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Part 1

Economy

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IASBABA'S

RAPID REVISION (RaRe) SERIES - UPSC 2021

RaRe Notes

DAY 10 - ECONOMY

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Topics Coverage:

71. Extra budgetary (off-budget) borrowings
72. Fiscal deficit and different Fiscal Indicators
73. Financing Fiscal Deficit
74. Government Security (G-Sec) and its types
75. Gilt account
76. Government Securities Acquisition Programme (G-SAP)
77. Treasury Single Account
78. Inverted Duty Structure
79. Currency manipulation
80. Export Preparedness Index 2020

*Extra Topic: Yield Curves

Topic 71: Extra budgetary (off-budget) borrowings

What is off-budget borrowing or financing?

- Extra budgetary (off-budget) borrowings are those borrowings made by the government entities to run various government schemes **that are not shown in the budget**.
- These borrowings made by the **government owned entities** that are effectively becomes the debt of the government are known as extra budget borrowings or resources.
- Governments in order to restrict their fiscal deficit to a respectable number, they resort to "off-budget borrowings".
- Such financing tends to hide the actual extent of government spending, borrowings and debt and increase the interest burden.

Table 1: Fiscal Indicators (as percent of GDP)

		Revised Estimates 2020-21	Budget Estimates 2021-22
1.	Fiscal Deficit	9.5	6.8
2.	Revenue Deficit	7.5	5.1
3.	Primary Deficit	5.9	3.1
4.	Gross Tax Revenue	9.8	9.9
5.	Non-tax Revenue	1.1	1.1
6.	Central Government Debt *Of which Liabilities on account of EBR*	3.1	2.9

*EBR = Extra Budgetary Resources

Topic 72: Fiscal deficit and different Fiscal Indicators

Key points:

1. The projected fiscal deficit (as per Government Budget for the FY 2020-21), was 3.3% of the GDP for the FY 2021-22.
2. However, the fiscal deficit rose to 9.5% of the GDP in the FY 2020-21.
3. We are targeting to bring Fiscal Deficit down to 4.5% by FY26 **by increasing buoyancy** of tax revenues through increased tax compliance as well as asset monetisation.

What is tax buoyancy?

- Tax buoyancy explains the relationship between the changes in government's tax revenue earnings and the changes in GDP or economic growth.
- When a tax is buoyant, the tax revenue of the government should increase without increasing the tax rate.

Different Fiscal Indicators

Fiscal Deficit	It is the difference between the total income of the government (total taxes and non-debt capital receipts) and its total expenditure. Govt describes fiscal deficit of India as "the excess of total disbursements from the Consolidated Fund of India, **excluding repayment of the debt**, over total receipts into the Fund **(excluding the debt receipts)** during a financial year". Fiscal Deficit = Total expenditure of the government (capital and revenue expenditure) – Total income of the government (Revenue receipts + recovery of loans + other receipts) except borrowings
Revenue deficit	It indicates the excess of expenditure over receipts in the revenue budget of the government.
Effective Revenue Deficit	It is the difference between revenue deficit and grants for creation of capital assets. Effective Revenue Deficit signifies that amount of capital receipts that are being used for actual consumption expenditure of the Government. Effective revenue Deficit = Revenue Deficit – grants for the creation of capital assets
Primary deficit	It is Fiscal deficit net of interest payments. It is the non-interest deficit and reflects the current Fiscal efforts of the government Primary Deficit = Fiscal deficit- interest payments
Monetized Fiscal Deficit	that part of the fiscal deficit covered by borrowing from the RBI.

Table 1. Levels of Deficit

	2019-20	2020-21	2020-21	2021-22
	Actuals	Budget Estimates	Revised Estimates	Budget Estimates
Fiscal Deficit	933651	796337	1848655	1506812
	(4.6)	(3.5)	(9.5)	(6.8)
Revenue Deficit	666545	609219	1455989	1140576
	(3.3)	(2.7)	(7.5)	(5.1)
Effective Revenue Deficit	480904	402719	1225613	921464
	(2.4)	(1.8)	(6.3)	(4.1)
Primary Deficit	321581	88134	1155755	697111
	(1.6)	(0.4)	(5.9)	(3.1)

Source: Government of India (2021), Union Budget 2021-22 documents

Topic 73: Financing Fiscal Deficit

Key points:

1. Deficit financing is the budgetary situation where expenditure is higher than the revenue.
2. It is a practice adopted for financing the excess expenditure with outside resources.

Note: The expenditure revenue gap is financed by either printing of currency or through borrowing.

Table 2. Sources of Financing Fiscal Deficit (Rs crore)

	2019-20		2020-21		2020-21		2021-22	
	Actual	% of Total	Budget Estimates	% of Total	Revised Estimates	% of Total	Budget Estimates	% of Total
Debt Deficit (Net)								
Market Borrowings (G-Sec + T Bills)	624089	66.84	535870	67.29	1273788	68.9	967708	64.22
Securities against Small Savings	240000	25.71	240000	30.14	480574	26	391927	26.01
State Provident Funds	11635	1.25	18000	2.26	18000	0.97	20000	1.33
Other Receipts (Internal Debt and Public Account)	44273	4.74	50848	6.39	39129	2.12	54280	3.6
External Debt	8682	0.93	4622	0.58	54522	2.95	1514	0.1
Draw Down of Cash Balance	4971	0.53	(-)53003	(-)6.66	(-)17358	(-)0.94	71383	4.74
Grand Total	933651	100	796337	100	1848655	100	1506812	100

Source: Government of India (2021), Union Budget 2021-22 documents

Topic 74: Government Security (G-Sec) and its types

Key points:

1. G-Sec is a tradable instrument issued by the Central Government or the State Governments

2. As these debt instruments are issued by the government, these carry very low risk associated with them.
3. G-Secs carry practically no risk of default and, hence, are called risk-free gilt-edged instruments.

Types of government securities:

Treasury Bills or T-Bills	• T-bills can be issued only by the central government. • They are short-term money market instruments with a maturity period of less than one year. • Treasury bills are issued with three different maturity periods: 91 days, 182 days, and 364 days. • The Treasury bills are zero coupon securities.
Cash Management Bills	• These Bills are zero coupon securities. • These securities have maturity periods less than 91 days. • These securities are used by the government of India to meet any temporary cash flow requirements.
Dated G-Secs	• These G-Secs are long-term money market instruments with maturity period starting from 5 years and going all the way up to 40 years. • These instruments come with a fixed as well as a floating interest rate. • There are around 9 different types of dated G-Secs currently issued by the government of India.
State Development Loans (SDLs)	• SDLs are issued by the state governments of India to fund their activities and to satisfy their budgetary needs. • These are similar to dated G-Secs with a wide range of investment tenures.

Topic 75: Gilt account

Key points:

1. A Gilt Account is an account which is opened and maintained for holding Government securities.
2. This account can be opened and maintained by an entity or a person including 'a person resident outside India' with a "Custodian" permitted by the Reserve Bank

Note: For person resident outside India, account will be governed by rules and regulations specified in the Foreign Exchange Management Act, 2000

Topic 76: Government Securities Acquisition Programme (G-SAP)

Key points:

1. Through the Government Securities Acquisition Programme (G-SAP), RBI planned to purchase government securities worth Rs 1 lakh crore in the first quarter of FY22.
2. We know that, RBI periodically purchases Government bonds from the market through Open Market Operations (OMOs).

3. G-SAP is in a way an OMO with a 'distinct character.'

Benefits of G-SAP

1. It aims to provide more comfort to the bond market
2. It will provide for orderly evolution of the yield curve amid comfortable liquidity.
3. It controls undue volatility faced by the market participants

About Open Market Operations:

- OMOs are the market operations conducted by the RBI by way of sale/ purchase of G-Secs to/ from the market with an objective to adjust the rupee liquidity conditions in the market on a durable basis.
- The objective of OMO is to regulate the money supply in the economy.
- When the RBI feels that there is excess liquidity in the market, it resorts to sale of securities thereby sucking out the rupee liquidity.
- Similarly, when the liquidity conditions are tight, RBI may buy securities from the market, thereby releasing liquidity into the market.
- RBI carries out the OMO through commercial banks and does not directly deal with the public.
- OMO is one of the tools that RBI uses to smoothen the liquidity conditions through the year and minimise its impact on the interest rate and inflation rate levels.

Topic 77: Treasury Single Account

Key points:

1. Treasury Single Account (TSA) was implemented as a pilot beginning FY 2018-19 and was mooted to make it universal in 2021-22.
2. A treasury single account (TSA) is an essential tool for consolidating and managing governments' cash resources, thus minimizing borrowing costs.
3. According to the International Monetary Fund (IMF), a **TSA is a unified structure of government bank accounts that gives a consolidated view of government cash resources**. Based on the principle of unity of cash and the unity of treasury, a TSA is a bank account or a set of linked accounts through which the government transacts all its receipts and payments.

Benefits of TSA:

1. The primary objective of a TSA is to ensure effective aggregate control over government cash balances
2. Minimises cost of borrowing
3. Ensures better utilisation of funds
4. Improves the quality of expenditure
5. Reduces the parking of funds by implementing agencies

Topic 78: Inverted Duty Structure

Key points:

1. It is a situation where the rate of tax on inputs used is higher than the rate of tax on the finished goods.
2. Take an imaginary situation of the Fabric Bag; the tax rate on non-woven fabric (input) purchased is 12% whereas the tax rate on finished Fabric Bag is 5%. Here since the tax rate on input is higher than that on the finished good, there is an inverted tax structure.

Products		GST on	
Finished Goods (Output)	Raw Materials (Input)	Finished Goods	Raw Materials
Fabric Bag	Non-Woven Fabric	5%	12%

Note: The normal situation is that tax on inputs used is lower than the tax rate of the finished goods. Inverted duty structure is usually prevalent in the case of customs duty (import duty).

Topic 79: Currency manipulation

What does the term 'currency manipulator' mean?

1. This is a label given by the US government to countries it feels are engaging in "unfair currency practices" by deliberately devaluing their currency against the dollar.
2. The practice would mean that the country in question is artificially lowering the value of its currency to gain an unfair advantage over others.
3. This is because the devaluation would benefit exporters as their earnings would increase

What are the parameters used?

The U.S. Treasury uses three benchmarks to judge currency manipulators:

1. A bilateral trade surplus with the U.S. of more than $20 billion.
2. A current account surplus of at least 3% of GDP.
3. Net purchases of foreign currency of 2% of GDP over a 12-month period.

India breached the first and the third benchmarks. On the second, on a four-quarter basis, the country's current account surplus remained below the threshold level.

Note: The designation of a country as a currency manipulator does not immediately attract any penalties, but tends to dent the confidence about a country in the global financial markets.

Topic 80: Export Preparedness Index 2020

Key points:

1. Released by: NITI Aayog and the Institute of Competitiveness.
2. It is the first report to examine export preparedness and performance of Indian states.
3. Objective: To identify challenges and opportunities; enhance the effectiveness of government policies; and encourage a facilitative regulatory framework.
4. The structure of the EPI includes 4 pillars: Policy; Business Ecosystem; Export Ecosystem; Export Performance.

Key takeaways

Indian states scored average 50% in sub-pillars of Exports Diversification, Transport Connectivity, and Infrastructure.

Overall, most of the Coastal States are the best performers.

1. Top Coastal States: Gujarat, Maharashtra and Tamil Nadu
2. Top landlocked states: Rajasthan, Telangana and Haryana.
3. Top Himalayan states: Uttarakhand, Tripura and Himachal Pradesh.
4. Top Union Territories: Delhi, Goa and Chandigarh.

Topic: Yield Curves

For video discussion, refer Session 19 (Topic 291) of 2020 RRS Video – CLICK HERE

Why in news?

- The yield on 10-year bonds in India moved up from the recent low of 5.76% to 6.20%.

What is yield curve?

1. A yield curve is the graph you get by plotting the interest rates at which a single borrower can take loans from the market, for different time periods.
2. A yield curve is a graphical representation of yields for bonds over different time horizons.

The Government of India, for instance, periodically borrows money from the market through auctions of treasury bills and government securities. To plot its yield curve, you draw a graph through current market interest rates on its 91-day, 182-day and 364-day treasury bills, and its 10-year, 20-year and 30-year borrowings.

Note: Most market watchers use the spread between one-year and 10-year borrowings to gauge the shape of a country's yield curve.

Why is yield curve important?

- The behaviour of the yield curve and the interest rate provides signals about future health of the economy.
- In other words, a rise in bond yields means interest rates in the monetary system have fallen, and the returns for investors (those who invested in bonds and govt securities) have declined.

Different types of yield curves

Upward sloping yield curve	• Bond investors expect the economy to grow normally, then they would expect to be rewarded more when they lend for a longer period. • It is a sign that markets expect interest rates to spike up sharply in future.
Flat yield curve	• Steepness of yield curve determines how fast an economy is expected to grow • When the economy is expected to grow only marginally, the yield curve is "flat"

'Inverted yield curve'	• 'Inverted yield curve' - difference between its one-year and 10-year treasury bill turned negative • Yield inversion happens when the yield on a longer tenure bond becomes less than the yield for a shorter tenure bond. A yield inversion typically portends a recession. • An inverted yield curve shows that investors expect the future growth to fall sharply.

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RAPID REVISION (RaRe) SERIES - UPSC 2021

RaRe Notes

DAY 11 - ECONOMY

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Topics Coverage:

81. Poverty (Basics)
82. Post- Independence Poverty Estimation
83. Poverty trend in pandemic struck India
84. Global Multidimensional Poverty Index
85. Multidimensional Poverty Index Coordination Committee
86. Sustainable Development Goals (SDG) India Index 2020-21
87. SOCIO-ECONOMIC CASTE CENSUS SURVEY (SECC) 2011
88. Global Gender Gap Report
89. Global Wage Report 2020-21
90. State of Food Security and Nutrition in the World (SOFI) report

Topic 81: Poverty (Basics)

Key points:

1. Poverty line is computed based on household expenditures (which estimates the purchasing power to buy food with a small margin for non-food expenses)
2. National Sample Survey Office (NSSO) uses consumption as an underlying factor in supplying data for defining the poverty line
3. The current poverty line calculation is done based on the money spent to consume 2,100 and 2,400 calories per capita in urban and rural India, respectively.
4. World Bank's International Poverty Line (IPL) stands at person living daily on US$1.90 (PPP exchange rate).

Data Collection Method for NSSO Expenditure Survey

Uniform Resource Period (URP)	• Till 1993-94, the poverty line was based on URP data • Involved asking people about their consumption expenditure across a 30-day recall period
Mixed Reference Period (MRP)	• From 1999-2000 onwards, the NSSO switched to an MRP method • It measures consumption of five low-frequency items (clothing, footwear, durables, education and institutional health expenditure) over the previous year, and all other items over the previous 30 days.

NSSO measures unemployment in India on following approaches:

Usual Status Approach	• This approach estimates only those persons as unemployed who had no gainful work for a major time during the 365 days preceding the date of survey.
Weekly Status Approach	• This approach records only those persons as unemployed who did not have gainful work even for an hour on any day of the week preceding the date of survey.
Daily Status Approach	• Here, unemployment status of a person is measured for each day in a reference week. A person having no gainful work even for 1 hour in a day is described as unemployed for that day.

Topic 82: Post- Independence Poverty Estimation

Various expert groups constituted for Poverty Estimation

1. Working Group (1962)
2. Study by VM Dandekar and N Rath (1971)
3. Task Force on "Projections of Minimum Needs and Effective Consumption Demand" headed by Dr. Y. K. Alagh (1979)
4. Lakdawala Expert Group (1993)
5. Tendulkar Expert Group (2009)
6. Rangrajan Committee (2014)

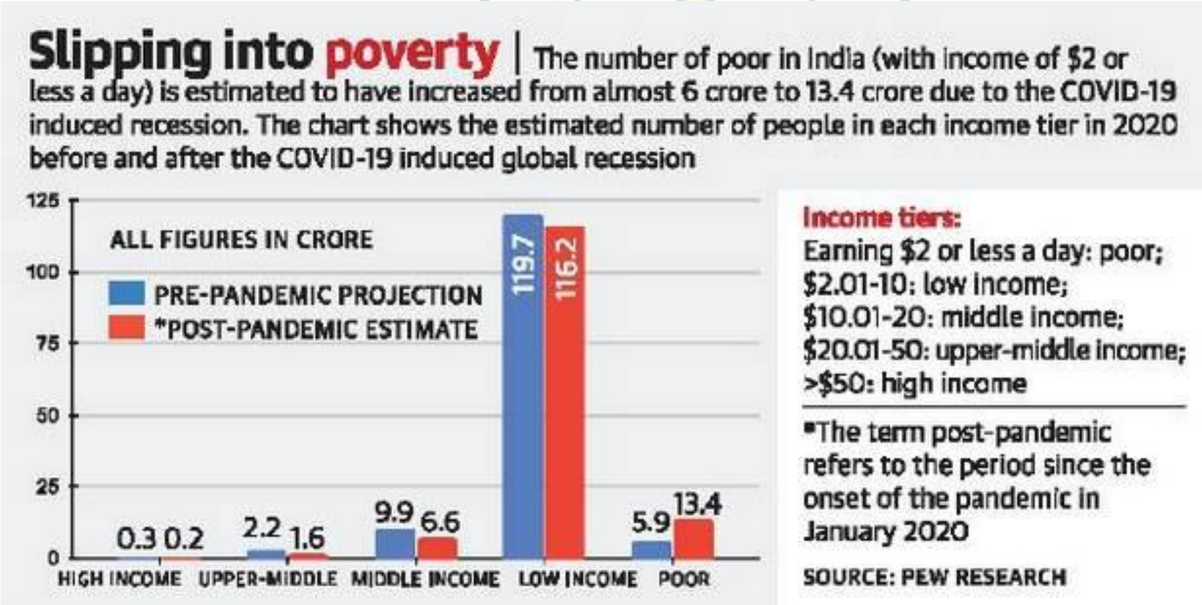
Tendulkar Expert Group (2009)	• In 2005, expert group chaired by Suresh Tendulkar was constituted to review the methodology for poverty estimation. • The Expert Group submitted its report in 2009. • It did not construct a poverty line and adopted the officially measured urban poverty line of 2004-05 (25.7%) based on Expert Group (Lakdawala) methodology. • Lakdawala Expert Group redefined the poverty line and retained the separate rural and urban poverty lines recommended by the Alagh Committee at the national level based on minimum nutritional requirements. **Tendulkar Expert Group Recommendations** 1. It recommended a shift away from basing the poverty lines from calorie norms used in all poverty estimations since 1979 and towards target nutritional outcomes instead. 2. Instead of two separate PLBs for rural and urban poverty lines, it recommended a uniform all-India urban PLB across rural and urban India. 3. It recommended using Mixed Reference Period (MRP) based estimates, as opposed to Uniform Reference Period (URP) based estimates used in earlier methods for estimating poverty. 4. It recommended incorporation of private expenditure on health and education while estimating poverty. 5. It validated the poverty lines by checking the adequacy of actual private consumption expenditure per capita near the poverty line on food, education and health by comparing them with normative expenditures consistent with nutritional, educational and health outcomes respectively. 6. Instead of monthly household consumption, consumption expenditure was broken up into per person per day consumption, resulting in the figure of Rs 32 and Rs 26 a day for urban and rural areas. 7. The national poverty line for 2011-12 was estimated at Rs. 816 per capita per month for rural areas and Rs. 1,000 per capita per month for urban areas.
Rangrajan Committee (2014)	• It was set up in 2012 and it submitted report in June 2014 • It recommended separate consumption baskets for rural and urban areas which include food items that ensure recommended calorie, protein & fat intake and non-food items like clothing, education, health, housing and transport

	• This committee raised the daily per capita expenditure to Rs 47 for urban and Rs 32 for rural from Rs 32 and Rs 26 respectively at 2011-12 prices. • Monthly per capita consumption expenditure of Rs. 972 in rural areas and Rs. 1407 in urban areas is recommended as the poverty line at the all India level. • The government did not take a call on the report of the Rangarajan Committee. • The Rangarajan committee estimation is based on an independent large survey of households by Center for Monitoring Indian Economy (CMIE).

