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Economics –PT Shots (OCTOBER-2019)

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

October 2019

1) Why state budgets matter?

Recently, RBI released its annual study of state-level budgets.

Key findings:

• Except during 2016-17, state governments have regularly met their fiscal deficit target of 3% of GDP. This should allay a lot of apprehensions about state-level finances, especially in the wake of extensive farm loan waivers that many states announced as well as the extra burden that was put on state budgets after the UDAY scheme for the power sector was introduced in 2014-15.

• **Concern**: However, most states ended up meeting the fiscal deficit target not by increasing their revenues but by reducing their expenditure and increasingly borrowing from the market.

• There has been a reduction in the overall size of the state budget in 2017-19. This retarding fiscal impulse has coincided with a cyclical downswing in domestic economic activity and may have inadvertently deepened it.

• Also worrisome is that while states have met their fiscal deficits, the overall level of debt-to-GDP (Chart 4) has reached the 25% of GDP prudential mark. A slightly stringent criterion as prescribed by the FRBM Review Committee and in line with the revised FRBM implied debt target of 20 per cent will put most of the states above the threshold.

• States have found it difficult to raise revenues: States revenue prospects are confronted with low tax buoyancies, shrinking revenue autonomy under the GST framework and unpredictability associated with transfers of IGST and grants.

• Unrealistic revenue forecasts in budget estimates thereby leave no option for states than expenditure compression in even the most productive and employment-generating heads.

Why understanding about state government finances is becoming more and more important?

1. States now have a greater role to play in determining India's GDP than the Centre. States now spend one-and-a-half times more than the Union government.

2. They are the bigger employment generators. They employ five times more people than the Centre.

3. Since 2014-15, states have increasingly borrowed money from the market. Thus, this overall trend has serious implications on the interest rates charged in the economy, the availability of funds for businesses to invest in new factories, and the ability of the private sector to employ new labour.

Why fiscal deficit matters? What happens if the debt-to-GDP ratio widens?

• Each year's borrowing (or deficit) adds to the total debt. Paying back this debt depends on a state's ability to raise revenues.

• If a state, or all the states in aggregate, find it difficult to raise revenues, a rising mountain of debt — captured in the debt-to-GDP ratio — could start a vicious cycle.

• Then, states end up paying more and more towards interest payments instead of spending their revenues on creating new assets that provide better education, health and welfare for their residents.

• That is why, the 14th Finance Commission had mandated prudent levels of both fiscal deficit (3% of state GDP) and debt-to-GDP (25%) that must not be breached.

2) PRAKASH PORTAL

Recently, the Union Government jointly launched PRAKASH (Power Rail Koyla Availability through Supply Harmony) portal.

About Prakash Portal

• The Portal aims at bringing better coordination for coal supplies among all stakeholders - Ministry of Power, Ministry of Coal, Coal India, Railways and power utilities.

• This is an important step in ensuring adequate availability and optimum utilization of coal at thermal power plants.

• The Portal is developed by NTPC and sources data from different stakeholders such as Central Electricity Authority (CEA), Centre for Railway Information System (CRIS) and coal companies.

• The Portal is designed to help in mapping and monitoring entire coal supply chain for power plants. o Coal Stock at supply end (mines) o Coal quantity /rakes planned o Coal quantity in transit o Coal availability at power generating station.

Benefits of Portal to the Stakeholders

• Coal Company will be able to track stocks and the coal requirement at power stations for effective production planning.

• Indian Railways will plan to place the rakes as per actual coal available and stock available at power stations.

• Power stations can plan future schedule by knowing rakes in pipe line and expected time to reach.

• Ministry of Power/Ministry of Coal can review overall availability of coal at thermal power plants in different regions.

The Portal will make available four reports as detailed below -

• **Daily Power Plant Status:** This report gives Station data related to power generation, coal receipt, consumption and stock.

• **Periodic Power Plant Status:** report gives Station data related to power generation, coal receipt, consumption and stock for selected period.

• **Plant Exception Report:** This report gives materialization and rakes in pipeline through Rail.

• **Coal Dispatch Report:** This report gives Coal subsidiary wise, plant wise, source wise and siding wise details.

3) POWER PURCHASE AGREEMENTS

Recently, various states have been working to renegotiate the Power Purchase Agreements (PPAs) with the renewable energy companies.

What are PPAs?

• A Power Purchase Agreement (PPA) is a contract between two parties, one who generates electricity and one who is looking to purchase electricity.

o These define all of the commercial terms for the sale of electricity between the two parties, including when the project will begin commercial operation, schedule for delivery of electricity, penalties for under delivery, payment terms, and termination.

• In India, the state governments have entered into such agreements with private renewable energy companies to establish the power plant and sell the power back to the government.

o With PPAs in place, India can boost renewable energy generation in the country and incentivise the global renewable energy companies to invest by giving them policy certainty about purchase of power.

Current situation on PPAs with renewable energy companies

• In the recent times, some state governments have reviewed/ moved out from their respective agreements.

o The Uttar Pradesh government stopped power purchase from 650 mw wind power plants stating that the Central Electricity Regulatory Commission did not approve the tariffs for these plants.

o The Andhra Pradesh government has sought downward revision of 139 solar and wind contracts.

• There is a concern of mounting debts and untimely payments by the state power distribution companies (DISCOMs. In this backdrop, the Government of India has advised the state governments to uphold the sanctity of contracts.

Why these states want to renegotiate the PPAs?

