture sector besides protecting farmers from production risks.

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