Note:

- India has not counted its poor since 2011.
- The number of poor in the country was pegged at 269.8 million or 21.9% of the population. (according to 2011 estimate)
- But the United Nations estimated the number of poor in the country to be 364 million in 2019, or 28 per cent of the population. (excluding the new poor due to the pandemic)

Topic 83: Poverty trend in pandemic struck India



Key points:

1. The middle class in India is estimated to have shrunk by 3.2 crore in 2020 as a consequence of the downturn.
2. Middle income class are people with incomes of approximately ₹700-1,500 or $10-20 per day.
3. The number of people who are poor in India (with incomes of $2 or less a day) is estimated to have increased by 7.5 crore because of the COVID-19 recession.

4. The vast majority of India's population fall into the low income tier, earning about ₹150 to 700 per day. This group shrank from 119.7 crore to 116.2 crore per day. (about 3.5 crore dropping below the poverty line.)
5. The richer population who earn more than ₹1,500 a day also fell almost 30% to 1.8 crore people.

Note:

According to Pew Research Center, using World Bank data –

1. Number of poor in India has more than doubled to 134 million from 60 million in just a year
2. India is back in a situation to be called a "country of mass poverty" after 45 years

Topic 84: Global Multidimensional Poverty Index

Key points:

1. It is released by Oxford Poverty and Human Development Initiative (OPHI)
2. The idea behind this index is to measure acute multidimensional poverty across developing countries using various indicators.
3. It was developed by OPHI with the United Nations Development Programme (UNDP) in 2010.
4. It is a part of UNDP's Human Development Report (HDR) and is released annually.

Dimensions and Indicators of Global MPI

There are three dimensions and 10 indicators using which countries' performances are measured. These are mentioned below:

Three dimensions of Global MPI	Indicator
1. Health	• Nutrition • Child mortality
2. Education	• Years of Schooling • School Attendance
3. Living Standards	• Cooking Oil • Sanitation • Drinking Water • Electricity

	• Housing • Assets

Global Multidimensional Poverty Index 2020 – Key Findings

1. The theme of the MPI 2020 was 'Charting Pathways out of Multidimensional Poverty: Achieving the SDGs.'
2. India ranked 62 in the Global MPI 2020 which ranked 107 countries.
3. Out of 5.9 billion people in 107 developing countries evaluated, MPI 2020 termed 1.3 billion people (22% of people) as multidimensionally poor.
4. Children show higher rates of multidimensional poverty: half of them are under age 18.
5. The regions with multidimensional poverty are:
    - Sub-Saharan Africa – 558 million are MPI poor.
    - South Asia – 530 million are MPI poor.
    - Middle-income countries home 2/3rd of MPI poor.
6. It was the first time that OCHI and UNDP brought a first comprehensive study of harmonized MPI trends, also known as Changes over Time.
7. This study indicated that 65 out of 75 countries reduced MPI significantly. The study included 80 countries with harmonised poverty trends. India was one of them.

Note:

The MPI collects data using India's National Family Health Survey (NFHS). India scored 0.123 in MPI 2020 with a rank of 62. The headcount ratio of India in Global MPI 2020 was 27.91%.

The MPI ranks of India's Neighbours in 2020 were:

1. Sri Lanka – 25
2. Nepal – 65
3. Bangladesh – 58
4. China – 30
5. Myanmar – 69
6. Pakistan – 73

Topic 85: Multidimensional Poverty Index Coordination Committee (MPICC)

Key points:

1. NITI Aayog has constituted a Multidimensional Poverty Index Coordination Committee (MPICC).

2. NITI Aayog is the nodal agency for the Global MPI and has been assigned the responsibility of leveraging the monitoring mechanism for it and to drive reforms.
3. MPICC is chaired by Ms Sanyukta Samaddar, Adviser (SDG)
4. Global MPI is part of Government of India's decision to monitor the performance of the country in 29 select Global Indices.

Topic 86: Sustainable Development Goals (SDG) India Index 2020-21

Key points:

1. Launched by: NITI Aayog in 2018
2. NITI Aayog had constructed the SDG India Index with 13 out of 17 SDGs with 62 indicators in its first edition in 2018; however, the third edition now covers 16 Goals on 115 quantitative indicators.
3. SDG India Index was developed in collaboration with the Ministry of Statistics & Programme Implementation (MoSPI), Global Green Growth Institute and United Nations in India.
4. Index tracks the progress of all the states and Union Territories (UTs) on a set of 62 National Indicators.
5. The SDG India Index scores range between 0–100, higher the score of a State/UT, the greater the distance to target achieved.

Key findings:

1. India's overall SDG score improved by 6 points — from 60 in 2019 to 66 in 2020-21
2. India improved its poverty eradication, zero hunger and reduced inequality scores in 2020-21 over the previous fiscal.
3. Kerala has retained the top rank, while Bihar was ranked as the worst performer.
4. Second best performers: Himachal Pradesh and Tamil Nadu
5. Worst performing States besides Bihar: Jharkhand and Assam
6. Chandigarh maintained its top spot among the UTs with a score of 79, followed by Delhi (68).


GOAL-WISE TOP STATES/UTs
Goal 1: No Poverty
Tamil Nadu, Delhi
Goal 2: Zero Hunger
Kerala, Chandigarh
Goal 3: Good Health and Well-being
Gujarat, Delhi
Goal 4: Quality Education
Kerala, Chandigarh
Goal 5: Gender Equality
Chhattisgarh, Andaman and Nicobar Islands
Goal 6: Clean Water and Sanitation
Goa, Lakshadweep
Goal 7: Affordable and Clean Energy
Andhra Pradesh, Goa, Haryana, Himachal Pradesh, Karnataka, Kerala, Maharashtra, Mizoram, Punjab, Rajasthan, Sikkim, Tamil Nadu, Telangana, Uttarakhand, Uttar Pradesh, Andaman and Nicobar Islands, Chandigarh, Delhi, Jammu and Kashmir, Ladakh
Goal 8: Decent Work and Economic Growth
Himachal Pradesh, Chandigarh
Goal 9: Industry, Innovation and Infrastructure
Gujarat, Delhi
Goal 10: Reduced Inequality
Meghalaya, Chandigarh
Goal 11: Sustainable Cities and Communities
Punjab, Chandigarh
Goal 12: Responsible Consumption and Production
Tripura, Jammu and Kashmir, Ladakh
Goal 13: Climate Action
Odisha, Andaman and Nicobar Islands
Goal 14: Life Below Water
Odisha
Goal 15: Life on Land
Arunachal Pradesh, Chandigarh
Goal 16: Peace, Justice and Strong Institutions
Uttarakhand, Puducherry

Topic 87: SOCIO-ECONOMIC CASTE CENSUS SURVEY (SECC) 2011

Key points:

1. Dr. N. C. Saxena expert committee was constituted to propose a new methodology for identifying BPL households.
2. The committee proposed three-fold classification of households into "excluded", "automatically included" and "others".
3. Based on Saxena Committee's recommendations, in 2011, the MoRD launched the Socio-Economic and Caste Census (SECC)
4. Sumit Bose Committee (2017) recommended using SECC 2011 data to identify beneficiaries for all centrally sponsored, central and state government schemes as far as possible.

Note:

1. SECC objective was not to replace the poverty line, but to provide 'information regarding the socio economic condition, and education status of various castes and sections of the population' and 'enable households to be ranked on their socio economic status' to identify households that live below the poverty line.
2. SECC 2011 census started in June 2011 and was completed in March 2016
3. SECC-2011 used the Census-2011 data as its base data
4. SECC 2011 is also the first paperless census in India conducted on hand-held electronic devices by the government in 640 districts.

5. Unlike BPL Censuses, SECC-2011 allows for the first time to track the deprivation of households and address gaps effectively with focus on multi-dimensionality of poverty.

The SECC 2011 ranked households in three categories:

1. Automatically Excluded: Households meeting exclusion criteria - any of the 13 assets and income based parameters are automatically excluded from welfare benefits;
2. Automatically Included: Households satisfying inclusion criteria – any one of the 5 acute social destitution parameters are automatically included for welfare benefits;
3. Others: "Others" are ranked on the basis of 7 indicators of deprivation and would, resources permitting be eligible for welfare benefits.

SECC 2011 has three census components which were conducted by three separate authorities, but under the overall coordination of Department of Rural Development in the Government of India:

1. Census in Rural Area has been conducted by the Department of Rural Development.
2. Census in Urban areas is under the administrative jurisdiction of the Ministry of Housing and Urban Poverty Alleviation.
3. Caste Census is under the administrative control of Ministry of Home Affairs: Registrar General and Census Commissioner of India.

SECC 2011 captured data on socio economic status of 17.97 crore rural households which has resulted in automatic exclusion of 7.07 crore (39.36 %) of households as not poor, automatic inclusion of 0.16 crore (0.91 %) households as poorest of the poor, and grading of deprivation of 8.72 crore (48.54%) of rural households.

Topic 88: Global Gender Gap Report

Key points:

1. Global Gender Gap Report 2021 was released recently.
2. Released by: World Economic Forum

Key takeaways

1. India has fallen 28 places
2. It is now one of the worst performers in South Asia
3. It is ranked below neighbouring countries – Bangladesh, Nepal, Bhutan, Sri Lanka and Myanmar.
4. India's rank: 140 among 156 countries.
5. South Asia incidentally is one of the worst performing regions, followed only by the Middle East and northern Africa.
6. Overall, many countries have fared worse in this year's rankings compared to last year's, on account of economic performance.
7. On its current trajectory, it will now take 135.6 years to close the gender gap worldwide.

Topic 89: Global Wage Report 2020-21

Key points:

Global Wage Report 2020-21: Wages and minimum wages in the time of COVID-19' was recently released. The 2020-21 edition analyses the relationship of minimum wages and inequality, as well as the wage impacts of the COVID-19 crisis.

Key takeaways

1. Released by: International Labour Organisation
2. The Report comments on various issues including on Indian workers having low average wages, longer hours.
3. It also reported that the workers in Asia and the Pacific enjoyed the highest real wage growth among all regions over the period 2006–19.

4. The report has taken into account the National Floor Level Minimum Wage which is Rs.176/- per day. (However, actual wages are far higher.)
5. If the median of the minimum wages in different states is drawn, it would be Rs.269/- per day in India.
6. The report shows that not all workers have been equally affected by the crisis. The impact on women has been worse than on men.

Topic 90: State of Food Security and Nutrition in the World (SOFI) report

Key points:

1. It is an annual flagship report jointly prepared by FAO, IFAD, UNICEF, WFP and WHO
2. SOFI report provides in depth analysis on key SDG goals and progress towards ending hunger, achieving food security and improving nutrition

Note:

Since 2017, SOFI presents two key measures of food insecurity:

1. the conventional measure called the Prevalence of Undernourishment (PoU) and
2. a new measure called the Prevalence of Moderate and Severe Food Insecurity (PMSFI)

While PoU is focused on estimating the proportion of population facing chronic deficiency of calories, the PMSFI is a more comprehensive measure of the lack of access to adequate and nutritious food.

Key findings:

- Between 8.3 crore and 13 crore people globally are likely to go hungry this year due to the economic recession triggered by COVID-19.
- Hunger continues to be on the rise since 2014 and the global prevalence of undernourishment, or overall percentage of hungry people, is 8.9%.
- Asia remains home to the greatest number of undernourished (38 crore). Africa is second (25 crore), followed by Latin America and the Caribbean (4.8 crore).
- According to current estimates, in 2019, 21.3% (14.4.crore) of children under 5 years were stunted, 6.9% (4.7 crore) wasted and 5.6% (3.8 million) overweight.
- The report highlights that a healthy diet costs more than ₹143 (or $1.90/ day), which is the international poverty threshold.
- The number of people globally who can't afford a healthy diet is at 300 crore people, or more than the combined population of China and India.

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Sudarshan Sen Committee

In News: Reserve Bank of India recently set up a committee to study about the Asset Reconstruction Companies (ARC) in the country.

Terms of reference:

Legal and regulatory framework applicable to ARCs

Role of ARCs under the Insolvency and Bankruptcy Code (IBC)

To review the business models of ARCs.

Issue:

The regulatory guidelines for ARC were given by SARFAESI Act the was enacted way back in 2002.

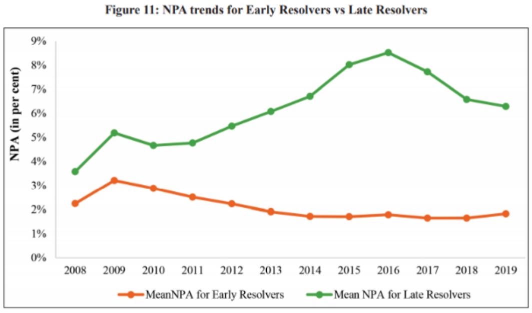
New provisions of IBC like – Insolvency Professionals, Insolvency professional Agency, etc. are incompatible.

RBI has rejected several reconstructions proposals made by ARCs. Ex: UV ARC Limited's resolution plan for Aircel.

About the Asset Reconstruction Company (ARC)

- It is a specialized financial institution that buys the Non-Performing Assets (NPAs) from banks and financial institutions so that they can clean up their balance sheets.
- This helps banks to concentrate in normal banking activities. Banks rather than going after the defaulters by wasting their time and effort, can sell the bad assets to the ARCs at a mutually agreed value.
- The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 provides the legal basis for the setting up of ARCs in India.
- The SARFAESI Act helps reconstruction of bad assets without the intervention of courts.
- As per provisions in SARFAESI Act, ARC should have a minimum net owned fund of Rs. 100 Crore and maintain a capital adequacy ratio of 15% of its risk weighted assets.

172. Bad Bank



Source: IMF Financial Soundness Indicators

- A bad bank is a financial entity set up to buy non-performing assets (NPAs), or bad loans, from banks.
- The aim of setting up a bad bank is to help ease the burden on banks by taking bad loans off their balance sheets and get them to lend again to customers without constraints.
- After the purchase of a bad loan from a bank, the bad bank may later try to restructure and sell the NPA to investors who might be interested in purchasing it.
- A bad bank makes a profit in its operations if it manages to sell the loan at a price higher than what it paid to acquire the loan from a commercial bank.
- However, generating profits is usually not the primary purpose of a bad bank — the objective is to ease the burden on banks, holding a large pile of stressed assets, and to get them to lend more actively.

	On-balance-sheet guarantee	• Here, the bank uses some mechanism (typically a government guarantee) to protect part of its portfolio against losses. • While **simple** to implement, this situation is **difficult for investors to assess.**
	Internal restructuring	• In this, the bank creates **a separate unit** to hold the bad assets. • This solution is **more transparent**, but **does not isolate the bank from risk.**
	Special purpose entity (SPE)	• Here, the bank transfers its bad assets to another organization, typically government backed. • This solution requires **significant government participation.**
	Bad bank spinoff	• The bank creates a new, **independent bank** to hold the bad assets. • This completely isolates the original bank from the risky assets.

	Advantages of Bad Bank	• It can help consolidate all bad loans of banks under a single exclusive entity.

		● It can improve banks' capital buffers by freeing up capital. ● It could help banks feel more confident to start lending again. ● It reduces government need to recapitalize banks which are suffering from high NPAs
	Concerns of Bad Band	● A bad bank backed by the government is likely to pay too much for stressed assets. ● Bailing out banks through a bad bank does not really address the root problem of the bad loan crisis. ● The safety net provided by a bad bank gives these banks more reason to lend recklessly, and thus, further exacerbate the bad loan crisis.

173. Stances of RBI

	Accommodative stance	● It means RBI may reduce the policy rates to increase the money supply in the economy. ● Policy rates normally decrease (can remain same also). ● This policy is adopted when there is slowdown in the economy.
	Neutral stance	● It means the RBI would have the flexibility to either increase or decrease the policy rates by taking into account the macroeconomic conditions. ● Policy rates would move in either direction. ● This policy is adopted when the inflation rate is stable.
	Calibrated Tightening stance	● It means the RBI would either keep the rates constant or increase the rates. ● Policy rates either remain unchanged or increase. ● This policy is adopted during higher rate of inflation.
	Hawkish Monetary Policy Stance	● In order to keep inflation in check, the Hawkish stance favors high-interest rates. ● Because of the high interest rates, borrowing (taking loans from banks) will become less attractive.
	Neutral Monetary Policy Stance	● This monetary policy stance involves low interest rates. ● Low-Interest Rates would entice consumers to take credit (loans) from Banks and other sources.