• Dynamic nature of tariffs- Owing to changing tariffs, several State Electricity Boards (SEBs) want to revisit their tariff agreements. E.g. Andhra Pradesh's signed PPAs with various wind power generators around Rs 4.76 per unit in 2015, which appeared competitive at that time. Now, the Solar Energy Corporation of India (SECI) managed to get bids as low as Rs 3.46 per unit.

• Long Tenure of PPA- The PPAs are signed for longer durations like 15-25 years and the states are feeling the heat of higher tariffs they have agreed in the PPAs.

• Financial conditions of DISCOMs- The DISCOMs in these states are going through a financial crisis, and one of the main reasons for this was the higher tariffs in the wind and solar PPAs.

Possible impact of renegotiation of PPAs

• Affect Investor Sentiment –The cancellation of contracts and arm-twisting of agreements would effect investor sentiments & discourage new investments.

• Ease of Doing Business- The key to the ease of doing business is enforceability of contracts which needs to be protected.

• Will increase Non-Performing Assets- As the banks have lent heavily to these developers, so with shutting down of projects, the loans may not be serviced. It could start a new cycle where the banks will be apprehensive in advancing loan to such generators.

• India's renewable energy targets- of installing 175 GW of renewable energy capacity before 2022 may get jeopardised due to this.

Way Forward

The states should focus on improving the financial health of DISCOMs using mechanisms under UDAY and other reforms available. Inefficiencies in metering, collection, low power tariffs among others should be reviewed rather than blaming the PPAs for the poor financial health of DISCOMs.

Significance of Power Purchase Agreements For the State-

• No Operating and Maintenance Responsibilities,

• No need to deal with complex system design and permitting process,

• A predictable cost of electricity over 15-25 years.

For the energy company-

• Assured bulk purchase- as the state is involved which will not default.

• Better project structuring- PPAs remove the uncertainties regarding the demand of electricity and some guarantee as to quantities purchased and price paid are required to make the project viable.

• Buffer from competition- as there is a possibility of competition from cheaper or subsidized domestic or international competition.

4) SELF EMPLOYMENT

Recently there were renewed talks on Self-employment after the data reported by Periodic Labour Force Survey Report.

Self employment in India

• **Definition**:

o As per ILO, Self-employed workers are those workers who, working on their own account or with one or a few partners or in cooperative, hold the type of jobs defined as a "selfemployment jobs." and, in this capacity, have engaged, on a continuous basis, one or more persons to work for them as employee(s).

o Self-employment jobs are the jobs where the remuneration is directly dependent upon the profits derived from the goods and services produced.

• As per latest Periodic Labour Force Survey (PLFS) report, self-employment between 2009-10 to 2017-18 among, o Rural men increased to 57.8% from 53.5%.

o Rural women increased to 57.7% from 55.7 %.

o Urban men decreased to 39.2% from 41.1%

o Urban women decreased to 34.7% from 41.1%

o In the urban areas, there is a decline in the percentage of self-employed or casual labour due increase in the percentage of people working on regular wage or salary.

• Recently, ILO's latest report titled 'Small Matters' also discussed the contribution of self employment across various countries. As per the report, 85 per cent of workers in India are self-employed or do casual work.

• Significant role played by self-employment:

o Multiplier effect in job creation

o Diversification in jobs making economy resilient and competitive.

oIndigenization of manufacturing activities providing a boost to make in India.

o Fostering a culture of innovation

o Women empowerment Factors contributing to growth of self-employment in India

• Government schemes and policies: The government has launched many schemes to incentivize and promote self-employment in India such as Pradhan Mantri Mudra Yojana (PMMY), Pradhan Mantri Rojgar Protsahan Yojana, Skill India Mission etc.

• Growth led by services industry: In the last decade, although the economy grew steadily, it was primarily led by services industry. This growth led to the creation of many highly skilled jobs. Without a parallel focus on improving skill-level across the workforce, those with low skills were left behind in the economic journey India was undertaking. It was this portion of the workforce which then turned towards self-employment.

• Underdeveloped macro-financial system in India: low returns on bank deposits, risk related to investments in stock market and real estate etc. force people to use their wealth for starting their own business.

Issues related to self employment in India

• Dominated by agriculture: About 60% of self employed are engaged in agriculture which is less productive and this share is significantly higher in rural areas than urban ones.

• Only a small fraction acts as job creators: As the data reveals, only 4 % of India's self-employed actually hire workers from outside.

• Below average earnings: Most self-employed people in India make very little money. According to PLFS report, the average monthly earnings for all self-employed workers stood at ₹8,000 per month, much lower than the average monthly earnings of regular workers.

• Gender pay gap is highest in the category of those who are self-employed, where in rural areas, male workers earn 2.67 times more than female workers, and in urban areas, a male worker earns three times what female workers earn.

• Mostly unregistered: The self-employed are tagged 'formal' only after they've registered with some branch of the government and /or pay taxes. o According to a National Sample Survey Organisation report, 63 million enterprises in India have no registration, out of which 96% are run by individuals and most of them pay no GST as their volume of business is below Rs 20 lakh.

• Ineffectiveness of schemes Through a host of schemes, like the MUDRA, the government has sought to provide capital to people who wish to start something of their own. But still, many such schemes are yet to either reach their intended benefactors or are still too small in their ambit to create a significant change.

• Systemic inefficiencies: The jobs market in India is still plagued with systemic inefficiencies and delays mainly in the registration process. Due to this most startups or owner managed enterprises end up becoming a part of the unorganized sector of the economy.

Way forward

Self-employment is a great option to bridge the gap that often arises in government efforts to create quality employment opportunities. It helps spur entrepreneurship opportunities and also helps tackle rising unemployment rates.

Following steps can be taken to develop and promote the ecosystem of self-employment in the country:

• Access to capital: Since the provision of capital becomes vital to transform a self-employed individual to entrepreneurs who contribute effectively to their own wellbeing as well as economic productivity, increasing the access to such capital is vital. Improved cash flow will enable reinvestment to expand businesses, and thus create more jobs, and will help source more local goods.

• Access to good quality skill-training that can provide some strength to the self-employed community. These programs can help them to either stop being self-employed and join regular and better-paying jobs or can help them become better at being self-employed.

• Formalisation of informal self-employment ventures leading to capturing their contribution in the growth of the economy.

• Simplifying Taxation policy for startups that will prevent tax evasion.

• Overcoming Bureaucratic hurdles and systemic inefficiencies thus easing the registration process for setting up personal ventures.

• Regulating wages and ensuring safe working environment.

5) What is AGR?

The Supreme Court has upheld the definition of Adjusted Gross Revenue (AGR) calculation as stipulated by the Department of Telecommunications. This means that telecom companies will have to pay up as much as Rs 92,642 crore to the government.

What is AGR?

Adjusted Gross Revenue (AGR) is the usage and licensing fee that telecom operators are charged by the Department of Telecommunications (DoT). It is divided into spectrum usage charges and licensing fees, pegged between 3-5 percent and 8 percent respectively.

How is it calculated and what ' s the contention?

As per DoT, the charges are calculated based on all revenues earned by a telco – including non-telecom related sources such as deposit interests and asset sales. Telcos, on their part, insist that AGR should comprise only the revenues generated from telecom services.

Impact of the ruling:

1. Clearly this judgment has significantly damaging implications for India's telecom industry, which is already reeling under huge financial stress and is left with only four operators.

2. Significant investment of several billion dollars has been made in creating world class networks. This order has huge impact on two private operators while most of the other impacted operators have exited the sector.

6) Sovereign Gold Bond scheme

Government of India, in consultation with the Reserve Bank of India, has decided to issue Sovereign Gold Bonds. The Bonds will be sold through Scheduled Commercial banks (except Small Finance Banks and Payment Banks), Stock Holding Corporation of India Limited (SHCIL), designated post offices, and recognised stock exchanges viz., National Stock Exchange of India Limited and Bombay Stock Exchange Limited.

About the Sovereign Gold Bond Scheme:

1. The sovereign gold bond was introduced by the Government in 2015. 2. Government introduced these bonds to help reduce India's over dependence on gold imports. 3. The move was also aimed at changing the habits of Indians from saving in physical form of gold to a paper form with Sovereign backing.

Key facts:

Eligibility: The bonds will be restricted for sale to resident Indian entities, including individuals, HUFs, trusts, universities and charitable institutions.

Denomination and tenor: The bonds will be denominated in multiples of gram(s) of gold with a basic unit of 1 gram. The tenor will be for a period of 8 years with exit option from the 5th year to be exercised on the interest payment dates.

Minimum and Maximum limit: The minimum permissible investment limit will be 1 gram of gold, while the maximum limit will be 4 kg for individual, 4 kg for HUF and 20 kg for trusts and similar entities per fiscal (AprilMarch) notified by the government from time to time.

Joint Holder: In case of joint holding, the investment limit of 4 kg will be applied to the first applicant only.

Collateral: Bonds can be used as collateral for loans. The loan-to-value (LTV) ratio is to be set equal to ordinary gold loan mandated by the Reserve Bank from time to time.

Tenor: The tenor of the Bond will be for a period of 8 years with exit option after 5th year to be exercised on the interest payment dates.

Interest rate: The investors will be compensated at a fixed rate of 2.50 percent per annum payable semiannually on the nominal value.

7) Advance Pricing Agreements (APAs)

CBDT inks the 300th Advance Pricing Agreement. APA Programme is currently in its seventh year.

What are APAs?

An APA is an agreement between a taxpayer and the tax authority determining the Transfer Pricing methodology for pricing the tax payer's international transactions for future years. Purpose: An APA provides certainty with respect to the tax outcome of the tax payer's international transactions. Statutory basis: The Finance Act, 2012, inserted sections 92CC and 92 CD in the ITA to provide the legal basis for APA in India.

An APA can be one of the three types – unilateral, bilateral and multilateral:

1. Unilateral APA is an APA that involves only the taxpayer and the tax authority of the country where the taxpayer is located.
2. Bilateral APA (BAPA) is an APA that involves the tax payer, associated enterprise (AE) of the taxpayer in the foreign country, tax authority of the country where the taxpayer is located and the foreign tax authority.
3. Multilateral APA (MAPA) is an APA that involves the taxpayer, two or more AEs of the tax payer in different foreign countries, tax authority of the country where the taxpayer is located and the tax authorities of AEs.

Significance: The progress of the APA scheme strengthens the government's resolve of fostering a non-adversarial tax regime. The Indian APA programme has been appreciated nationally and internationally for being able to address complex transfer pricing issues in a fair and transparent manner.

8) VEHICLE SCRAPPAGE POLICY

The Ministry of Road Transport and Highways has formulated Draft Guidelines for setting up, authorisation and operation of Authorized Vehicle Scrapping Facility (AVSP) to legalise the industry in India.

What is scrappage?

• Scrappage is the process in which End of life - vehicles are disposed of, typically using shredders that tear them down into tiny pieces of metal which can then be recycled. Other non-metal parts of the vehicle are also disposed of in an environmentally sustainable fashion.