174. RBI's Revised Priority Sector Lending guidelines

About Priority Sector Lending

- The RBI mandates banks to lend a certain portion of their funds to specified sectors, like agriculture, Micro, Small and Medium Enterprises (MSMEs), export credit, education, housing, social infrastructure, renewable energy among others.

- All scheduled commercial banks and foreign banks (with a sizable presence in India) are mandated to set aside 40% of their Adjusted Net Bank Credit (ANDC) for lending to these sectors.
- Regional rural banks, co-operative banks and small finance banks have to allocate 75% of ANDC to PSL.
- The idea behind this is to ensure that adequate institutional credit reaches some of the vulnerable sectors of the economy, which otherwise may not be attractive for banks from the profitability point of view.

Revised Guidelines

	Fresh Categories	Following categories are now eligible for finance under priority sector ● Bank finance to start-ups up to Rs. 50 crore ● Loans to farmers for installation of solar power plants for solarisation of grid connected agriculture pumps ● Loans for setting up Compressed BioGas plants
	Farmers' Related	● Higher credit limit has been specified for Farmers Producers Organisations (FPOs) but subject to an **aggregate limit of Rs. 2 crore** per borrowing entity. ● The targets prescribed for **small and marginal farmers** and weaker sections will be increased in a phased manner. ● It has defined farmers with land holding of up to one hectare as marginal farmers, and farmers with a landholding between 1 to 2 hectares as small farmers.
	Renewable Energy	● Bank loans up to a limit of **Rs. 30 crore** to borrowers for purposes like solar-based and biomass-based power generators, windmills, non-conventional energy-based public utilities, etc. For individual households, the loan limit will be **Rs. 10 lakh per borrower.**
	Healthcare	● Bank loans up to a **limit of Rs.10 crore per borrower** for building healthcare facilities including under 'Ayushman Bharat' in Tier II to Tier VI centres, have been allowed.
	Addresses Disparity	● It seeks to address the issues concerning regional disparities in the flow of priority sector credit at district level which includes: ● Ranking districts on the basis of per capita credit flow to the priority sector. ● Building an **incentive framework** for districts with comparatively low flow of credit and a **dis-incentive framework** for districts with comparatively high flow of priority sector credit. ● Higher weightage has been assigned to priority sector credit in 'identified districts' where priority sector credit flow is comparatively low.

175. Targeted Long Term Repo Operations

- Repo rate is the rate at which Banks borrow from RBI. Generally, these loans are for short durations from 3-28 days.
  - Loans with higher maturity period (here like 1 year and 3 year) will have higher interest rate compared to short term (repo) loans
- The LTRO is a tool under which the RBI provides one-year to three-year money to banks **at the prevailing repo rate**, accepting government securities as the collateral.
- It is called 'Targeted' LTRO if the Central Bank wants banks opting for funds under this option to be specifically invested in investment-grade corporate debt.

Potential effects of LTRO

- LTRO operations are intended to prevent short-term interest rates in the market from drifting a long way away from the policy rate (i.e. repo rate)
- LTRO/TLTRO will enhance liquidity in the banking system.
- Since the interest rate is comparatively low, there will be downward pressure on short term lending rates.
- It will result in a slightly easy Monetary Policy.
- The LTRO will also help bring down the yields for shorter-term securities (in the 1-3-year tenor) in the bond market.

Do You Know?

- LTRO was first introduced by the European Central Bank (ECB) during its sovereign debt crisis that began in 2008.
- The term LTRO was coined by the ECB that stood for "long-term refinancing operations".

Feature	LTRO	Term Repo
Interest rate	Fixed and at repo rate	Variable, depending upon auctions but higher than repo rate.
Term structure	1 year or 3 year	3 to 28 days
Individual bank's bid size	No restriction on the maximum amount of bidding by individual bidders.	0.75% of the banks' NDTL.
Disbursal	Auction (e-Kuber)	Auction (e-Kuber)
Applicants	Scheduled commercial banks	Scheduled commercial banks
Collateral	Same as under LAF	Same as under LAF
Total fund injections	Limit to be determined by the RBI	Limit to be determined by the RBI

176. Credit Default Swaps (CDS)

Context: RBI came out with the draft guidelines for allowing derivatives trading in the credit default swaps (CDS) in over-the-counter (OTC) markets and on recognised stock exchanges in the country.

- The CDS refers to credit derivative contract in which CDS seller commits to compensate the buyer for the loss in the value of an underlying debt instrument (loans) resulting from a credit event (default on loans by borrowers)
- In return, the protection buyer makes periodic payments (premium) to the CDS seller until the maturity of the contract or the credit event, whichever is earlier.
- It is a derivative or contract that permits the investor to swap or offset his credit risk with another investor.

Key guidelines by RBI w.r.t CDS

- As per the guidelines, the non-retail users will be allowed to do the transactions in credit derivatives for the purpose of hedging as well as other purposes.
- The person who is resident in India and a non-resident can participate in the market.
- As per the guideline, the exchanges can offer standardised single-name CDS contracts by specifying guaranteed cash settlement.
- The commercial papers, listed or unlisted rated rupee corporate bonds, Unrated bonds issued by the special purpose vehicles, certificates of deposit and non-convertible debentures of maturity up to 1 year are eligible to be a reference or deliverable obligation in the CDS contract.

177. Co-operative Banking

News: RBI will consider amalgamation of District Central Co-operative Banks (DCCBs) with State Cooperative Banks (StCBs) subject to various conditions, including that a proposal should be made by the state government concerned.

The rural co-operative credit system in India is primarily mandated to ensure flow of credit to the agriculture sector.

- It comprises short-term and long-term co-operative credit structures.
- The short-term co-operative credit structure operates with a three-tier system –
  - Primary Agricultural Credit Societies (PACS) at the village level
  - Central Cooperative Banks (CCBs) at the district level
  - State Cooperative Banks (StCBs) at the State level
- **PACS are outside the purview of the Banking Regulation Act, 1949** and hence not regulated by the Reserve Bank of India.
- StCBs/DCCBs are registered under the provisions of State Cooperative Societies Act of the State concerned and are regulated by the Reserve Bank.
- Powers have been delegated to **National Bank for Agricultural and Rural Development (NABARD**) under Sec 35 A of the Banking Regulation Act (As Applicable to Cooperative Societies) to conduct inspection of State and Central Cooperative Banks.

Primary Cooperative Banks (PCBs), also referred to as Urban Cooperative Banks (UCBs), cater to the financial needs of customers in urban and semi-urban areas.

- UCBs are primarily 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 if the area of operation of the bank extends beyond the boundaries of one state.

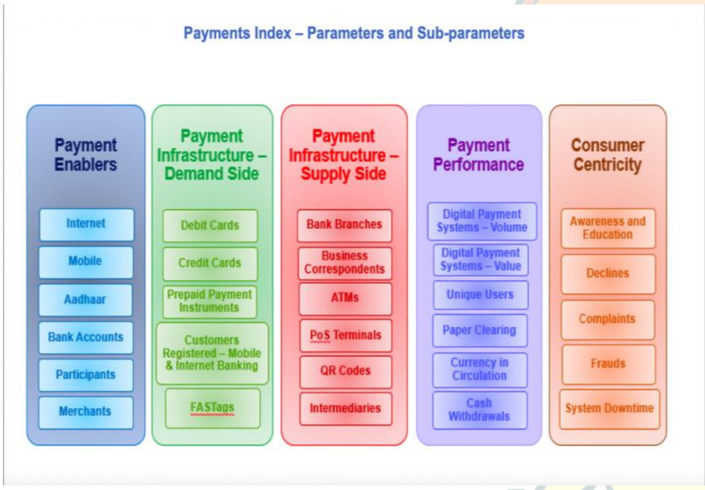
- The sector is heterogeneous in character with uneven geographic spread of the banks. While many of them are unit banks without any branch network, some of them are large in size and operate in more than one state.

- Though the Banking Regulation Act came in to force in 1949, the banking laws were made applicable to cooperative societies only in 1966 through an amendment to the Banking Regulation Act, 1949.

- Since then there is **duality of control over these banks** with banking related functions being regulated by the Reserve Bank and management related functions regulated by respective State Governments/Central Government.
    - The Reserve Bank regulates the banking functions of StCBs/DCCBs/UCBs under the provisions of Sections 22 and 23 of the Banking Regulation Act, 1949 (As Applicable to Cooperative Societies (AACS).

    - The Department of Co-operative Bank Regulation (DCBR) of States regulates State Co- operative Banks (StCBs), District Central Co-operative Banks (DCCBs) and Urban Cooperative Banks (UCBs).

178. Digital Payments Index (DPI)



- RBI has constructed a composite Digital Payments Index (DPI) to capture the extent of digitisation of payments across the country.
- The RBI-DPI comprises five broad parameters
    - Payment Enablers (weight 25%),
    - Payment Infrastructure – Demand-side factors and (10%)
    - Payment Infrastructure – Supply-side factors (15%)
    - Payment Performance (45%)
    - Consumer Centricity (5%)
- These parameters enable the measurement of deepening and expansion of digital payments in the country over different time periods.
- The RBI-DPI has been constructed with **March 2018 as the base period.**
- RBI-DPI shall be published on a **semi-annual basis** from March 2021 onwards with a lag of 4 months.

179. Bond Yield

- Bond yield is the return an investor realizes on a bond.
- The mathematical formula for calculating yield is the annual coupon rate divided by the current market price of the bond
    - **Bond:** Is an instrument to borrow money. A bond could be issued by a country's government or by a company to raise funds.
    - **Coupon Rate:** It is the rate of interest paid by bond issuers on the bond's face value.
- The major factors affecting the yield is the monetary policy of the Reserve Bank of India, especially the course of interest rates, the fiscal position of the government and its borrowing programme, global markets, economy, and inflation.
- A fall in interest rates makes bond prices rise, and bond yields fall — and rising interest rates cause bond prices to fall, and bond yields to rise.

	Relation with Equity Markets	• **Bond yields are inversely proportional to equity returns**; when bond yields decline, equity markets tend to outperform, and when yields rise, equity market returns tend to falter. • Traditionally, when bond yields go up, investors start reallocating investments away from equities and into bonds, as they are much safer. • As bond yields rise, the opportunity cost of investing in equities goes up, and equities become less attractive.
	Cost of Capital	• A rise in bond yields raises the cost of capital for companies, which in turn compresses the valuations of their stocks. • That is something that investors see when RBI cuts or raises the repo rate. A cut in the repo rate reduces the cost of borrowing for companies, leading to a rise in share prices, and vice versa
	Foreign Portfolio investment(FPI) flow.	• Bond yields play a big role in FPI flow. • Traditionally, when bond yields rise in the US, FPIs move out of Indian equities.

		● Also, it has been seen that when the bond yield in India goes up, it results in capital outflows from equities and into debt. ● A continued rise in yields in developed markets (like USA) may put more pressure on Indian equity markets, which may witness an outflow of funds. ● Even a rise in domestic bond yields would see allocation moving from equity to debt.

RBI's Stand:

- The RBI has been **aiming to keep yields lower as that reduces borrowing costs for the government** while preventing any upward movement in lending rates in the market.
- A rise in bond yields will put pressure on interest rates in the banking system which will lead to a hike in lending rates. The RBI **wants to keep interest rates steady to kick-start investments.**

180. Blank-cheque company

- It is also known as **special purpose acquisition company (SPAC)**
- SPAC is an entity specifically set up with the objective of acquiring a firm in a particular sector.
- The aim of this SPAC is to raise money in an initial public offering (IPO), and at this point in time, it does not have any operations or revenues.
- Once the money is raised from the public, it is kept in an escrow account, which can be accessed while making the acquisition.
- If the acquisition is not made within two years of the IPO, the SPAC is delisted and the money is returned to the investors.

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181. Negative Oil Prices

In News: In April 2020, the prices of West Texas Intermediate (WTI), the best quality of crude oil in the world, fell to minus $40.32 a barrel in interlay trade in New York (the USA).

It means that the seller of crude oil would be paying the buyer $40 for each barrel that is bought.

	Oil Pricing	• Crude oil prices like any other commodity are **determined by global supply and demand.** • Growing economies are engines which generate demand for oil. • On the other hand, **supply** of crude oil in majorly controlled by a selected countries or groupings such as **OPEC** • Historically, the OPEC (led by Saudi Arabia) used to work as a cartel and fix prices in a favourable band. It could bring **down prices by increasing oil production** and raise prices by cutting production. • In the recent past, the OPEC has been working with 10 other known as **OPEC+**, to fix the global prices and supply.
	Reasons for Price Fall	• **Falling Demand**: Crude oil prices were already falling before the global lockdown due to the higher supply and lower demand. • **Supply Factor:** The **breakdown of the OPEC+ agreement** between Russia and Saudi Arabia in March 2020 meant the production of oil kept increasing unchecked that led to continuous fall in prices • Crude Oil were close to $60 a barrel at the start of 2020 and, by March-end, they were closer to $20 a barrel. • **Pandemic Shock:** Shutting down of travel routes and global lockdown due to Covid-19 has drastically decreased the demand for oil which has compounded the problem Consequence – Storage Issue • The continuous supply of oil accompanied with the huge demand slump has created a situation where there is a **worldwide shortage of storage space for oil.** • Trains and ships, which were typically used to transport oil, are being used up just for storing oil.
	Oil Prices Below Zero for WTI Crude	In the above background, the historic event unfolded in following manner: • The fall in prices was triggered by the expiry of May futures contracts for US West Texas Intermediate (WTI) crude. *A futures contract is a standard contract to buy or sell a specific commodity of standardized quality at a certain date in the future.* • Each contract trades for a month and May contract was due to expire on 23rd April 2020. • Investors holding May contracts **didn't want to take delivery of the oil and incur storage costs** (that had risen because of shortage of storage space) • Oil producers on the other hand wanted to get rid of their oil even at unbelievably low prices. If not, they had to cut or even **shut down production** which is a difficult decision, because restarting

		it is complicated and more expensive compared to loss incurred with lows (even negative) prices • Moreover, if a country cuts production, it **risks losing market share** if other countries do not follow the suit. • Ultimately, for both — the holders of the delivery contract and the oil producers — it was **less costly to pay $40 a barrel** and get rid of the oil instead of storing it (buyers) or stopping production (producers).

Organization of the Petroleum Exporting Countries (OPEC)

- It is an intergovernmental Organization, created at the **Baghdad Conference** in 1960.
- OPEC has **13 members led by Saudi Arabia and** includes Iran, Iraq, Kuwait, UAE, Venezuela among other
- OPEC members control **about 82%** of total world proved **oil reserves.**
- In 2018, OPEC members **accounted for 41%** of total world **crude oil production.**
- OPEC plus countries include OPEC + Azerbaijan, Bahrain, Brunei, Kazakhstan, Malaysia, Mexico, Oman, Russia, South Sudan and Sudan. This grouping is also informally known as 'Vienna Group'.
- OPEC Plus had formalized an agreement in 2016 to jointly cut production for stabilization of prices which was not renewed in March 2020, leading to oil price crash.

Crude pricing mechanism in India

- Over a period of time the **APM (administered pricing mechanism)** was established for crude pricing.
- APM followed a pooled pricing mechanism under which the weighted average of international prices and the domestic cost of production was used to arrive at the administrated price.
- Starting from **2002, APM were officially dismantled.**
- With the dismantling of APM, **the price of indigenous crude** has been **linked to international prices**, which implies that the price received by domestic crude oil producers is linked to international prices.
- After dismantling of APM, **Petrol & Diesel prices** were finally **deregulated** by Indian Government in 2010 and 2014 respectively.
- The price of fuel at the retail station comprises additional costs like central government excise and taxes, State government taxes and operating costs, margin of the oil companies and profits of retailer.

182. CONSOL Bonds

- Consol bond (also known as perpetual bond) is a fixed income security with no maturity date.
- It is often considered a type of equity, rather than debt.
- The major benefit of these bonds is that they pay a steady stream of interest payments forever. However, these bonds can be redeemed at issuer's discretion.

Origin of Consol Bonds

- The bonds, which paid out an **interest of 5%,** were issued in 1917 by UK government to raise more money to finance the ongoing cost of war (World War-I)

- Citizens were asked to invest in these bonds with a message that their investment will help fight the country, akin to a soldier's fight but with no risk to their lives.
- As a result, most of the Consol bonds in the UK were **owned by small investors**, with over 70% holding less than £1,000
- In 2014, the British government, a century after the start of the WWI, paid out 10% of the total outstanding Consol bond debt

Consol Bonds were suggested as better solution for the Indian government in the backdrop of economic shock induced by COVID-19 Pandemic.

- **Mutually beneficial**: An attractive coupon rate for the bond or tax rebates could also be an incentive for investors, who are looking for avenues to invest. Government, whose revenues had fallen, can also raise resources from public through this option.
- **Low Risk for investors**: With the fall of real estate and given the lack of profitable alternatives, the bond would offer a dual benefit as a risk free investment for retail investors.
- **Flexibility for government**: It would be issued by the central government on a perpetual basis with a right to call it back when it seems fit. The government can consider a phased redemption of these bonds after the economy is put back on a path of high growth
- **Welfare Oriented**: Unlike PM-CARES, the proceeds of the bonds could be used for everything — from Personal Protective Equipment for doctors to a stimulus for MSMEs
- **Participative**: It makes citizens active participants in the fight against slowdown caused by pandemic.