• End of life – Vehicles means vehicle o Not have valid registration,

o Owners are willing to voluntarily scrap their vehicles,

o Enforcement authorities have to scrap vehicles impounded or seized by them, or

o In accordance with any court directions. Benefits of Vehicle scrappage

• Boost Auto Sector: vehicle scrappage policy encourages vehicle owners to scrap vehicles older than 15 years and purchase new ones instead.

• Control Air Pollution: It helps reduce air pollution by removing older and more polluting vehicles from the roads. • Encourage reuse: India imports 6 million tonnes of scrap steel, which can be managed from proper dismantling treatments of automobiles.

• Job Opportunity: The policy is expected to generate new business and job opportunities as new scrapping centres are set up across the country.

• Boost Economy: This will support the steel and other sectors as well, and will benefits the broader economy.

Challenges with Vehicle scrappage

• Large number of vehicles to be scrapped: The National Green Tribunal (NGT) earlier in

July noted that the number of 'end of life vehicles' will be over 21 million by 2025

• Authorized scrappage centres: India does not have enough authorized scrapping centres to dismantle old vehicles, with most of the existing ones being illegal and flouting environment norms.

• Environment challenges: About 25% of the waste material coming from an ELV poses a potential environmental threat, due to the presence of heavy metals, waste oils, coolants, ozone depleting substances, etc.

Way Ahead

• Strict recyclable material code: Globally it's mandated to have 85-95 per cent of recyclable content and India should go for something similar.

• Exemption of registration fee: Government should exempt registration fees for buyers of vehicles who produce a scrapping certificate of a vehicle of same category.

• Involve private players: This will help to improve infrastructure at faster pace.

o Recently, Mahindra & Mahindra has set up a joint venture and is planning to set up at least half a dozen such dismantling facilities in cities like Kolkata, Delhi, Chennai and the like.

o TVS also has a pilot centre running in Chennai.

9) NEW PROCESS OF STRATEGIC DISINVESTMENT

Recently, the Cabinet has approved a new process of Strategic Disinvestment for expediting privatization of select PSUs.

Recent changes in the process of Strategic Disinvestment

• The Union Cabinet headed by Prime Minister approved the new Strategic Disinvestment policy under which the Department of Investment and Public Asset Management (DIPAM) under the Ministry of Finance has been made the nodal department for the strategic stake sale.

• DIPAM and NITI Aayog will now jointly identify PSUs for strategic disinvestment

• DIPAM secretary would now co-chair the inter-minister group on disinvestment, along with the secretary of administrative ministries concerned.

Reasons

• This was done with a view to streamlining and speeding up the process.

• Reducing the role of administrative ministries which often used to place hurdles in the path of major stake sales. • The idea is to complete the stake sale within a timeframe, around 4-5 months.

Strategic Sale

• The Disinvestment commission defines Strategic Sale as, "The sale of substantial portion of the Government shareholding of a central public sector enterprise (CPSE) of upto 50%, or such higher percentage as the competent authority may determine, along with transfer of management control".

• Unlike the simple disinvestment, Strategic sale implies some sort of privatization.

10) INVOLVING PRIVATE PLAYERS IN RAILWAYS

India's first private train, Tejas Express, was recently flagged off on the Lucknow-Delhi-Lucknow corridor.

• Indian Railways' commercial tourism and catering arm, IRCTC has been given the task of operating two premium trains as a private entity. 2nd private train will soon be run on the Mumbai-Ahmedabad-Mumbai sector.

• Additionally, the Government is in the process of forming a task force to draw a blueprint for handing over operations of 150 trains and 50 railway stations to private operators.

Arguments in favour of involving private players

• Improved Infrastructure: Privatisation may lead to better infrastructure, which would lead to better amenities for travelers.

• Better investment: It would bring in more private investment in Indian Railways, which has been languishing despite allowing 100% FDI in railway infrastructure.

• Lesser accidents: Because private ownership is synonymous with better maintenance, privatisation may reduce the number of accidents, thus resulting in safe travel and higher monetary savings in the long run. The success of private trains in Japan in this regard is a good example.

• Better utilization of existing assets of Indian Railways would improve operating ratio of Indian Railways. The operating ratio of the IR was 96.2% in 2018-19, which is marginally better than 98.4% in 2017-18 implying there is virtually nothing left to re-invest.

Issues involved in involving private players

• Ownership and sharing of infrastructure: It is difficult to privatize a portion of the Railways' operations as it is strongly vertically integrated.

• Conflict of Interest: Private participation has failed to catch up in the Railways because policy making, the regulatory function, and operations are vested in the same organization.

o This leads to a clear conflict of interest when the policy maker and the regulator is also a competitor.

o In absence of an independent regulator, it is not possible to have a level playing field for private players, especially where a publicly held companies are its competitors

• Tariff Issues: Under the Railways Act, 1989, Central government is the competent authority to decide on tariff and not the private enterprises (such as IRCTC). E.g. Tejas Express violated this rule as the fare was higher than the Shatabdi Express without any change in the running time. This rule needs to be amended to incentivize private parties in railways operations.

o Given the inability of the Railways to raise passenger fares in the past due to political compulsions, tariff management would be a critical issue.

• High Regulatory Burden: High costs and lower returns, policy uncertainty, lack of a regulator to create a level playing field, lack of incentives for investors and procedural/operational issues such as delays in land acquisition etc. have significantly restricted private sector participation.

11) URBAN COOPERATIVE BANKS (UCB)

Recently, Reserve Bank of India (RBI) imposed restrictions on withdrawals from the Punjab and Maharashtra Cooperative (PMC) Bank, one of the largest urban cooperative lenders.

• Bank was put under regulatory restriction under Section 35A of the Banking Regulation Act, for a period of six months due to irregularities like fraudulent loans, excessive lending to Housing Development & Infrastructure Ltd (HDIL) etc.

• The bank has been barred from granting, renewing and loans and advances, make any investments and accept fresh deposits, without the prior written approval from the RBI.

Background

• After initially encouraging UCBs to spring up all over India for financial inclusion, the

RBI began to wake up to their poor governance from 2005 when it stopped issuing new UCB licences.

o In 2001, Ahmedabad's Madhavpura Mercantile Cooperative Bank also went bust which landed another 210 UCB in trouble and some of them had to be liquidated.

• The financial robustness of UCBs has been assessed through CAMELS (capital adequacy; asset quality; management; earnings; liquidity; and systems and control) ratings.

• With many of these banks failing, and the RBI encouraged weak ones to merge, the number of UCBs operating in India has shrunk from 1,926 in 2005 to 1,551 by 2018.

• The RBI has also been trying to improve governance at these banks by putting up a Board of Management to oversee them and recent PMC bank crisis has also put the question on the poor condition on the management and regulation of UCB in India.

About Urban Cooperative Banks (UCB)

• Co-operative banks, which are distinct from commercial banks, were born out of the concept of cooperative credit societies where members from a community band together to extend loans to each other, at favourable terms.

• Broadly, co-operative banks in India are divided into two categories - urban and rural.

o Rural cooperative credit institutions could either be short-term or long-term in nature.

✓ Further, short-term cooperative credit institutions are further sub-divided into State Co-operative Banks, District Central Co-operative Banks, Primary Agricultural Credit Societies.

✓ Meanwhile, the long-term institutions are either State Cooperative Agriculture and Rural Development Banks (SCARDBs) or Primary Cooperative Agriculture and Rural Development Banks (PCARDBs).

o Urban Co-operative Banks (UCBs) are either scheduled or non-scheduled. Scheduled and non-scheduled UCBs are again of two kinds- multi-state and those operating in single state.

• Urban Cooperative Banks (UCBs) are registered as cooperative societies under the provisions of, either the State Cooperative Societies Act of the State concerned or the Multi State Cooperative Societies Act, 2002.

• These banks provide a wide range of regular banking and financial services and are located in urban and semi-urban areas.

• In the event UCBs fail, deposits with them are covered by the Deposit Insurance and Credit Guarantee Corporation of India up to a sum of ₹1 lakh per depositor, the same as for a commercial bank.

• Regulation: The UCBs in India are under dual regulation, by the Reserve Bank of India (RBI) and the Registrar of Cooperative Societies (RCS) under the government. o RBI: Banking operations are regulated and supervised by the RBI, which lays down their capital adequacy, risk control, lending norms, issuing licences, new branches etc.

✓ They are governed under two laws, namely, the Banking Regulations Act, 1949, and the Banking Laws (Co-operative Societies) Act, 1955.

✓ RBI also has developmental function like refinance facilities to urban cooperative banks.

o Government: Registration and management related activities are governed by the Registrar of Cooperative Societies (RCS) in case of UCBs operating in single State and Central RCS (CRCS) in case of multi-State UCBs.

• **Significance of UCB**

o Catering urban class: UCBs are organised with the objective of promoting thrift and self-help among the middle class/lower middle class population and providing credit facilities to the people with small means in the urban/semi-urban centers.

o Financial inclusion: On account of their local feel and familiarity, UCBs were set up to allow ease of access to credit and ensure financial inclusion.

o Attractive interest rates: UCBs remain quite a hit with retail savers and small businesses because they offer attractive interest rates on deposits, far higher than commercial banks.

o Local nature: Due to their local nature, UCBs have an advantage over their commercial rivals in terms of having information both about upcoming business opportunities as well as borrower quality, which national-level banks have a hard time gathering. Issues faced by UCB

• Management issues:

o Such banks are sometimes hijacked by vested political interests. This could mean favoritism in appointments, sanction of fraudulent loans which are later written off, forcing government employees to hold salary accounts with cooperative banks and so on.

• Regulatory issues:

o RBI's supervision of cooperative banks is not as stringent as that of commercial banks. Typically, the state government audits cooperative banks while RBI inspects their books once a year. o There have also been cases of ignoring the guidelines and directives issued by Reserve Bank of India from time to time leading to unfair practices to inflate the major statistics.

• Structural issues:

o Most of are single-branch banks and have the problem of correlated asset risk. This means the entire bank can come down if there is a local problem of significant scale.

o UCBs often borrow and lend among themselves, the collapse of one UCB can actually destabilise others.

o They have a small capital base. For example, urban cooperative banks can start with a capital base of Rs 25 lakh compared to Rs 100 crore for small finance banks.

• Operational issues:

o UCBs face a unique problem – restricted by their cooperative nature, they cannot issue fresh equity to shore up capital. The only capital growth they have, therefore, has to be in line with the growth of the business of their clientele.

o The UCBs are facing stiff competition from other financial institutions such as small finance banks, payment banks, NBFCs and so on. As a result, they offer unreasonably high interest rates to depositors. In order to be able to make these interest payments, UCBs extend risky and volatile loan units. This has created unhealthy competition among themselves and also leading to NPA & profitability issue.

o Lack of professionalism is a common allegation hurled at UCBs from the mainstream banks. It is often viewed that while on one hand, hiring local people has helped keep the costs down and has enhanced the connectedness of these banks with the respective communities and groups, at times it has come at the cost of a professional work ethic and also leading to weak governance.

o No clear-cut loan policy is practised by the Urban Co-operative Banks and even in a single bank also, the rules were varied from branch to branch.