183. Digital Currencies

Context: Japan Bank launches one year test of digital currencies

	CBDCs: Central Bank Digital Currencies	Crypto Currencies
	Created by central bank	Created by any one via consensus algorithm
	Reduced tax evasion	Huge opportunities for tax evasion
	Government controlled	Highly volatile
	Transparent	Opaque

B) Global Consortium for Governance of Digital Currency

- In Jan 2020, **The World Economic Forum (WEF)** in its annual meeting in Davos, **launched a global consortium for digital currency governance**
- It is focused on designing a framework for the governance of digital currencies.
  - Digital currencies have remained outside of the realm of mass adoption due to a lack of good governance.
  - Properly regulated digital currency can be used for cheaper and faster cross-border payments, financial inclusion, and rooting out illicit finance
- The **emergence of digital currencies** in a myriad of different forms - from Bitcoin to Facebook's Libra to central bank-issued alternatives - has left the international community scrambling to build a suitable, integrated regulatory system.

- The initiative aims to bring together leading companies, financial institutions, government representatives, technical experts, academics, international organizations, NGOs and members of the Forum's communities on a global level.
    - It will aim **to increase access to the financial system through innovative policy solutions** that are inclusive and interoperable

World Economic Forum

- WEF is a **Swiss nonprofit foundation established in 1971,** based in **Geneva, Switzerland.**
- It is recognized by the Swiss authorities as the international institution for **public-private cooperation.**
- WEF is committed to improving the state of the world by engaging business, political, academic, and other leaders of society to shape global, regional, and industry agendas.
- Some major reports published by WEF are:
    - ✓ Energy Transition Index.
    - ✓ Global Competitiveness Report.
    - ✓ Global IT Report
    - ✓ WEF along with INSEAD, and Cornell University publishes this report.
    - ✓ Global Gender Gap Report.
    - ✓ Global Risk Report.
    - ✓ Global Travel and Tourism Report.

184. Fiscal Responsibility and Budget Management (FRBM) Act Relaxations

Context: Several States had sought flexibility under the Fiscal Responsibility and Budget Management (FRBM) Act. This is to ensure that fiscal stimulus in the wake of COVID-19 does not get deterred by FRBM considerations.

- FRBM Act as enacted in **August 2003.**
- **Background**: Reckless borrowing by government to finance its programmes had led to high Fiscal Deficit, high Revenue Deficit, and high Debt-to-GDP ratio.
- **Aim of FRBM:** To make the Central government responsible for ensuring inter-generational equity in fiscal management and long-term macro-economic stability.
- The Act envisages the **setting of limits on the Central government's debt and deficits.**
    - The act mandated the **reduction of the fiscal deficit** to 3% of GDP – Initial goal was March 31, 2009 but it has been postponed since 2008 to the most recent target of 3.1% for March 2023.
- Following documents were supposed to be placed in the Parliament annually along with the Budget, to ensure **transparency & accountability in fiscal operations**:
    - Macroeconomic Framework Statement
    - Fiscal Policy Strategy Statement
    - Medium Term Fiscal Policy Statement
    - Medium Term Expenditure Framework Statement
- To ensure that the States too are financially prudent, the 12th Finance Commission's recommendations in 2004 linked debt relief to States with enactment of similar laws.
    - The States have since enacted their own respective Financial Responsibility Legislation, which sets the same 3% of Gross State Domestic Product (GSDP) cap on their annual budget deficits.
- **The NK Singh committee** (set up in 2016) had recommended that the government should target a fiscal deficit of 3% of the GDP in years up to March 31, 2020 cut it to 2.8% in 2020-21 and to 2.5% by 2023.

Relaxation of the FRBM i.e. Escape Clause

- Under **Section 4(2) of the Act,** the Centre can exceed the annual fiscal deficit target citing certain grounds.
- The grounds include
    - National security, war

- National calamity
- Collapse of agriculture
- Structural reforms
- Decline in real output growth of a quarter by at least **3%** below the average of the previous four quarters.

Instances of the FRBM Norms relaxed in the Past

- **In 2008-09** – during the global financial crisis, when the Centre resorted to fiscal stimulus – lead to fiscal deficit climbing to 6.2% of GDP, from a budgeted goal of 2.7%.
  - Simultaneously, the deficit goals for the States too were relaxed to 3.5% of GSDP for 2008-09 and 4% of GSDP for fiscal 2009-10.
- In the **recent Union Budget for 2020-21** – Reductions in corporate tax was considered as structural reforms so as to trigger the escape clause – fiscal deficit target for 2019-20 was recalibrated to 3.8%, from the earlier 3.3%

185. Banking Licence to Large Corporate Houses

Context: In Nov 2020, the Reserve Bank of India's (RBI's) Internal Working Group (IWG) suggested that large corporate and industrial houses may be allowed as promoters of banks.

- The cap on promoters' stake, in the long run, might be raised from the current level of **15% to 26% of the paid-up voting equity share capital of the bank**
- It suggested increasing the initial paid-up capital or net worth required to set up a new universal bank to ₹1,000 crore; for Small Finance Banks to ₹300 crore and for urban cooperative bank transiting to SFBs, it is ₹300 crore in five years.
- The report offers industrial houses two options — either make a **straightforward application for a license**, or those that already have lending operations can **convert their existing businesses to a bank.**

Do You Know?

- ✓ According to the **Banking Regulation Act, 1949**, no company in India shall **carry on banking business, unless it holds a license issued in that behalf by the Reserve Bank of India** and any such license may be issued subject to such conditions as the Reserve Bank may think fit to impose.
- ✓ Since the nationalization of 14 large private banks in 1969, the RBI has not given licenses to large corporate and industrial houses for setting up banks. At present, there are 12 old and nine new private banks (established in the post-1991 period) with the majority of ownership held by individuals and financial entities.
- ✓ **RBI has not been very liberal with banking licenses**. The last two licenses were given seven years ago to IDFC First Bank and Bandhan Bank with a specific objective of achieving financial inclusion. Before these, RBI gave two licenses to Kotak Mahindra Bank and YES Bank.

Analysis of Banking License to Large Corporate Houses

	Why recommend it	• The Indian economy, needs money (credit) to grow. • Government finances were already strained. • Public Sector banks suffering from NPAs • Dead funds of large corporates can be made the best use of.
	Benefits	• Capital requirement can be fulfilled. • The opening of more branches and inclusion. • Will pressurize Public sector banks to become competitive.

	Concerns	• Concentration of economic power, • Financial stability in allowing corporates to own banks are potential risks. • Intergroup lending and diversion of funds. • Corporate defaults spreading to the financial sector.

186. Green Term Ahead Market (GTAM)

Context: In September 2020, Ministry of Power and New & Renewable Energy (MNRE) has launched pan-India Green Term Ahead Market (GTAM) in electricity.

This step comes after **Real Time Market (RTM) trading was approved in power exchanges in June 2020.**

Indian Energy Exchange (IEX) currently trades through following models:

1	**Day Ahead Market (DAM)**	• Here transactions in electricity are allowed for a day in advance.
2	**Term Ahead Market (TAM)**	• Here electricity is traded the same day to up to 11 days in advance.
3	**Renewable Energy Certificate (REC)**	• Here green energy attributes of electricity are traded.
4	**Real time Market (RTM)**	• Here auction sessions are conducted at even time blocks on the hour, and delivery commences one hour after the trade session is closed.

Background for GTAM

- ✓ Though the renewable penetration in the country is increasing, the participation of renewable energy in the existing DAM and TAM segment has remained negligible (less than 1%) as there has been no segregation between conventional power and green power by the system.
- ✓ To overcome this issue, an alternative new model, namely GTAM was introduced.

About GTAM

- GTAM has been specifically introduced for **selling off the power by the renewable developers in the open market** without getting into long term Power Purchase Agreements (PPAs).
- GTAM will provide an **exclusive platform for short-term trading of Renewable Energy**.

Key Features of GTAM are

- ✓ **Integrates Renewable Purchase Obligation (RPO)**: Energy scheduled through GTAM contract shall be considered as deemed RPO compliance of the buyer. Earlier, buyer of power from wind or a solar company could not claim that he had met RPO.
- ✓ **Bilateral Transactions**: Also, transactions through GTAM will be bilateral in nature with clear identification of corresponding buyers and sellers, there will not be any difficulty in accounting for Renewable Purchase Obligations (RPO)
- ✓ **Solar &Non-Solar:** There will be separate contracts for both Solar and Non Solar energy to facilitate Solar and Non-Solar RPO fulfillment
- ✓ **Multiple Instruments:** It will have
  - Green Intraday (Ten Hourly Contracts for SameDay)
  - Day Ahead Contingency (Hourly Contracts for Next Day)
  - Daily (All or a block of Hours in a single day)
  - Weekly Contracts (Monday to Sunday)

- ✓ **Price discovery** will take place on a continuous basis i.e. price time priority basis

GTAM witnessed an encouraging response since its launch and has **registered trade of three million units (MU) in the first 11 days.**

About Renewable purchase obligation (RPO)

- RPO is a mechanism by which the obligated entities are obliged **to purchase certain percentage of electricity from Renewable Energy sources,** as a percentage of the total consumption of electricity.
- Obligated Entities include Discoms, Open Access Consumers and Captive power producers.
- RPOs are categorized as Solar and Non Solar RPO.
- RPOs are provided under **Electricity Act 2003 and the National Tariff Policy 2006**.

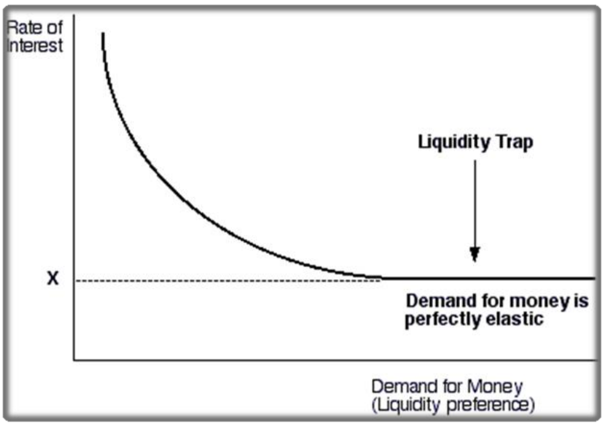
Significance and benefits of GTAM initiative:

- **Benefit to Producer**: GTAM platform will benefit renewable energy producers by providing access to pan-India market. The green market will ultimately encourage green generators to adopt multiple models of sale and trading.
- **Benefit to Buyer**: It will benefit buyers of Renewable Energy through competitive prices and transparent and flexible procurement.
- **Incentivises State Governments:** It would lessen the burden on Renewable Energy-rich States and incentivize them to develop RE capacity beyond their own RPO.
- **Strengthens RE Market**: With robust value proposition such as transparency, competitive prices, flexibility, and payment security and financial savings that the exchange market offers, a pan-India green market has the potential to make the renewable energy market robust by increasing the number of participants in the sector.
- **Helps achieve National Targets**: The transparent platform would help in achieving RE capacity addition targets of the country. The Government has a target of 175 GW RE Capacity by 2022.

187. Liquidity Trap

Context: In Nov 2020, IMF economist Gita Gopinath stated that the global economy may be heading towards a liquidity trap.

- A liquidity trap is a contradictory economic situation in which **interest rates are very low and savings rates are high**.
- Central bank efforts to spur economic activity are hampered as they are unable to lower interest rates further to incentivize investors and consumers, rendering **monetary policy ineffective.**
- It leads to a scenario where any additional money supply that is generated in the economy get **channelled towards savings rather than investment** thus rendering the economy to remain at same liquidity level.
- While a liquidity trap is a function of economic conditions, it is also **psychological** since consumers are making a choice to hoard cash instead of choosing higher-paying investments because of a negative economic view.
- During a liquidity trap, **consumers choose to avoid bonds** and keep their funds in cash savings because of the prevailing belief that interest rates could soon rise (which would push bond prices down)



  - Additionally, because bonds have an inverse relationship to interest rates, many consumers do not want to hold an asset with a price that is expected to decline.
- A liquidity trap isn't limited to bonds. It also affects other areas of the economy, as consumers are spending less on products which means businesses are less likely to hire.

	Signs of Liquidity Trap	• Low-Interest Rates • Prices Remain Low • Businesses Don't Spend the Extra Cash • Wage Remain Stagnant • Lower Interest Rates Don't Translate to Increased Lending
	Solutions	• Raise Interest Rates • Price Fall Enough • Expansionary Fiscal Policy • Financial Innovation • Global Rebalancing

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What made Gita Gopinath to state that global economy was heading towards liquidity trap?

- **Low interest rates a global phenomenon:** 60 per cent of the global economy -- including 97 per cent of advanced economies -- central banks have pushed policy interest rates below 1%. In one-fifth of the world, they are negative. This leaves very little room for Central Banks to further cut interest rates if another shock strikes.
- **Weak Global demand:** Despite the extremely low interest rates, the global demand is still sluggish due to the impact of the COVID-19 pandemic.
- **Threat of a potential currency war:** Due to decrease in interest rates, money supply around the world would increase which can potentially trigger a currency war due go sliding exchange rates in the trading arena.
- **Effects reaching the developing world:** Generally, the developing countries are unlikely to develop this problem due to high average interest rates. But recently, developing countries like Peru and Chile have almost brought the borrowing costs to zero due to their crashing economies, thus signalling a liquidity trap.

188. Financial Stability Report

Context: FSR released by RBI in Jan 2021

- FSR reflects the **risks to financial stability, and the resilience of the financial system** in the context of contemporaneous issues relating to development and regulation of the financial sector.
- FSR is a biannual report released by Reserve Bank of India

	Parameters		FSR Jan 2021 Finding
1	**Capital to risk-weighted assets ratio (CRAR):**	• CRAR also known as Capital Adequacy Ratio (CAR), it is the ratio of a bank's capital in relation to its risk weighted assets and current liabilities.	CRAR of Scheduled Commercial Banks (SCBs) improved to 15.8% in September 2020 from 14.7%in March 2020.

		• Basel III norms stipulated CRAR 8%.	
2	**Gross non-performing asset (GNPA) ratio:**	• A non performing asset (NPA) is a loan or advance for which the principal or interest payment remained overdue for a period of 90 days.	• GNPA ratio of the SCB declined to 7.5% from 8.4%. • The GNPA ratio of all SCBs may increase to 13.5% by September 2021 under the baseline scenario and up to 14.8% under a severe stress scenario.
3	**Provision coverage ratio (PCR)**	• Banks are required to set aside a portion of their profits as a provision against bad loans. This is called PCR. • A high PCR ratio (ideally above 70%) means most asset quality issues have been taken care of and the bank is not vulnerable.	• PCR improved to 72.4% from 66.2%.
4	**Sovereign debt**	• **Sovereign debt** refers to the financial liability of the government of a sovereign nation to its foreign and domestic creditors • **crowding out:** opportunity of borrowing (from banks) for private sector is reduced due to dominance of the government,	• The expansion in the market borrowing programme of the government due to revenue shortfall has imposed additional pressures on banks. • Also it is increasing sovereign debt to levels that have intensified concerns relating to sustainability with crowding out

189. Capital Gains Tax

Context: The Finance Bill, 2021 proposed an amendment to the regulations relating to Capital Gains Tax (CGT).

- The amendment imposes CGT on any assets or shares received by a partner of a company when s/he retires.
- The guideline also clarified that where a partner receives any money or other asset at the time of dissolution or reconstitution of the firm/association, the profits or gains that arise shall be chargeable under '**capital gains'.**
- Further, the tax will be levied on notional gain i.e., the gain realized from the difference between the fair market value and the actual cost in the case of asset transfer

About Capital Gain Tax

- **Capital Gains Tax is a tax on growth of value of investments** incurred when individuals and corporations sell those investments.
- **Capital gains treatment only applies to "capital assets"** such as stocks, bonds, jewelry, coin collections, and real estate property among others. In other words, it applies only to transactions which are capital in nature i.e., result in change of assets or liabilities

- Capital gains are not applicable to an **inherited property** as there is no sale, only a transfer of ownership. The Income Tax Act has specifically exempted assets received as gifts by way of an inheritance or will. However, if the person who inherited the asset decides to sell it, capital gains tax will be applicable.

The following do not come under the category of capital asset:

- Any stock, consumables or raw material, **held** for the purpose of business or profession
- Personal goods such as clothes and furniture held for personal use
- Agricultural land in rural India
- 6½% gold bonds (1977) or 7% gold bonds (1980) or national defence gold bonds (1980) issued by the central government
- Special bearer bonds (1991)
- Gold deposit bond issued under the gold deposit scheme (1999) or deposit certificates issued under the Gold Monetisation Scheme, 2015

The CGT framework divides the tax in two types based on the time for which they are held-

	Short-term Capital Gains Tax (STCG) on Short-term capital asset	• When an asset is held for a period of 36 months or less, it is termed as a short-term capital asset. • The criteria of 36 months have been reduced to 24 months for immovable properties such as land, building and house property. • For instance, if you sell house property after holding it for a period of less than 24 months, any income arising will be treated as short-term capital gain.
	Long-term Capital Gains Tax (LTCG) on Long-term capital asset	• An asset that is held for more than 36 months is a long-term capital asset.

190.Infrastructure Financing – NBFID & InvITs

A) National Bank for Financing Infrastructure and Development (NABFID)

Context: The Parliament passed **NaBFID Bill, 2021.**

- Bill **seeks to set up NaBFID, a Development Financial Institution (DFI)** to support the development of long-term non-recourse infrastructure financing.

	Functions of NaBFID	• Extending or refinancing loans and advances for infrastructure projects. • Attracting **investment from private sector** and institutional investors for infrastructure projects • Providing **Consultancy services** in infrastructure financing • **Facilitating negotiations** with government authorities for dispute resolution in the field of infrastructure financing • Organising and **facilitating foreign participation** in infrastructure projects
	Shareholding of NaBFID:	• NaBFID will be set up as a corporate body with authorised share capital of 1 lakh crore rupees held by central government, multilateral

		institutions, sovereign wealth funds, pension funds, insurers, financial institutions, etc. • Initially, central government will own 100% shares of the institution which may subsequently be reduced up to 26% once the institution has achieved stability and scale.
	Source of funds:	• NBFID may raise money in the form of loans or otherwise both in Indian rupees and foreign currencies, or the issue and sale of various financial instruments including bonds and debentures
	Management	• NBFID will be governed by a Board of Directors and the Chairperson appointed by the central government in consultation with RBI. • A body constituted by the central government will recommend candidates for the post of the Managing Director and Deputy Managing Directors. • The Board will appoint independent directors based on the recommendation of an internal committee
	Investigation and prosecution	• Courts will also require prior sanction for taking cognisance of offences in matters involving employees of NBFID. • No investigation can be initiated against employees of NBFID without the prior sanction of o the central government in case of the chairperson or other directors o the managing director in case of other employees.