Way forward

• Fair recruitment: In order to improve efficiency, increase transparency and promote fairness, the decision-making processes pertaining to staff administration, granting of credit and new membership should be clearly laid down. o In order to accomplish these goals, UCBs need to have sound processes, professional management and a leadership whose incentives and motivation are totally beyond doubt.

• Technology absorption and deploying smart-banking techniques: It is important to outsmart the competitors and to sustain as well as to grow.

• Umbrella organization for UCBs: And instituting a board of management to make them more financially resilient and to enhance the depositors' confidence.

o Y H Malegam Committee also introduced the concept of board of management (BOM) in UCBs, batted for doing away with dual regulation

• Independent auditing: As suggested by Madhava Rao Committee, audit of UCB should be done by independent external auditors like commercial banks and be inspected likewise.

• Strictly adhering to RBI norms: The foremost duty of the Urban Co-operative Banks is to implement the rules and regulations and strictly adhere to the set of rules and regulations framed by the Reserve Bank of India for the healthy growth of their bank as well as the healthy growth of the Urban Co- operative Banking sector.

12) STATE FINANCES

RBI released its annual study of state-level budgets entitled "State Finances: A Study of Budgets" which analyses the fiscal position of state governments.

Findings of the report

The salient features that emerge from the analysis of state finances in the Report are:

• States' gross fiscal deficit (GFD) has remained within the FRBM threshold of 3% of gross domestic product (GDP) during 2017-18 and 2018-19.

• For 2019-20, states have budgeted for a consolidated GFD of 2.6% of GDP with a marginal revenue surplus (as against revenue deficits in the previous three years).

• Outstanding debt of states has risen over the last five years to 25% of GDP, posing medium-term challenges to its sustainability.

• Committed expenditures are on the rising trend, driven by interest and pension payments.

• There has been a decline in the share of conditional and tied transfers while unconditional or general purpose transfers have become more dominant form of transfers, thereby providing greater fiscal autonomy to the states.

Why understanding state finances are important?

• Impact of rising market borrowings: Since 2014-15, states have increasingly borrowed money from the market, which has reduced the availability of funds for businesses to invest. Additionally, this would raise the cost of credit for the private sector, as more number of debtors are now chasing the same amount of money.

• Impact of rising fiscal deficit & debt-to-GDP ratio: State government finances are important not only for India's GDP growth and job creation but also for its macroeconomic stability. If states find it difficult to raise revenues, a rising debt-to-GDP ratio could start a vicious cycle wherein states end up paying more towards interest payments instead of spending their revenues on creating new assets that provide better education, health and welfare for their residents. o 14th Finance Commission had mandated prudent levels of both fiscal deficit (3% of state GDP) and debtto-GDP (25%) that must not be breached.

• Employment: States now spend one-and-a-half times more than the Union government and employ five times more people than the Centre. Not only do states have a greater role to play in determining India's GDP than the Centre, they are also the bigger employment generators.

Issues with states' financial management

• Fiscal position of state governments: Although the state governments have regularly met their fiscal deficit target of 3% of the GDP (except during 2016-17), it was mainly on account of reducing their expenditure (mostly towards social & infrastructural sectors) and increasingly borrowing from the market.

o This reduction in overall size of state budgets during 2017-19 has likely worsened the economic slowdown. Additionally, overall level of debt-to-GDP has increased to the 25% in 2019 compared to 22% in 2015.

• Quality of expenditure: Erosion of development expenditure indicated that the quality of expenditure was compromised by a combination of higher revenue expenditure (more than 80% of the total expenditure) and lower capital expenditure.

• Populism: Political class has the tendency to make fiscal policy over-expansive, which increases burden on future Govt. and thus, has detrimental long-run impacts e.g. loan waivers to farmers.

• Absence of uniform fiscal consolidation rules for centre & states:

o Various cesses and surcharges, in which States' have no share, are becoming a disproportionate portion of overall divisible revenue. This is against the spirit of fiscal federalism and financial devolution process.

o For State Govt., Art 293(3) provides a constitutional check over market borrowings while no such restriction is there for the centre.

o States have constraints in managing their finances as the RBI controls their deficit and cannot float a bond on a state's behalf without the Centre's approval.

• Impact of GST: With the advent of GST framework, revenue autonomy of states has shrunk considerably as states have lost decision making power on tax rates. Also, there is a greater unpredictability associated with transfers of IGST and grants.

• Poor taxation practices: for instance, many states don't levy property tax, which is a more buoyant source of income.

• Liability Burden: State governments' expenditure on the power sector is in the form of subsidies for agriculture and domestic customer segments and loans and advances.

o Impact of UDAY on State finances is expected to continue beyond interest payments, as outstanding dues of DISCOMs have risen sharply in the recent period.

o State governments provide off-budget support to State Public Sector Enterprises (SPSEs) through guarantees on their borrowings from financial institutions. But, weak cost recovery mechanism poses a systemic risk to the States' finances.

Way Forward

• Increase Tax Revenue: Fiscal consolidation through strengthening tax buoyancy rather than compressing public expenditure should be the approach.