About Development Financial institution (DFI)

- DFI known as a development bank or a development finance company are institutions that provides **long term development finance** to various sectors like industry, agriculture, housing and infrastructure.
- DFIs play a **pivotal role in extending credit and boosting economies**, especially in developing countries.
- DFIs can be **either wholly or partially owned by the government and few have majority private ownership,** determined by the nature of the activities being financed, and their associated risk-returns profile.
- There is **no specific use of the term 'DFI' in either the RBI Act, 1934 or the Companies Act, 1956** or various statutes establishing DFIs, while some financial institutions under RBI Act and Companies Act perform the role of DFIs in the broadest sense.

	Commercial Bank	**Development financial institutions**
Definition	Banks that provide services to individuals and industries.	• Banks that function as multi-purpose financial institutes, with a broad development agenda.
Legal Basis	Set up under the Companies Act, as Banking Companies.	• Set up under specialized act E.g. Industrial Finance Corporation Act
Objective	To make a profit by lending money at a high rate of interest.	• To make a profit by lending money at a high rate of interest.
Source Funds	Funds are raised through investments and deposits made by Depositors	• Funds are borrowed and acquired by grants, selling securities

Duration of Loans	Short and Medium-term loans Clients include Individuals, and Business Entities	Medium and Long-term loans • Clients include Government and Corporates

B) Infrastructure Investment Trust (InvITs)

Context:

- Union Cabinet in December 2019 authorised **NHAI to set up InvIT.**
- In April 2021, Power Grid Corporation of India (PGCIL) launched its InvIT called PowerGrid Infrastructure Investment Trust (PGInvIT).

About InvITS

- InvIT is a collective investment scheme **similar to a mutual fund**, which enables direct investment of money from individual and institutional investors in infrastructure projects to earn a small portion of the income as return.
- It is created to hold income-generating and operational infrastructure assets such as roads, power transmission lines, gas pipelines, etc.
  - **These assets have long-term contracts** with strong counterparties that provide a steady cash flow over the long term – typically 15-20 years.
- The InvITs are regulated by **the SEBI (Infrastructure Investment Trusts) Regulations, 2014.**
- An InvIT consists of four elements:
  - **Trustee** has the responsibility of inspecting the performance of an InvIT.
  - **Sponsor**(s) are promoters of the company that set up the InvIT.
  - **Investment Manager** is entrusted with the task of supervising the assets and investments of the InvIT.
  - **Project Manager** is responsible for the execution of the project.
- Units of InvITs can be listed and traded on a stock exchange, providing them liquidity. Or they can be private and unlisted, in which case they are not publicly traded and largely invested in by institutional investors.

Merits of InvITs

- ✓ **For sponsors** (infrastructure developers), InvITs provide a convenient route to monetize revenue-generating assets, unlock equity gains, and deleverage their balance sheets (i.e. to reduce debts).
- ✓ InvIT is highly likely to **attract the interest of foreign investors** especially pension funds, sovereign wealth funds and insurance companies.
- ✓ Regulatory framework build around InvITs **offers corporate governance, stable long-term returns** because of mandatory distribution rules, lower risks, high quality assets and tax benefits on income distributions.
- ✓ Being a trust, all income received by the InvIT from underlying assets receives a pass-through treatment and is not taxable at the InvIT level. As a result, InvITs also **present a more tax-friendly structure.**
- ✓ InvITs provide a good low-risk investment opportunity **for investors** such as banks, financial institutions, pension funds, insurance companies, and even retail investors.

Disadvantages of InvITs:

- ✓ InvITs are **sensitive to changes in regulatory and tax law.**
- ✓ Infrastructure **assets are not inflation-linked in India.** A high rate of inflation has a significant impact on the performance of InvITs.

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RaRe Notes

DAY 38 - ECONOMY

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271. NEER & REER

- India trades with many other countries in many other forms of currency.
- Therefore, if we want to objectively measure Rupee's strength/volatility, we have to compare its price fluctuations with multiple currencies (Euro, Yen, Pound etc.) and not just against US Dollar. Thus, the origin of NEER & REER

Nominal effective exchange rate (NEER)

- The nominal effective exchange rate (NEER) is an index of the weighted average of bilateral nominal exchange rates of home currency vis-à-vis currencies of trading partners, with weights derived from their shares in the trade basket of the home currency.
    - The nominal exchange rate is the amount of domestic currency needed to purchase foreign currency.
- This is a weighted index — that is, countries with **which India trades more are given a greater weight in the index.**
    - A **decrease** in this index denotes **depreciation in rupee's value** whereas an increase reflects appreciation
- The NEER is calculated as the **geometric weighted average** of bilateral exchange rates of the home currency in terms of trading partner currencies. Specifically, the NEER can be calculated as follows:

$$NEER = \prod_{i=1}^{n} \left(\frac{e}{e_i}\right)^{w_i}$$

- 'e' represents the exchange rate of the rupee against a numeraire, i.e., the IMF's Special Drawing Right (SDR), in index form.
- 'e_i' is the exchange rate of the foreign currency 'i' against the numeraire (IMF's SDR) in index form.
- 'w_i' denotes trade-/export-based weight assigned to foreign currency/trading partner 'i',
- 'n' is the number of currencies (other than home currency) included in REER basket.
- A rise in 'e' or 'e/e_i' represents an appreciation of the rupee relative to currency 'i' and vice versa.

Real effective exchange rate (REER)

- REER is the NEER adjusted by relative prices or costs, typically captured in inflation differentials between the home economy and trading partners.
- REER, which is the NEER adjusted by the weighted average of ratio of domestic price to foreign prices, is calculated as

$$REER = \prod_{i=1}^{n} \left[\left(\frac{e}{e_i}\right)\left(\frac{P}{P_i}\right)\right]^{w_i}$$

- P' and 'P_i' represent price indices of the home economy and the trading partner 'i', respectively.
- 'w_i' denotes trade-/export-based weight assigned to foreign currency/trading partner 'i',
- 'n' is the number of currencies (other than home currency) included in REER basket.

Country/Area	2015-16	
	Trade-based Weight	Export-based Weight
1. Euro Area	11.4	14.0
2. China	10.0	5.0
3. UAE	9.4	12.4
4. US	9.1	14.7
5. Saudi Arabia	6.4	4.1
6. Switzerland	3.7	0.5
7. Hong Kong	2.9	4.8
8. Indonesia	2.9	1.8
9. Singapore	2.8	4.4
10. Iraq	2.7	0.4
11. Korea	2.5	1.6
12. Kuwait	2.5	0.4
13. Japan	2.5	2.3
14. Qatar	2.4	0.3
15. Nigeria	2.3	1.0
16. UK	2.2	3.5

Table: Sample of 40-Currency NEER/REER Basket – Normalised Weights

Do You Know?

- Conceptually, EERs are founded on the **purchasing power parity (PPP) hypothesis**
- **2015-16 is chosen as the new base year** for the NEER/REER indices.
- The coverage of the NEER/REER basket has been expanded from 36 to **40 currencies**.
- In order to derive the trade-based currency weights, the geometric means of India's trade (exports plus imports) with trading partners during the **preceding three years** are computed and then normalised to 100.
- The new trade-weighted basket is dominated by the currencies of EMDEs. While the euro area retains its top position in the **trade basket,** the US is assigned the highest weight in the **export basket** in 2015-16 (Check above Table Entry 1 & 4)
- Effective exchange rates (EERs) serve as
    - Gauge for assessing the fair value of a currency
    - Gauge for the external competitiveness of an economy
    - Guideposts for setting monetary and financial conditions

272. Operation Twist of RBI

- Operation Twist is the RBI's simultaneous selling of short-term securities and buying of long term securities through Open Market Operations (OMO).
- This is done to **bring down long-term interest rates and bolster short-term rates.**
    - Operation Twist was first used in 1961 by the US Federal Reserve (central bank) as a way to strengthen the U.S. dollar and stimulate cash flow into the economy.

How does it function?

- As the central bank **buys long-term securities (bonds),** their demand rises which in turn **pushes up their prices.**
- However, the **bond yield comes down** with an increase in prices **(inverse relationship)**

  - Yield is the return an investor gets on his (bond) holding/investment.
- The interest rate in an economy is determined by yield. If yield is low, interest rates decrease.
- Thus, lower long-term interest rates mean people can **avail long-term loans** (such as buying houses, cars or financing projects) **at lower rates.**
- This will lead to a boost in consumption and spending in the economy which in turn will revive the growth.

Bond

- A bond is a **debt instrument** in which an investor loans money to an entity (typically corporate or government) which borrows the funds for a defined period of time at a variable or fixed interest rate.
- Bonds are used by companies, municipalities, states and sovereign governments to raise money to finance a variety of projects and activities.
- Owners of bonds are debt holders, or creditors, of the issuer.

Government Security

- A G-Sec is a **tradable instrument issued by the Central Government or the State Governments.** It acknowledges the Government's debt obligation
- **Short term securities**: They are usually called treasury bills, with original maturities of less than one year- presently issued in three tenors, namely, 91 day, 182 day and 364 day.
- **Long term securities**: They are usually called Government bonds or dated securities with original maturity of one year or more.
- In India, the Central Government issues both treasury bills and bonds or dated securities while the **State Governments issue only bonds or dated securities,** which are called the State Development Loans (SDLs).
- G-Secs carry practically no risk of default and, hence, are called risk-free gilt-edged instruments.

About Open Market Operations

- OMOs are conducted by the RBI by way of **sale or purchase of government securities (g-secs) to adjust money supply conditions.**
- RBI carries out the OMO **through commercial banks** and does not directly deal with the public.
- The central bank **sells g-secs to remove liquidity** from the system and **buys back g-secs to infuse liquidity** into the system.

273. Quantitative Easing & Fed Tapering

- Quantitative easing (QE) is a form of monetary policy used by central banks as a method of **quickly increasing the domestic money supply** and spurring economic activity.
- Quantitative easing usually involves a country's central bank purchasing longer-term government bonds to lower the yield of such bonds (thus lowering interest rate).

- Central Bank also **buys specified amounts of financial assets from commercial banks and other private institutions**, thus increasing the monetary base and lowering the yield on those financial assets.
- Quantitative easing is typically implemented when interest rates are already near zero, because, at this point, central banks have fewer tools to influence economic growth.
- US has done Quantitative Easing measures three times – in 2008, 2010 and 2012
- If quantitative easing itself loses effectiveness, a government's fiscal policy may also be used to further expand the money supply.

Possible After-effects of Quantitative Easing

- If central banks increase the money supply, it can create **inflation**.
    - The worst possible scenario for a central bank is that its quantitative easing strategy may cause inflation without the intended economic growth.
    - An economic situation where there is inflation, but no economic growth, is called **stagflation**.
- Another potentially negative consequence of quantitative easing is that it can **devalue the domestic currency.**
    - Devalued currency can help domestic manufacturers because exported goods gets cheaper in the global market and this helps stimulate exports.
    - However, a falling currency value makes imports more expensive.
- Also, banks may decide to keep funds generated by quantitative easing in reserve rather than lending those funds to individuals and businesses (failing the purpose of QE).

Federal Tapering

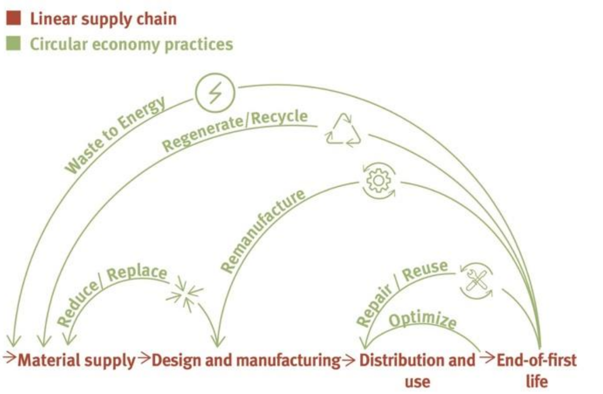
- Tapering refers to a gradual reduction in the monthly purchase of assets by the Federal Reserve of USA. In other words, it is the process of slowing down the rate at which Quantitative Easing is done.
    - For ex: $85 billion in assets were being added to the Fed's balance sheet each month—$45 billion in Treasuries and $40 billion in mortgage-backed securities (MBS). The first step in the Fed's exit framework was to decrease the level of asset purchases each month, or taper them.
- **Why emerging markets like India fear Fed Tapering?**
    - Quantitative easing had increased money flow with US Banks & Investors which found its way as FDI/FPI into emerging markets like India.
    - Once federal tapering happens, banks will have only less free money with them to lend loans. This can affect FDI and FII inflows to India.
    - Capital flows shift to the US as growth in US recovers. This will strengthen US Dollar and weaken Indian Rupee (exchange rate increases)

274. Circular Economy

- It is an economy where products are designed for durability, reuse and recyclability and thus almost everything gets reused, remanufactured, and recycled into a raw material or used as a source of energy.
    - **Linear economy** – produce, use, dispose
    - **Circular economy** – reduce, reuse, recycle
- Circular Economy includes **3 R's (Reduce, Reuse and Recycle),** Refurbishment, Recover, and Repairing of materials.

Circular economy aims

- To reach the **maximum efficiency** in the use of finite resources,
- The gradual transition to **renewable resources**
- **Recovery** of the materials and products at the end of their useful life.
- Essentially, a circular economy describes a **regenerative economic system.**



275. Reform Linked Borrowing

Context: Indian states were able to borrow an extra Rs. 1.06 lakh crore in 2020-21 (FY21) due to the Reform Linked Borrowing window.

About Reform Linked Borrowing

- In October 2020, the Central government had linked permission for additional borrowing of 1% of their GSDP (Gross State Domestic Product) to implementation of four critical reforms, which are:
  1. **Implementation of One Nation One Ration Card System**: Aadhar Seeding of all Ration Cards, Biometric authentication of beneficiaries, automation of all the Fair Price Shops in State)
  2. **Ease of doing business reform**: Elimination of renewal requirements of Registration certificates/approvals/licences, computerized central random inspection system and 'District Level Business Reform Action Plan'.
  3. **Urban Local body/ utility reforms**: financial strengthening of Urban Local Bodies and States to notify floor rates of property tax and of water and sewerage charges
  4. **Power Sector reforms:** reduction in AT& losses, targeted reduction in Average Cost of Supply and Average Revenue Realisation gap, and DBT of electricity subsidy to farmers.
- This was a nudge, **incentivising the States to adopt progressive policies to avail additional funds.**
- Under this reforms-linked borrowing window, **states were to get access to funds of up to Rs 2.14 lakh crore** on completion of all the **four reforms.**
- For FY 2021-22, the net borrowing ceiling for states has been fixed at 4% of the projected GSDP (about Rs 8.46 lakh crore), based on recommendations of the Fifteenth Finance Commission.

- **Article 292** covers borrowing by the Central Government
- **Article 293** covers borrowing by State Governments.
  - Article 293 (3) requires State Governments that are indebted to the Central Government to seek the consent of the Central Government before raising further borrowings.

276. Cess & Surcharge

Context: The latest audit of the Union Government's accounts tabled in Parliament has revealed that about 40% of all the cess collections in 2018-19 have been retained in the Consolidated Fund of India (CFI).

- Cess is a form of tax charged/levied over and above the base tax liability of a taxpayer.
  - For example, a 3% education cess on a 30 percent personal income tax is levied as a tax on the existing 30 percent. As a result, the overall tax rate rises to 30.9 percent (30 percent basic rate + 3% (cess) of the 30 percent tax rate).
- A cess is usually imposed additionally when the state or the central government looks to raise funds for **specific purposes.**
  - For example, the government levies an education cess to generate additional revenue for funding primary, secondary, and higher education.
- Cess is **not a permanent source** of revenue for the government, and it is discontinued when the purpose levying it is fulfilled.
- It can be levied on **both indirect and direct taxes**.
- Tax revenue from Cess are **first credited to the Consolidated Fund of India (CFI)** and the Union Government may, after due appropriation made by Parliament, utilise the money for the specified purposes.
- **Article 270** of the Constitution allows cess to be **excluded from the purview of the divisible pool of taxes** that the Union government must share with the States.
- Post-Independence, the cess taxes were linked initially to the **development of a particular industry**, including a salt cess and a tea cess in 1953.
- The introduction of the **Goods and Services tax (GST)** in 2017 led to most cesses being done away with. Some of the cess present now are:
  - Krishi Kalyan Cess
  - Swachh Bharat Cess:
  - Health and Education Cess
  - Road and Infrastructure Cess,
  - Other Construction Workers Welfare Cess,
  - National Calamity Contingent Duty
  - Duty on Tobacco and Tobacco Products
  - The **GST Compensation Cess**

Surcharge

- Surcharge is an additional charge or **tax levied on an existing tax.**
- Unlike a cess, which is meant to raise revenue for a temporary need, surcharge is usually **permanent in nature.**
- The revenue earned via surcharge is **solely retained by the Centre** and, unlike other tax revenues, is not shared with States.
- Surcharge goes to the Consolidated Fund of India (CFI) and **can be spent for any purposes**. Cess also goes to CFI but can be spent only for the specific purposes.
- Surcharges, in India, are used to make the taxation system more 'progressive'.

277. Remittances

Context: According to the latest edition of the World Bank's Migration and Development Brief, despite Covid-19, remittance flows remained resilient in 2020, registering a smaller decline than previously projected.

About Remittance

- Remittances are **funds transferred from migrants to their home country.**
- For many developing nations, remittances from citizens working abroad provide an import source of much-needed funds. Remittances help families in home country to afford food, healthcare, and basic needs.
- Remittances represent one of the largest sources of income for people in **low-income and developing nations.** It often exceeds the amount of direct investment and official development assistance.
- Remittance flows tend to be more stable than capital flows, and they tend to be countercyclical—increasing during economic downturns or after a natural disaster when private capital flows tend to decrease.
- India is the world's biggest recipient of remittances. Remittances bolsters India's foreign exchange reserves and helps fund its current account deficit.

There are potential costs associated with remittances.

- Countries that receive remittances from migrants incur costs if the emigrating workers are highly skilled or if their departure creates **labor shortages.**
- Also, if remittances are large, the recipient country could face **real exchange rate appreciation** that may make its economy less competitive internationally.
- Some argue that remittances can **undercut recipients' incentives to work** and thus slow economic growth.
- Remittances also have **human costs**. Migrants sometimes make significant sacrifices—including separation from family—and incur risks to find work in another country.

Key Points

- **India** being at top, received over USD 83 billion in remittances in 2020, a drop of just 0.2 per cent from the previous year, despite a pandemic that devastated the world economy.
- **China** is second in terms of global remittances in 2020 which received USD 59.5 billion in remittances in 2020
- India and China are followed by Mexico, the Philippines, Egypt, Pakistan, France and Bangladesh.
- Remittance outflow was the maximum from the **United States (USD 68 billion),** followed by UAE, Saudi Arabia, Switzerland, Germany, and China.

Reason for the Steady Flow of Remittances:

- **Fiscal stimulus** that resulted in better-than-expected economic conditions in host countries.
- Shift in flows from **cash to digital** and from informal to formal channels.
- Cyclical movements in oil prices and currency exchange rates.

278. Difference between FDI & FPI

Context: In the Financial Year 2020-21, India sees growth of 10% (to $82 bn) in Foreign Direct Investment (FDI). FDI equity investments rise 19% to $60 billion.

- In 2019-20, India had received $74.39 billion in FDI, with almost $50 billion coming in the form of equity investments.

Key Points

- **Singapore** emerged as the **top investor** with almost a third of all investments, **followed by the US** which accounted for **23% of FDI** and **Mauritius from where 9%** of the foreign capital flows originated.
- **Gujarat** was the top FDI destination in 2020-21, accounting for 37% of the foreign equity inflows, followed by Maharashtra (2nd) which got **27% of** the equity inflows.
- **Karnataka (3rd)** accounted for another 13% of the equity investments.
- **Computer software and hardware** has emerged as the top sector during 2020-21 with about **44% share** of the total FDI equity inflow. These are followed by **construction (infrastructure) activities** (13%) and **services sector (8%),** respectively.

	FDI	FII
1	FDI is when foreign company brings capital into a country or an economy to set up a production or some other facility. FDI gives the foreign company some control in the operations of the company	FII is when a foreign company buys equity in a company through the stock markets. Therefore, in this case, FII would not give the foreign company any control in the company
2	FDI involves in the direct production activity & also of medium to long term nature	FII is a short term investment mostly in the financial markets & it consist of FII
3	It enables a degree of control in the company	It does not involve obtaining a degree of control in a company
4	FDI brings-long term capital	FII brings short-term capital
5	Any investment above 10% treated as FDI	Allowed to invest up to 10% of the paid-up capital
6	More stable	less stable
7	Only targets specific enterprise	It increases capital availability in general
8	Difficult entry and exit	Easy entry-exit
9	Investment inflows in the primary market	Investment inflows in the secondary market
10	Critical driver of economic growth	Gives impetus to the equity market of the country

279. Index-linked Insurance Policies (ILIPS)

Context: A committee set up by the Insurance Regulatory and Development Authority of India (IRDAI) has recommended the introduction of index-linked insurance policies (ILIPs).

About Index-linked Insurance Policies

- The returns from ILIPs will be linked to benchmark indices.
- ILIPs are the Insurance products linked with the benchmark indices. It includes 10-year Sovereign Bond Index, Sensex or Nifty etc.
    - The ILIPs linked with the government bonds are less risky while those linked with the equity-based indices will go through the fluctuation in returns in accordance with the stock market performance.
- ILIPs can be an alternative or complementary option to the current conventional guaranteed products (including annuities and savings products) and unit-linked insurance plans (ULIPs).
- ILIP could be seen as a suite of products wherein greater transparency can be facilitated to the customers with respect to product structure and benefits and where risks are in line with the choice made by the customers.
- The ILIPs can be regarded as a life insurance policy under Section 10(10D) and taxability of the Insurance Policy Act.

Insurance Regulatory and Development Authority of India (IRDAI)

- It is an autonomous, statutory body which is given the task to regulate and promote the insurance and re-insurance industries & insurance agency in India.
- An Act of Parliament passed by the Government of India in 1999 known as Insurance Regulatory and Development Authority Act, 1999 which led to its creation.
- Headquarters: Hyderabad, Telangana.
- It is a 10-member body which includes: Chairman, Five full time & Four part time members appointed by the government of India.

Functions

- Promote and regulate professional organisations connected with insurance and reinsurance business; regulate investment of funds by insurance companies
- Protect the rights of insurance policy holders.
- Provide registration certification to life insurance companies.
- Adjudication of disputes between insurers and intermediaries or insurance intermediaries.

280. Social Impact Bond (SIB)

Context: In Dec 2020, Pimpri Chinchwad Municipal Corporation (PCMC) signed an MoU with UNDP India to co-create India's first Social Impact Bond (SIB).

About Social Impact Bond (SIB)

- SIB is a contract with the public sector or governing authority, whereby it pays for better social outcomes in certain areas and passes on the part of the savings achieved to investors.
- It lays down outcome-based targets to be achieved at the start of the contract.
- It allows for tracking the progress of the outcomes, thus ensuring transparency for investors.
- This SIB will support the PCMC in improving healthcare services for its citizens, especially with respect to the pandemic while incurring minimum investment risks
- The introduction of the SIB will **attract more investors** from public and private sectors to fund public welfare projects and thus help to meet the investment deficit.
- This is the first time that a **government body will act as the 'outcome funder' in a bond**, whereas traditionally most government-funded public projects require large and early investments by the government with a substantial gestation period of outcomes and involve various kinds of risks.

Key Features of Social Impact Bonds

- They operate over a **fixed period of time.**
- They **do not provide fixed rate of return.**
- The outcome is completely **dependent on success of social outcome.**
- They are **not affected by market risk.**
- They are **subjected to inflation risk.**

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281. NFRA

In News: National Financial Reporting Authority (NFRA) is in the process of creating a verified and accurate **database of companies (Public Interest Entities) and auditors** that come under the regulatory ambit of it.

- In this regard, the NFRA has been engaging with the Corporate Data Management (CDM) division of the Ministry of Corporate Affairs (MCA) and three recognised stock exchanges in India

About NFRA

- It is an **audit regulator.**
- NFRA was **constituted in 2018** by the Government of India **under section 132 (1) of the Companies Act, 2013.**
- The decision to constitute the NFRA was taken after the role of auditors and the Institute of Chartered Accountants of India came under the scanner for alleged lapses in various corporate scams including that at the Punjab National Bank.

	Key Features of NFRA
Composition	• It consists of a chairperson, who shall be a person of eminence and having expertise in accountancy, auditing, finance or law, appointed by the Central Government • And such other members **not exceeding 15.**
Functions and Duties	○ **Recommends accounting and auditing policies and standards** to be adopted by companies for approval by the Central Government. ○ **Monitor and enforce compliance** with accounting standards and auditing standards. ○ **Oversee the quality of service of the professions** associated with ensuring compliance with such standards and suggest measures for improvement in the quality of service. ○ Protect the **public interest.**
Powers	It can **undertake investigation** related to the following class of companies and bodies corporate called **Public Interest Entities:** ○ Companies whose **securities are listed on any stock exchange** in India or outside India. ○ Unlisted public companies having paid-up capital of not less than **Rs. 500 crores** or having annual turnover of **not less than Rs. 1,000 crores** or having, in aggregate, outstanding loans, debentures and deposits of **not less than Rs. 500 crores** as on the **31st March** of immediately preceding financial year. ○ Insurance companies, banking companies, companies engaged in the generation or supply of electricity. **No other institute shall initiate any proceedings** in such matters of misconduct where the NFRA has initiated an investigation. It shall have the **power to investigate, either suo motu or on a reference made to it by the Central Government,**

	It shall have the **same powers as are vested in a civil court** under the Code of Civil Procedure, 1908, while trying a suit in matters of: o discovery and production of books of account and other documents; o summoning and enforcing the attendance of persons and examining them on oath; o Inspection of any books, registers and other documents. Where **professional or other misconduct** is proved, it has the power to make order for imposing penalty and debar the CA or firm for up to 10 years
HQ	New Delhi
Accountability	▪ Its account is monitored by the Comptroller and Auditor-General of India. ▪ NFRA shall **prepare its annual report** giving a full account of its activities during the financial year and forward a copy thereof to the Central Government and the Central Government shall cause the annual report to be laid before each House of Parliament.

- **ICAI** (Institute of Chartered Accountants of India) will continue its role in respect of **private limited companies, and public unlisted companies** below the threshold limit to be notified in the rules.
- ICAI would continue playing the advisory role through **recommendations to the NFRA**.
- Quality audit of non listed PSUs and other below the prescribed threshold, would be continued to monitored by the **Quality Review Board (QRB).**

282. E-Way Bill

In News: During National Lockdown, transporters had raised concerns over potential penalties arising from expired electronic way (e-way) bills

Electronic Way Bill

- The E-way bill is a document to be generated online under the GST system, when goods of the value of more than Rs. 50,000 are shipped inter-State or intra-State.
- The E-way bill must be raised before the goods are shipped
- When an eway bill is generated, **a unique E-way Bill Number (EBN) is allocated** and is available to the supplier, recipient, and the transporter.
- The transporter has to carry the invoice and the copy of E-way bill as support documents for the movement of goods.
- Though check-posts have been abolished under GST, a consignment can be intercepted at any point for the verification of its E-way bill, for all inter-State and intra-State movement of goods.
- If a consignment is found without an E-way bill, a penalty of Rs.10,000 or tax sought to be evaded, whichever is greater, can be levied.
- An e-way bill can be regenerated by the transporter before expiry, but, **if the e-way bill has expired, the system won't allow regeneration** linked to the same invoice.

Advantage of an e-way Bill

- Eliminating the **time spent** on inter-state check points. Earlier a typical truck in India spent 20% of its time in inter-state check points.
- E-way bill helps in **reducing Tax-Evasion** since every e-way bill generated by both sender and buyer it to be updated to file a GST return.
- In previous tax regime, tax official had to **manually cross-check** the way bill.
- Single electronic way bill for movement of goods across the country will **save lot of paperwork.**
- Improvement in **LPI (Logistics Performance Index)**
- Improvement in **Ease of doing business.**
- It may increase the govt revenues by 20%.

283. Currency Swap Facility

In News: Bangladesh's central bank has approved a **$200 billion currency swap facility to Sri Lanka.**

- RBI has agreed to **a $400 million currency swap facility for Sri Lanka** till November 2022.

About

- The word swap means exchange.
- A currency swap between the two countries is an agreement or contract to exchange currencies with predetermined terms and conditions.
- **Central banks and Governments** engage in currency swaps **with foreign counterparts** to meet **short term foreign exchange liquidity** requirements or to ensure adequate foreign currency to **avoid Balance of Payments (BOP) crisis** till longer arrangements can be made.
- These swap operations carry **no exchange rate or other market risks** as transaction terms are set in advance.
    - **Exchange rate risk,** also known as **currency risk,** is the financial risk arising from **fluctuations in the value of a base currency against a foreign currency** in which a company or individual has assets or obligations.

Bangladesh-Sri Lanka Agreement

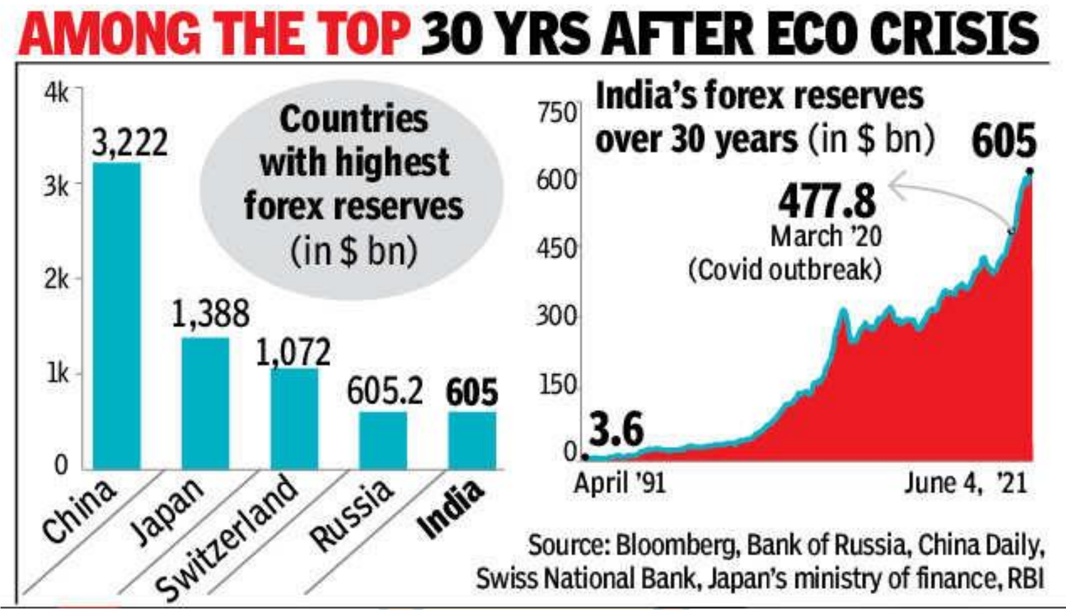
- In the present context, a currency swap is effectively a loan that Bangladesh will give to Sri Lanka in dollars, with an agreement that the debt will be repaid with interest in Sri Lankan rupees.
- For Sri Lanka, this is cheaper than borrowing from the market, and a lifeline as it struggles to maintain adequate forex reserves even as repayment of its external debts looms.

RBI's Framework for Swap Facilities for SAARC:

- The SAARC currency swap facility came into operation on **15th November, 2012.**
- The **RBI can offer a swap arrangement within the overall corpus of USD 2 billion.**
- The swap drawals can be made in US dollar, euro or Indian rupee. The framework provides certain **concessions for swap drawals in Indian rupee.**
- The facility will be **available to all SAARC member countries,** subject to their signing the bilateral swap agreements.

284. Forex Reserves

In News: As per Reserve Bank of India, India's Foreign Exchange (Forex) Reserves surged by $ 5 billion to $ 609 billion in the week ended 25th June, 2021



About Forex

- Foreign exchange reserves are **assets held on reserve by a central bank in foreign** currencies, which can include bonds, treasury bills and other government securities.
- India's Forex Reserve include:
  - Foreign Currency Assets
  - Gold reserves
  - Special Drawing Rights
  - Reserve position with the International Monetary Fund (IMF)
- These reserves are used to back liabilities, influence exchange rate through RBI market intervention and influences monetary policy.

Significance of rising forex reserves:

- **Comfortable Position for the Government:** in managing India's external and internal financial issues.
- **Managing Crisis:** It serves as a cushion in the event of a **Balance of Payment (BoP)** crisis on the economic front.
- **Rupee Appreciation:** The rising reserves have also helped the rupee to strengthen against the dollar.
- **Confidence in Market**: Reserves will provide a level of confidence to markets and investors that a country can meet its external obligations.

Special drawing rights (SDR)

- The SDR is an **international reserve asset,** created by the IMF in 1969 to supplement its member countries' official reserves.

- The SDR is neither a currency nor a claim on the IMF. Rather, it is a potential claim on the freely usable currencies of IMF members. SDRs can be exchanged for these currencies.
- The value of the SDR is calculated from a weighted basket of **major currencies,** including the U.S. dollar, the euro, Japanese yen, Chinese yuan, and British pound.
- The interest rate on SDRs or (SDRi) is the interest paid to members on their SDR holdings.

Reserve Position in the International Monetary Fund

- A reserve tranche position implies a **portion of the required quota of currency each member country must provide to the International Monetary Fund (IMF)** that can be utilized for its own purposes.
- The reserve tranche is basically **an emergency account** that IMF members can access at any time without agreeing to conditions or paying a service fee.

285. Liberalized Remittance Scheme (LRS)

- This is the scheme of the Reserve Bank of India, introduced in the year 2004.
- Under the scheme, all resident individuals, including minors, are allowed to freely remit up to USD 2,50,000 per financial year (April – March) for any permissible current or capital account transaction or a combination of both.
- The Scheme is **not available to corporations, partnership firms, Hindu Undivided Family (HUF), Trusts etc.**
- Though there are no restrictions on the frequency of remittances under LRS, **once a** remittance is made for an amount up to USD 2,50,000 during the financial year, a resident individual would not be eligible to make any further remittances under this scheme.
- It is mandatory for the resident individual to provide his/her Permanent Account Number (PAN) for all transactions under LRS made through Authorized Persons.

Remitted Money can be used for:

- Expenses related to travelling (private or for business), medical treatment, study, gifts and donations, maintenance of close relatives and so on.
- Investment in shares, debt instruments, and buy immovable properties in the overseas market.
- Individuals can also open, maintain and hold foreign currency accounts with banks outside India for carrying out transactions permitted under the scheme.

Remitted Money cannot be used for:

- Any purpose specifically **prohibited under Schedule-I** (like the purchase of lottery tickets, proscribed magazines, etc.) or any item restricted under **Schedule II of Foreign Exchange Management (Current Account Transactions) Rules, 2000.**
- Trading in foreign exchange abroad.
- Capital account remittances, directly or indirectly, to countries identified by the **Financial Action Task Force (FATF)** as **"non- cooperative countries and territories",** from time to time.

- Remittances directly or indirectly to those individuals and entities identified as posing a significant risk of committing **acts of terrorism** as advised separately by the Reserve Bank to the banks.