• Augment non-tax revenue: Dedicated application of user charges on economic services such as power & irrigation with better cost recovery mechanisms offers scope for raising states' revenue. This may not only promote optimal usage of these services, but also help improve the quality of services.

• Make central transfers more effective: Well-defined calendars for transfer; compositional shift from tied to untied transfers and reducing the levy of cesses & surcharges, which are outside the divisible pool can help states to reduce their dependence on market borrowings and address fiscal shocks on account of schemes like UDAY etc.

• Rationalizing Expenditure: o Off-budget liabilities such as UDAY pose a risk to debt sustainability. Transparency in the disclosure/reporting of liabilities in state budgets may be the first step towards recognizing these guarantees as a medium-term fiscal risk, followed by conscious efforts to keep them at prudent levels.

o Events like farm loan waivers, which act as fiscal shocks, should give way to alternate policy tools like income support schemes providing cash transfers to farmers.

Income Support Schemes over Farm Loan Waivers

• They are not linked to volume of production, factors of production employed and prices. Accordingly, they are categorized as Green Box payments under the Agreement on Agriculture of the World Trade Organisation (WTO). • Income support schemes are more inclusive as even landless farmers and farmers having no access to bank credit can be covered, whereas farm loan waivers benefit only those farmers who have borrowed from banks.

• The problem of moral hazard does not exist in the case of income support schemes

• However, critical for their success is digitization of land records and their seeding with bank account and Aadhaar details for ensuring timely payments to farmers while minimizing inclusion and exclusion errors.

13) NON-TARIFF MEASURES

• According to recently published "The Asia-Pacific Trade and Investment Report 2019", non-tariff measures (NTMs) have increased in the past two decades.

• The report has been published by United Nations Economic & Social Commission for Asia and the Pacific (ESCAP) and the United Nations Conference on Trade and Development (UNCTAD).

What are non-tariff measures?

• Non-tariff measures (NTMs) are policy measures other than ordinary customs tariffs that can potentially have an economic effect on international trade in goods, changing quantities traded, or prices or both.

• NTMs are broadly distinguished into technical measures (SPS measures, TBTs etc.) and non-technical measures. These are further distinguished in hard measures (e.g. price & quantity control measures), threat measures (e.g. anti-dumping duties) and other measures such as trade-related finance and investment measures.

Types of NTMs

• Sanitary and Phytosanitary Measures: Measures that are applied to protect human or animal life from risks arising from contaminants or disease-causing organisms in food.

• Technical Barriers to Trade: Measures referring to technical regulations and procedures, related to environmental and sustainable standards E.g. Labeling requirements as in case of refrigerators need to carry a label indicating their size, weight & electricity consumption level

• Licensing, quotas, prohibitions & quantity-control: Measures to restrain the quantity of goods that can be imported

• Price Control Measures: Measures intending to control or affect the prices of imported goods. E.g. Minimum import prices imposed on precious metals like gold to cut down non-essential imports.

• Export Related Measures: Measures applied by the government of the exporting country on exported goods E.g. Exports of cultural heritage objects are prohibited.

• Geographical restrictions on eligibility: Restrictions on imports of dairy products from countries

• Contingent Trade Protective Measures: Measures implemented to counteract particular adverse effects of imports in the market. E.g. Anti-Dumping Duty, Countervailing Duty etc.

Positive Impact of NTMs

• Impact on Foreign Direct Investment (FDI): Certain NTMs could boost FDI, as they motivate a firm to pursue FDI instead of trade E.g. Government procurement restrictions and local content requirements (LCR) may sway a firm towards FDI.

• Development of International Standards: The WTO SPS and TBT Agreements are aimed at striking a balance between the public policy objectives of protecting health, safety and the environment, and the policy goal of trade facilitation and help in the development of international standards.

• Protection of human health and environment: Recently, European Union (EU) instituted an import ban on Sri Lankan seafood because of the country's systematic failure to regulate illegal, unreported and unregulated (IUU) fishing. Although led to initial decline in income, the ban helped in conservation of marine resources and encouraged sustainable fishing.

Challenges posed by Non-Tariff Measures

• Over-regulation: Often, quality restrictions and safety standards often exceed multilaterally acceptable norms and are of particular concern to poor countries whose producers are often ill-equipped to comply with them.

• Biased against developing & least developed countries (LDCs): In practice, SPS measures and TBTs erode the competitive advantage that developing countries have in terms of labour costs and preferential access, as the compliance cost is high.

• Reduces availability: Certain NTMs have negative impact on access to goods and technologies relevant to various SDGs. E.g. IPRs pose barriers to the access to medicines and medical technologies (e.g. dispute on compulsory licensing & evergreening of patents), technologies and goods relevant to targets on renewable energy and water efficiency (e.g. solar panel dispute between India & US).

• Lack of transparency: There is a lack of transparency in implementation due to paucity of data on trade policy measures which, unlike tariffs, are not quantified and are often hidden in legal and regulatory documents.

Way Forward

• Regulatory audits: Countries should conduct regulatory audits to review of existing NTMs to eliminate unnecessary ones, and to improve the design of existing and future measures, to ensure that there is no unnecessary burden on compliant traders.

• Trade Facilitation: Measures towards elimination of NTMs such as WTO Trade

Facilitation Agreement (TFA) can reduce cost of NTMs.

o Standards and conformance measures such as equivalence in technical regulations, standards harmonization, alignment with international standards etc.

o Advanced digital trade facilitation measures, such as electronic issuance and exchange of SPS and origin certificates. E.g. International Plant Protection Convention (IPPC) has developed IPPC ePhyto Solution for SPS e-certification.

o Establishment of national trade portals to provide access to all trade-related laws, regulations and procedures in one place will enhance transparency.