286. Anti – Dumping Duty

- Dumping is a process wherein a company exports a product at a price that is **significantly lower than the price it normally charges in its home** (or its domestic) market.
- An anti-dumping duty is **a protectionist tariff that a domestic government imposes on foreign imports that it believes are dumped.**
    - This is done with the rationale that these products have the potential to undercut local businesses and the local economy.
- **Anti-dumping duty is imposed to rectify the situation** arising out of the dumping of goods and its trade distortive effect.
- According to global trade norms, including the World Trade Organization (WTO) regime, a country is allowed to impose tariffs on such dumped products to provide a level-playing field to domestic manufacturers.
    - The duty is imposed only after a thorough investigation by a quasi-judicial body, such as Directorate General of Trade Remedies (Ministry of Commerce & industry) in India.
- While the intention of anti-dumping duties is to save domestic jobs, these tariffs can also lead to higher prices for domestic consumers.
- In the long-term, anti-dumping duties can reduce the international competition of domestic companies producing similar goods.

Different from Countervailing Duty (CVD):

- CVD is imposed in order **to counter the negative impact of import subsidies** to protect domestic producers.
- Countervailing Duties (CVDs) are tariffs levied on imported goods to offset subsidies made to producers of these goods in the exporting country.
- CVDs are meant to level the playing field between domestic producers of a product and foreign producers of the same product who can afford to sell it at a lower price because of the subsidy they receive from their government

287. Equalization Levy

In News: In July 2020, the Central government has stated that it will not extend the deadline for payment of equalisation levy by non-resident e-commerce players, even though a majority of them are yet to deposit the first installment of the tax.

About

- The equalization levy is aimed at taxing foreign companies which have a significant local client base in India but are billing them through their offshore units, effectively escaping the country's tax system.
- Equalisation levy at **6%** has been in force since 2016 on payment exceeding Rs 1 lakh a year to a **non-resident service provider for online advertisements**.

- Example: IASbaba pays Rs 1,50,000 to Google (non-resident service provider) for placing ads on their websites. Then, 6% (of 1.5 Laks) is deducted at source & paid towards Indian Tax authorities as equalization levy imposed on Google.

- The amendments to the **Finance Act, 2020** had expanded the ambit of the **equalisation levy for non-resident e-commerce** operators involved in supply of services, including online sale of goods and provision of services, with the levy at the **rate of 2%** effective April 1, 2020.
- The tax applies on e-commerce transactions on **websites such as Amazon.com. Google in particular** as the tax applies on advertising revenue earned overseas if those ads target customers in India.

Penalties Involved:

- The non-payment could result in a penalty equal to the amount of equalisation levy, along with interest.
- The late-payment would attract interest at the rate of 1% per month or part of the month.

288. Minimum Alternative Tax (MAT)

- At times it may happen that a taxpayer, being a company, may have generated income during the year, but by taking the advantage of various provisions of Income-tax Law (like exemptions, deductions, depreciation, etc.), it may have reduced its tax liability or may not have paid any tax at all.
- The concept of MAT was introduced to target those companies that make huge profits and pay the dividend to their shareholders but pay no/minimal tax under the normal provisions of the Income Tax Act.
- Minimum Alternate Tax (MAT) was introduced by the **Finance Act, 1987** with effect from assessment year 1988-89. Later on, it was withdrawn by the Finance Act, 1990 and then reintroduced by Finance Act, 1996.
- Minimum Alternative Tax is payable under the **Income Tax Act.** Here, the companies have to pay a fixed percentage of their profits as Minimum Alternate Tax**.**
- MAT is calculated at 15% (plus surcharge and cess as applicable) on the **book profit** (the profit shown in the profit and loss account) or at the usual corporate rates, and whichever is higher is payable as tax.
    - MAT is levied at the rate of 9% (plus surcharge and cess as applicable) in case of a company, being a unit of an **International Financial Services Centre** and deriving its income solely in convertible foreign exchange.
- **All companies in India,** whether domestic or foreign, fall under this provision. MAT was later extended to cover non-corporate entities as well.
- MAT is an important tool with which **tax avoidance can be prevented.**
- The provisions of MAT are applicable to a corporate taxpayer only, whereas Alternate Minimum Tax (AMT) applies to a person other than a company (same concept).
    - AMT shall apply to an individual or a Hindu undivided family or an association of persons or a body of individuals
    - AMT is levied @ 18.5% of adjusted total income

289. GST Cess or Compensation Cess

- GST Compensation Cess is levied by the Goods and Services Tax (Compensation to States) Act 2017.
- The object of levying this cess is to compensate the states for the loss of revenue arising due to the implementation of GST on 1st July 2017 for a period of five years or such period as recommended by the GST Council.
    - GST, being a consumption-based tax, would result in loss of revenue for manufacturing-heavy states.
- GST Compensation Cess is levied in addition to regular GST on **notified goods,** mostly belonging to the luxury and demerit categories. Ex Tobacco, Pan Masala, Coal, automobiles, aerated waters.
- The GST Act states that the cess collected on recommendation by the GST Council would be credited to the **Cess Compensation fund.**
- The proceeds will be distributed to loss-incurring States on the basis of a prescribed formula as compensation.

How is GST Compensation Cess calculated?

- GST Cess is calculated on the price of the notified goods before GST.
- For example, compensation Cess on coal is Rs. 400 per tonne.
- If you sell a tonne of coal that has a value of Rs. 5,000, GST Cess of Rs. 400 has to be paid. Additionally, GST at the rate of 5% for the same will be Rs. 250.
- Hence, the total GST liability for the supply of coal will be Rs. 750.
- However, when the compensation cess ends on July 1st, 2022, the total GST liability will be reduced to just Rs. 250.

How will the compensation cess be distributed to the states?

The amount of compensation to be distributed to each state is calculated as follows:

Step 1: Base revenue = Tax revenue of the state in FY 2016-17.

Step 2: Assume growth rate as 14% and calculate projected revenue for each financial year.

The implication of projected revenue is that this would be the revenue that a state could have earned if GST were not implemented. This calculation is done for a period of five years since compensation cess is intended to be in effect for the transition period of five years.

Step 3: Calculate the Compensation payable for each FY as follows

	Projected Revenue for that particular financial year	xxx
(-)	Actual Revenue earned by the state	yyy
=	**Compensation payable to the state**	(xxx-yyy)

290. Double Taxation Avoidance Agreement

- A DTAA is a tax treaty signed between two or more countries. Its key objective is that tax-payers in these countries can avoid being taxed twice for the same income.
- A DTAA applies in cases where a tax-payer resides in one country and earns income in another.
    - If a person aims to do business in a foreign country, he/she may end up paying income taxes in both cases, i.e. the country where the income is earned and the country where the individual holds his/her citizenship or residence.
- DTAAs can either be comprehensive to cover all sources of income or be limited to certain areas such as taxing of income from shipping, air transport, inheritance, etc.
- India has signed DTAA with more than 80 countries

Significance of DTAA

- DTAAs are intended to make a country **an attractive investment destination** by providing relief on dual taxation. Such relief is provided by exempting income earned abroad from tax in the resident country or providing credit to the extent taxes have already been paid abroad.
- DTAAs also provide for **concessional rates of tax in some cases.**

Misuse of DTAA

- India has signed DTAA with the tax havens such as Mauritius, Singapore, Cayman Islands etc.
- These DTAAs have been misused by the MNCs in order to reduce their tax liability in India.
- For example, If company (Shell Company) is registered in tax haven and carries out the operations through its subsidiary based in India.
- Under the provisions of DTAA, the company would be liable to pay tax only in the tax haven country, even for the profits which it makes in India.
- This causes significant revenue loss for India.

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371. Mutual Funds

- A mutual fund is a type of financial vehicle **made up of a pool of money** collected from **many investors** to invest in securities like multiple stocks, bonds, money market instruments, and other assets.
    - A share of a mutual fund represents investments in many different stocks (or other securities) instead of just one holding.
    - The average mutual fund holds over a hundred different securities, which means mutual fund shareholders gain important **diversification at a low price.**
- Mutual funds are operated by **professional money managers,** who allocate the fund's assets and attempt to produce capital gains or income for the fund's investors.
- Mutual funds give small or individual investors access to professionally managed portfolios of equities, bonds, and other securities. Each shareholder, therefore, participates proportionally in the gains or losses of the fund.
- **Mutual funds charge annual fees** (called expense ratios) and, in some cases, commissions, which can affect their overall returns.
- The price of a mutual fund share is referred to as the **net asset value (NAV)** per share. A fund's NAV is derived by dividing the total value of the securities in the portfolio by the total amount of shares outstanding.
- Investing in a share of a mutual fund is different from investing in shares of stock. Unlike stock, mutual fund shares **do not give its holders any voting rights.**
- **SEBI is the regulatory body** to control and regulate the securities market and mutual funds industry in India.

Nature of Mutual Funds

- A mutual fund is both an **investment and an actual company**. This dual nature may seem strange, but it is no different from how a share of AAPL is a representation of Apple Inc.
- When an investor buys Apple stock, he is buying partial ownership of the company and its assets. Similarly, a mutual fund investor is buying partial ownership of the mutual fund company and its assets.
- The difference is that Apple is in the business of making innovative devices and tablets, while a mutual fund company is in the business of making investments.
- If a mutual fund is construed as a virtual company, its CEO is the fund manager, sometimes called its **investment adviser.**
    - The investment adviser or fund manager may employ some analysts to help pick investments or perform market research.
- Most mutual funds are part of a much larger investment company; the biggest have hundreds of separate mutual funds.

Open Ended Mutual Fund:

- Here investor can buy or sell as and when they intend to at a **NAV-based price.**
- As investors buy and sell units the **number of units issued** also changes every day.
- Hence value of the scheme's portfolio and so, the NAV also changes on a daily basis.

Close-ended Mutual Fund:

- A close-ended fund usually issue units to investors only once.
- When they launch an offer, called **new fund offer (NFO)** in India.
- These are managed by fund houses for a **limited number of years**.
- And at the end of the term either **money is returned to the investors** Or the scheme is **made open-ended**.
- Any investor can buy and sell these units through the exchange.
- So, these have to be **listed in the stock exchanges.**

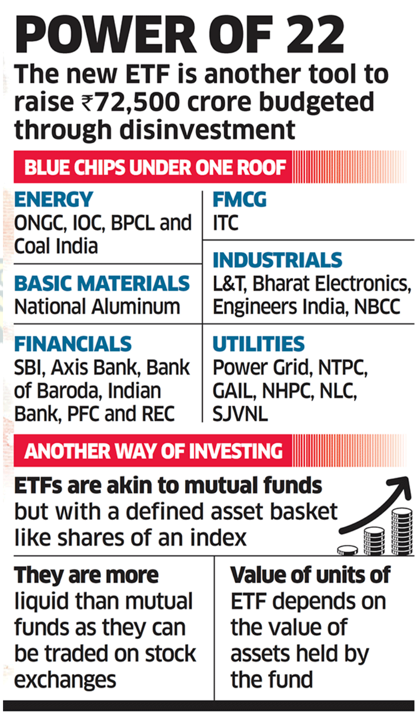
372. Exchange Traded Fund - Bharat Bond Exchange Traded Fund (ETF)

- **ETF is a basket of securities** that trade on an exchange, just like a regular stock.
- Its trading value is based on the Net Asset Value (NAV) of the underlying stocks (such as shares) that it represents.
- ETF share prices fluctuate all day as it is bought and sold. This is **different from mutual funds** that only trade once a day after the market closes.
- An ETF can own hundreds or thousands of stocks across various industries, or it could be isolated to one particular industry or sector.
- ETFs offer a **diversified investment portfolio to investors**, offer low expense ratios, fewer broker **commissions** than buying the stocks individually and **more liquid** when compared to mutual funds.

- ETFs can contain all types of investments including stocks, commodities, or bonds;
    - **Bond ETFs** are a type of ETFs which may include government bonds, corporate bonds, and state and local bonds—called municipal bonds.
    - **Industry ETFs** track a particular industry such as technology, banking, or the oil and gas sector.
    - **Commodity ETFs** invest in commodities including crude oil or gold.
    - **Currency ETFs** invest in foreign currencies such as the Euro or Canadian dollar.
    - **Inverse ETFs** attempt to earn gains from stock declines by shorting stocks. Shorting is selling a stock, expecting a decline in value, and repurchasing it at a lower price.

Bharat 22 Exchange Traded Fund (ETF)

- Bharat 22 is an ETF that will track the performance of 22 stocks, which the government plans disinvest.
- It is launched by the government by incorporating shares of different listed companies.
- The issued units are listed on exchanges for anyone to buy or sell at the quoted price.
- The B22 will span six sectors, such as basic materials, energy, finance, FMCG, industrials and utilities.
- Besides public sector banks, miners, construction companies, and energy majors, the ETF will also include some of the government's holdings in SUUTI (Specified Undertaking of Unit Trust of India).
- Bharat 22 ETF is managed by **ICICI Prudential Mutual Fund.**
- The foundation of Bharat 22 ETF was laid by the government in the **Union Budget 2017.**



Benefits of Bharat 22 ETF

- The ETF mechanism has proven to be a smart, effective way for the government to help meet its disinvestment targets.
- It is a key factor to keep fiscal deficit under control.
- The ETF route provides a neat workaround by letting the government pare small stakes (2-3 per cent) in a big basket.

373. Derivatives

- Derivatives are products whose value is derived from the value of one or more basic variables, which are called **Underlying Assets**.
- The underlying asset can be equity, index, foreign exchange (Forex), commodity or any other asset.
- The derivative itself is a contract between two or more parties, and the derivative derives its price from fluctuations in the underlying asset.
- The most common underlying assets for derivatives are stocks, bonds, commodities, currencies, interest rates, and market indexes. These assets are commonly purchased through brokerages.
- Commodity-linked derivatives remained the sole derivatives for almost three hundred years. But after 1970s, the financial derivatives came into spotlight.
- Most derivatives are not traded on exchanges and are used by institutions (over-the- counter exchange) to hedge risk or speculate on price changes in the underlying asset.
- Exchange-traded derivatives like futures or stock options are standardized and eliminate or reduce many of the risks of over-the-counter derivatives

Futures

- They are an agreement between two parties for the purchase and delivery of an asset at an **agreed upon price at a future date**.
- Traders will use a futures contract to hedge their risk or speculate on the price of an underlying asset.
- The parties involved in the futures transaction are obligated to fulfill a commitment to buy or sell the underlying asset.
- For example, say that Jan 1st, 2021, Company-A buys a futures contract for oil at a price of $62 per barrel that expires Feb 14th 2021.
  - The company does this because it needs oil in Feb and is concerned that the price will rise before the company needs to buy.
  - Buying an oil futures contract protects the company's risk because the seller on the other side of the contract is obligated to deliver oil to Company-A for $62 per barrel once the contract has expired.
  - Assume oil prices rise to $80 per barrel by Feb 14, 2021, Company-A can accept delivery of the oil from the seller of the futures contract at $62 per barrel.
  - However, if Company-A no longer needs the oil, it can also **sell the contract before expiration** and keep the profits.

Options

- An options contract is similar to a futures contract in that it is an agreement between two parties to buy or sell an asset at a predetermined future date for a specific price.
- The key difference between options and futures is that, with an option, **the buyer is not obliged** to exercise their agreement to buy or sell.
- It is an opportunity only, not an obligation—futures are obligations.

Example of Currency Derivative

Imagine a European investor, whose investment accounts are all denominated in euros (EUR). This investor purchases shares of a U.S. company through a U.S. exchange using U.S. dollars (USD). Now the investor is exposed to exchange-rate risk while holding that stock. Exchange-rate risk the threat that the value of the euro will increase in relation to the USD. If the value of the euro rises, any profits the investor realizes upon selling the stock become less valuable when they are converted into euros.

To hedge this risk, the investor could purchase a currency derivative to lock in a specific exchange rate.

374. Small Finance Bank

- Small Finance Banks are the financial institutions which provide financial services to the unserved and unbanked region of the country.
- They are registered as a public limited company under the Companies Act, 2013.
- The objectives of setting up of small finance banks are as follows:
    - To further the aim of financial inclusion by providing an avenue of savings for the general masses
    - To ensure the supply of credit for small business units, small and marginal farmers, micro and small industries; and other unorganised sector entities is maintained.
    - To provide an institutional mechanism for promoting rural and semi-urban savings and for providing credit for viable economic activities in the local areas.
- They are governed by the provisions of Reserve Bank of India Act, 1934, Banking Regulation Act, 1949 and other relevant statutes.
- The banks will not be restricted to any region.

Eligibility Criteria:

- **Resident individuals/professionals, singly or jointly,** each having at least **10 years of experience** in banking and finance and having successful track record of running their businesses for at least a period of **five years,** will be eligible as promoters to set up small finance banks.
- Existing Non-Banking Finance Companies **(NBFCs),** Micro Finance Institutions **(MFIs**), and Local Area Banks **(LABs)** in the private sector, **Primary (Urban) Co-operative Banks (UCBs)** can also opt for conversion into small finance banks.
- The minimum net worth of such small finance banks shall be Rs. 100 crore from the date of commencement of business. However, they will have to increase their minimum net worth to Rs. 200 crore within five years from the date of commencement of business.
- Promoter must contribute minimum 40% equity capital and should be brought down to 30% in 10 years.

Scope of Activities

- Take small deposits and disburse loans.
- Distribute mutual funds, insurance products and other simple third-party financial products.
    - With the prior approval of the RBI and after complying with the requirements of the sectoral regulator for such products
- **Lend 75%** of their total adjusted net bank credit to **priority sector.**
- Maximum loan size would be 10% of capital funds to single borrower, 15% to a group.
- At least 50% of its loan portfolio should constitute loans and advances of up to Rs. 25 lakh.
- The small finance bank can also become an **Authorised Dealer in foreign exchange** business for its clients' requirements.
- SFBs need to maintain a **Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR**).
- In view of the inherent risk of a small finance bank, it shall be required to maintain a **minimum capital adequacy ratio of 15% of its risk-weighted assets (RWA)** on a continuous basis, subject to any higher percentage as may be prescribed by RBI from time to time.

Activities that are not allowed

- Lend to big corporates and groups.
- Cannot open branches with prior RBI approval for first five years.