• Addressing Infrastructure Gaps: Increasing availability of quality infrastructure (e.g. SPS testing labs, accreditation system for labs etc.), supported by mutual recognition of standards and accreditation, can reduce trade costs and duplication of compliance efforts.

• Regional Efforts: Regional economies can increasingly address NTMs through trade agreements, with appropriate measures for harmonization to reduce processing time and dispute settlement.

o ASEAN has a mechanism that significantly focuses on ways to reduce costs of NTMs.

Conclusion

NTMs are not inherently good or bad – they can be important tools in achieving SDGs. At the same time, the proliferation of NTMs globally means that they are now a more significant deterrent to trade than ordinary customs tariffs. In many cases, NTMs could implicitly be used in lieu of tariffs to intentionally restrict trade, rendering NTMs as NTBs. The key challenge to policymakers is to strike the right balance between their positive (intended) effects and cost to traders (and ultimately the consumers) associated with them.

14) GLOBAL VALUE CHAINS

World bank released World Development Report titled "Trading for Development in the Age of Global Value Chains".

What is a Global value Chain (GVC)?

• A value chain refers to the "full range of activities that firms and workers do to bring a product from its conception to its end use and beyond".

• It involves activities like production of a good or service and its supply, distribution, and post-sales activities etc.

• When the value chain is distributed across different firms in different countries, it means that these activities are divided among different countries. This phenomenon where value chain is spread across the globe- it is called GVC.

• For example, a bike assembled in Finland with parts from Italy, Japan, and Malaysia and exported to the Arab Republic of Egypt is a GVC.

• The global value chains today account for nearly 50 per cent of trade worldwide.

Why are GVCs important?

• Hyper-specialisation: GVCs promote hyper-specialisation, which improves efficiency. By breaking up complex production process, GVCs allow countries to specialize in specific parts or tasks of production. E.g. China's "Button Town," where hundreds of factories produce more than 60 percent of all buttons on Earth.

• Productivity gains: In traditional trade, where products cross borders only as finished products. In GVC trade, intermediate inputs cross border, and domestic firms get access to greater variety of higher-quality or less costly intermediate inputs increasing productivity.

Studies suggest a 10 percent increase in the level of GVC participation is estimated to increase average productivity by close to 1.6 percent.

• GVCs are vehicles for technology transfer: Unlike in traditional trade in which firms in different countries compete, GVCs are networks of firms with common goals. GVCs involve longer-term firm-to-firm relationships. This nature of GVCs makes them a particularly powerful vehicle for technology transfer and sharing know-how along the value chain.

• Better jobs:

o Through firm-to-firm relationships, GVC play an important role in on-the-job learning, and employer sponsored training within GVCs can be an effective mechanism for skill development.

o GVCs promote capital-intensive production as it allows large scale production and precision of parts. This generates quality jobs, and also there's overall increase in jobs because of the large boost to exports. GVCs bring to countries pull workers out of less productive tasks and into more productive jobs.

Concerns associated with GVCs

• Gains from GVC participation are not distributed equally across and within countries. Inequalities arise in the distribution of capital and labor, between skilled and unskilled workers as well as between male and female workers and geographically within countries.

• Synchronization of economic activity across countries: When production in one country relies on inputs from its trading partners, the economic conditions in other countries affect its domestic activity. This affects how shocks are transmitted across borders.

• GVCs amplify the costs of protectionism for trade and growth. GVCs are affected to a greater extent by trade barriers. The hyper-specialization in tasks and parts across borders means that trade barriers are incurred multiple times.

• Policy uncertainty is costlier under GVCs: GVCs amplify the costs of sudden increases in trade policy uncertainty because firms may wait to invest in relationships with foreign suppliers until the uncertainty is resolved.

• Environmental effects: GVCs are associated with more waste and more shipping in the aggregate, both of which have environmental costs. Because trade costs are falling while environmental regulations are tightening in many countries, polluting manufacturers may respond to new environmental regulations by relocating to countries with less strict standards. This leads to pollution havens. E.g. dumping of plastic waste into developing countries. o However, GVCs can also promote improvements in production techniques. The knowledge flows, technology transfers among countries can enable the development or quicker application of more environmentally friendly techniques.

How can countries reap benefits from GVCs?

• Countries should exploit their comparative advantage by eliminating barriers to investment and ensuring that labor is competitively priced, by avoiding overvalued exchange rates and restrictive regulations.

• Promote linkages between domestic small and medium enterprises (SMEs) and GVC lead firms by coordinating local suppliers, providing access to information about supply opportunities, and supporting training and capacity building of SMEs.

• GVCs rely on the fast and predictable movement of goods. For many goods traded among GVCs, a day's delay is equal to imposing a tariff in excess of 1 percent. Improving customs and border procedures, promoting competition in transport services, improving port structure and governance and improving information and communication technology (ICT) connectivity—all are strategies that can reduce trade costs related to time and uncertainty.

• GVCs thrive on the flexible formation of networks of firms. Contract enforcement, stable and predictable legal arrangements, protecting intellectual property rights, strengthening national certification and testing capacity to ensure compliance with international standards etc.

• Developing countries need policies to spread gains from GVC participation across society. Access to child care for women, and training programs for youth, assistance to smallholders, such as extension services and access to finance etc. will ensure inclusion.

• Global cooperation on the environment and working conditions. Standardized international data will help expose poor production practices and induce firms to improve.

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