- Other financial activities of the promoter must not mingle with the bank.
- It cannot set up subsidiaries to undertake non-banking financial services activities.
- They cannot be a Business Correspondent (BC) for another bank. However, they can have their own BC network

Foreign Shareholding

- FDI Limit is as per **Foreign Direct Investment (FDI) policy f**or private sector banks. Currently, the aggregate FDI in a private sector bank from all sources will be allowed up to a **maximum of 74% of the paid-up capital** of the bank.
- In the case of Foreign Institutional Investors (FIIs)/Foreign Portfolio Investors (FPIs), individual FII/FPI holding is restricted to below 10% of the total paid-up capital.
- The aggregate limit for all FIIs/FPIs/Qualified Foreign Investors (QFIs) cannot exceed 24% of the total paid-up capital. The limit can be raised to 49% through resolution by its Board of Directors followed by a special resolution to that effect by its General Body.

375. Payment Bank

- There are two kinds of banking licences that are granted by the Reserve Bank of India - universal bank licence and **differentiated bank licence.**
- Payments bank comes under a differentiated bank licence since it cannot offer all the services that a commercial bank offers.
- The banking system where the need of a certain demographic segment of the population is met is called differentiated banking (Example Small Finance Bank & Payments Bank)

Scope of Activities

- Payments and remittance services can be provided through this banks
- Acceptance of demand deposits, initially restricted to holding a maximum balance of Rs 100,000 per individual customer.
- A payments bank **cannot lend.**
- It can issue debit cards but **not credit cards.**
- Distribution of non-risk sharing **simple financial products** like mutual fund units and insurance products, etc.
- They are only **allowed to invest** the money received from customers' deposits into government securities.
- They **cannot accept NRI deposits**.
- A payments bank account holder would be able to deposit and **withdraw money through any ATM** or other service providers.
- It will be registered as a public limited company under the Companies Act, 2013.
- Payments licensees would be granted to mobile firms, supermarket chains and others to cater to individuals and small businesses.

Regulation

- It is governed by the provisions of the Banking Regulation Act, 1949; RBI Act, 1934; Foreign Exchange Management Act, 1999, Payment and Settlement Systems Act, 2007, other relevant Statutes and Directives.
- They need to maintain a **Cash Reserve Ratio (CRR).**
- Required to invest a minimum **75%** of its "demand deposit balances" in **Statutory Liquidity Ratio (SLR)** in eligible Government securities.

- Need to hold maximum 25% in current and time/fixed deposits with other scheduled commercial banks for operational purposes and liquidity management.
- The minimum paid-up capital for payments bank is Rs 100 crore. Minimum initial contribution to the paid-up equity capital shall at least be 40% for the first five years from the commencement of its business.

376. Regional Rural Bank (RRB)

Background

- In the early 1970s, there was a feeling that even after Bank Nationalization in 1969, there were issues which made it difficult for commercial banks, even under government ownership, to lend to farmers.
- This issue was taken up by government and it set up **Narasimham Working Group** in 1975.
- On the basis of this committee's recommendations, RRB Ordinance was promulgated in September 1975, which was replaced by the RRB Act 1976.
- Regional Rural Banks came into existence on Gandhi Jayanti in 1975 with the formation of a Prathama Grameen Bank.

About RRBs

- RRBs are financial institutions which ensure adequate **credit for agriculture and other rural sectors.** They were conceived as low cost institutions having a rural ethos, local feel and pro poor focus.
- Every RRB was to be sponsored by a "Public Sector Bank", however, they were planned as the self-sustaining credit institution which were able to refinance their internal resources in themselves and were excepted from the statutory pre-emptions.
- The RRBs were owned by three entities with their respective shares as follows:
  - Central Government → 50%
  - State government → 15%
  - Sponsor bank → 35%
- The RRBs combine the characteristics of a cooperative in terms of the familiarity of the rural problems and a commercial bank in terms of its professionalism and ability to mobilise financial resources.
- Each RRB operates within the local limits as notified by the Government.
- The main objectives of RRBs are
  - To provide credit and other facilities to the small and marginal farmers, agricultural labourers, artisans and small entrepreneurs in rural areas.
  - To check the outflow of rural deposits to urban areas and reduce regional imbalances and increase rural employment generation.
  - The RRBs are required to provide 75% of their total credit as priority sector lending.
- Sponsor Bank have the power of managerial and operational supervision of the RRBs.
- Whereas, Performance monitoring and regulatory supervision is done by **NABARD**.
- In 1975, the number of total **Regional Rural Banks is only 6.** It was increased to maximum with 196 banks in 1990.
- Due to the financial crisis and poor performance by the RRBs, **some of the banks were merged with some other RRBs.** Finally the number of RRBs is 56 now.
- The recapitalisation process of RRBs was approved by the cabinet in 2011 based on the recommendations of a committee set up under the **Chairmanship of K C Chakrabarty.**
  - The National Bank for Agriculture and Rural Development (NABARD) identifies those RRBs, which require recapitalisation assistance to maintain the mandatory CRAR of 9% based on the CRAR position of RRBs, as on 31st March of every year.
  - The scheme for recapitalization of RRBs was extended up to 2019-20 in a phased manner post 2011.
  - CRAR or Capital Adequacy Ratio (CAR) is the ratio of a bank's capital in relation to its risk weighted assets and current liabilities.

377. Municipal Bonds

Context: Recently, Rs. 200-crore worth Lucknow Municipal Corporation (LMC) bonds have been listed on the Bombay Stock Exchange (BSE).

About Municipal Bonds:

- A **municipal bond (muni)** is a **debt security issued by a state, municipality or county** to **finance its capital expenditures,** including the construction of highways, bridges or schools.
  - Through muni bonds, a municipal corporation raises money from individuals or institutions and promises to pay a **specified amount of interest** and returns the **principal amount** on a specific maturity date.
- These are mostly **exempt from federal taxes and from most state and local taxes,** making them especially attractive to people in high income tax brackets.
- Municipal Bonds can help the **Urban Local Bodies (ULBs)** to garner revenue to complete budgetary projects as property tax is the only major source of municipal revenue.
- Municipal bonds that are issued to the public are rated by renowned agencies such as CRISIL, which allows investors **transparency** regarding the credibility of the investment option.
- Government bonds like Municipal Bonds are usually viewed as low-risk investments, because the likelihood of a government defaulting on its loan payment tends to be low.
- Bangalore Municipal Corporation was the first urban local body (ULB) to issue Municipal Bond in India in 1997.

There are two types of municipal bonds

- **General obligation bonds** are issued for enhancing civic amenities such as water, sanitation, garbage disposal, etc. They generally are not backed by revenue from a specific project.
- **Revenue bonds** are issued for a specific purpose such as construction of a toll road or a toll bridge.

As per the SEBI Regulations, 2015, a municipality or a Corporate Municipal Entity (CME) to issue **Municipal Bonds should meet certain conditions:**

- The ULB should **not have negative net worth** in any of three immediately preceding financial years.
- The municipality **should not have defaulted** in repayment of debt securities or loans obtained from banks or financial institutions during the last 365 days.
- Municipalities need to contribute at **least 20% of the project cost.**
- The corporate municipal entity, its promoter, group company or director(s), should not have been named in the **list of the willful defaulters** published by the RBI
- Should not have defaulted on payment of interest or repayment of principal amount in **respect of debt instruments** issued by it to the public, if any.
- Municipal bonds should have mandatory ratings **above investment grade for public issue.**

378. Securities Appellate Tribunal (SAT)

- SAT is a **statutory body** established under the provisions of Section 15K of the **SEBI Act, 1992.**
- **Functions of SAT:**
  - To hear and dispose of **appeals** against orders passed by the **SEBI** or by an adjudicating officer under the SEBI Act,1992.
  - To hear and dispose of appeals against orders passed by the Pension Fund Regulatory and Development Authority **(PFRDA).**
  - To hear and dispose of appeals against orders passed by the Insurance Regulatory Development Authority of India **(IRDAI).**

- SAT has the **same powers as vested in a civil court.** Further, if any person feels aggrieved by SAT's decision or order can appeal to the **Supreme Court.**
- SAT consists of a Presiding Officer and Two other members.
  - The Presiding officer of SAT shall be appointed by the Central Government in consultation with the Chief Justice of India or his nominee.
- Location of SAT: Mumbai

Securities and Exchange Board of India

- Initially, SEBI was a non-statutory body. In April, 1988 the SEBI was constituted as the regulator of capital markets in India under a resolution of the Government of India.
- It was given statutory status by enacting **SEBI Act, 1992.**
- Headquarters is in **Mumbai** and regional offices are located in Ahmedabad, Kolkata, Chennai and Delhi.
- SEBI is a quasi-legislative, quasi-judicial and quasi-executive body. It can draft regulations, conduct inquiries, pass rulings and impose penalties.
- **Functions of SEBI:**
  - To protect the interests of investors in securities and to promote and regulate the securities market.
  - There are primarily three types of securities: equity—which provides ownership rights to holders; debt—essentially loans repaid with periodic payments; and hybrids—which combine aspects of debt and equity.
  - Registering and regulating the working of stock brokers, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities markets in any manner.

379. RBI's Retail Direct scheme

In news The RBI has announced a scheme under which retail investors will be allowed to open retail direct gilt accounts (RDG) directly with the central bank

- A "**Gilt Account**" **means** an **account** opened and maintained for holding Government securities, by an entity or a person.
- It will provide registered users **access to primary issuance** of government securities (G-secs) and to **NDS-OM** (Negotiated dealing system – Order Matching Segment).
  - **NDS-OM means RBI's** screen based, anonymous electronic order matching system for trading in government securities in the secondary market.
- This will provide **one-stop solution** to facilitate investment in G-secs by individual investors.
- **No fee** will be charged for opening and maintaining the account with the RBI.
- **Non-Resident retail investors** eligible to invest in government securities under Foreign Exchange Management Act, 1999 are also eligible under the scheme.

G-Secs

- G-secs are **debt instruments** issued by the government to borrow money.
- Like bank fixed deposits, g-secs are not tax-free.
- They are generally considered the safest form of investment because they are backed by the government. So, the risk of default is almost nil.
- However, they are subject to fluctuations in interest rates. So, they are not completely risk-free.
- Such securities are **short term** (treasury bills having maturity period of 91 day, 182 day and 364 day) or **long term** (Government bonds with maturity of one year or more).

- In India, the Central Government issues both treasury bills and bonds or dated securities while the State Governments issue only bonds or dated securities, which are called the **State Development Loans (SDL)**
- When Government issues its securities first time **(Primary Market)** then authorized institutions are allowed to purchase G-secs. These institutions are called Primary dealers which include banks and finance related companies.
- Once these have purchased the G-secs, other institutions such as RBI, Banks, NBFCs can purchase these securities in the **secondary market**
- Few years back, RBI allowed individuals (retail investors) to participate in primary market as well as secondary market but not directly rather through other institutions. But now retail investors will be able to buy directly under RBI's Retail Direct scheme

380. Negative yield Bond

Context: China sold negative-yield debt for the first time. 5-year bond was priced with a yield of –0.152%, and the 10-year and 15-year securities with positive yields of 0.318% and 0.664%.

- Bond is an instrument to borrow money. A bond could be floated/issued by a country's government or by a company to raise funds.
- The yield of a bond is the effective rate of return that it earns.
    - Generally, investors purchase the bonds at their **face value,** which is the principal amount invested. In return, **investors typically earn a yield** of a bond.
    - Each bond has a **maturity date,** which is when the investor gets paid back the **principal amount.**
- Negative-yield Bonds are debt instruments that offer to pay the investor a maturity amount lower than the purchase price of the bond.
    - Usually, an investor, for example, will buy a bond at Rs. 100 and receive the Rs. 110 face value at maturity. In the case of negative yield bonds an investor will buy such bonds at Rs 110 and get back Rs 100 upon maturity.
- Therefore, **investors pay interest to the borrower to keep their money with them** (Bond issuers).

Why do Investors buy such bonds?

- Such instruments are usually in demand during times of stress and uncertainty. This is to protect **their capital from significant erosion.**
- From currency fluctuations to deflation, there are scenarios in which purchasers of negative-yield bonds can come out ahead.
- Many investors could also be temporarily parking money in negative-yielding government debt for the purpose of **hedging their risk portfolio in equities.**

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381. Small & Medium Industry

Erstwhile MSME Classification **Criteria: Investment in Plant and Machinery/Equipment**			
Classification	**Micro**	**Small**	**Medium**
Manufacturing Enterprises	Investment not more than INR 25 lakhs	Investment not more than INR 5 crores	Investment not more than INR 10 crores
Enterprises rendering Services	Investment not more than INR 10 lakhs	Investment not more than INR 2 crores	Investment not more than INR 5 crores

Revised MSME Classification (w.e.f. July 1, 2020) **Composite Criteria: Investment in Plant and Machinery/Equipment and Annual Turnover**			
Classification	**Micro**	**Small**	**Medium**
Manufacturing Enterprises **and** Enterprises rendering **Services**	Investment in P&M/Equipment not more than INR 1 crore and Annual Turnover not more than INR **5 crores**	Investment in P&M/Equipment not more than INR 10 crores and Annual Turnover not more than **INR 50 crores**	Investment in P&M/Equipment not more than INR 50 crores & Annual Turnover not more than **INR 250 crores**

MSMEs in News

- The Ministry of Corporate Affairs has expanded the turnover and borrowing thresholds for Small and Medium-sized Companies (SMC), allowing a larger number of firms to benefit from reporting exemptions under accounting norms.

What is the change?

- The MCA has increased the turnover threshold for SMCs to Rs 250 crore from Rs 50 crore, and the borrowing threshold to Rs 50 crore from Rs 10 crore.
- SMCs are permitted to avail a number of exemptions under the Company (Accounting Standards) Rule 2021 to reduce the complexity of regulatory filings for smaller firms.
- Banks, financial institutions, insurance companies, and listed companies cannot be classified as SMCs.
- Further, any company which is either the holding company or subsidiary of a company that is not an SMC cannot be classified as an SMC.

What are the exemptions available to SMCs that are not available to other firms?

- SMC are completely exempted from having to file **cash flow statements** and provide a segmental break up of their financial performance in mandatory filings.
- SMCs are exempted from having to provide a detailed analysis of **benefit obligations to employees**, but are still required to provide actuarial assumptions used in valuing the company's obligations to employees.
- SMCs are also exempted from having to report **diluted earnings per share** in their filings.

- Diluted earnings per share reflect the per-share earnings of a company assuming that all options to convert other securities into shares are exercised.

How does this impact these firms?

- The move would promote ease of doing business for the firms that would now be included under the definition of SMC.
- The Accounting Standards for SMC, which were notified in December 2006 and amended from time to time, are much simpler as compared to Indian Accounting Standards (Ind AS). These accounting standards involve less complexity in its application, including the number of required disclosures being less onerous
    - **Ind AS standards** are applied to larger firms, and are largely similar to International Financial Reporting Standards (IFRS) used in most developed jurisdictions.

382. Short Sell — and Short Squeeze

- Short selling is a fairly simple concept—an investor borrows a stock, **sells the stock, and then buys the stock back** to return it to the lender.
- Short sellers are betting that the stock they sell will drop in price. If the stock does drop after selling, the short seller buys it back at a lower price and returns it to the lender. The difference between the sell price and the buy price is the profit.
- Short-sellers bet on, and profit from, a drop in a security's price. This can be contrasted with long investors who want the price to go up.
- Short selling, when it is successful, can net the investor a nice profit in the short term as stocks tend to lose value faster

For example, if an investor thinks that Reliance Industries (RIL) stock is overvalued at ₹ 2100 per share, and is going to drop in price, the investor may "borrow" 10 shares of RIL from their broker, who then sells it for the current market price of ₹2100 per share. If the stock goes down to ₹1900, the investor could buy the 10 shares back at this price, return the shares to their broker, and net a profit of ₹2000 (₹21,000- ₹19,000). However, if the RIL price rises to ₹2200, the investor would lose ₹1000 (₹21,000- ₹22,000)

The process of locating shares that can be borrowed and returning them at the end of the trade is handled behind the scenes by the broker

What is a Squeeze:

- It occurs when large numbers of traders are forced out of the market due to the **price moving against them.**
- The triggering event for a squeeze can be unexpected news or any other.
- The name comes from the fact that many traders are trying to squeeze out of the **same exit at the same time.**

Short Squeeze

- Short squeeze is a term used by market participants to refer to a phenomenon where short sellers in a stock who have placed their bets on a stock's fall, rush to hedge their positions or buy the stock in the event of an adverse price movement, in order to cover their losses.
- This leads to a sharp rise in demand for the share, and huge rally in share prices.

Long Squeeze

- A long squeeze is a situation in which investors who hold long positions feel the need to sell into a falling market to cut their losses.
- This pressure to sell usually leads to a further decline in market prices.

383. Micro ATM

- A Micro ATM is a device that is used by a million Business Correspondents (BC) to deliver basic banking services.
- The platform will enable Business Correspondents (who could be a local kirana shop owner and will act as 'micro ATM') to conduct instant transactions.
- The micro platform will enable function through low cost devices that will be connected to banks across the country.
- This would enable a person **to instantly deposit or withdraw funds** regardless of the bank associated with a particular BC.
- This device will be based on a mobile phone connection and would be made available at every BC. Customers would just have to get their identity authenticated (finger print) and withdraw or put money into their bank accounts.
- This money will come from the cash drawer of the BC. Essentially, BCs will act as bank for the customers and all they need to do is verify the authenticity of customer using customers' UID (Ex: Finger print through Aadhar authentication).
- The basic transaction types, to be supported by micro-ATM, are Deposit, Withdrawal, Fund transfer and Balance enquiry.
- Micro ATMs are also card swipe machines through merchant transactions can take place. This machine comes with a **fingerprint scanner** attached to it

384. Convertible and Non-Convertible debentures

- Debentures are referred to as a type of long term debt instrument that is not backed by any collateral. In other words, debentures are not secured or lack any kind of security.
- Along with bonds, debentures are one of the most popular debt instruments.
- There are different categories of debentures based on properties such as convertibility, redeemability, transferability, etc.
- Based on convertibility, there are two kinds of debentures which are convertible and non-convertible debentures.

	Convertible Debentures	Non-convertible debentures
Definition	They are debentures that can be converted into equity shares of the company	These are debentures that cannot be converted into equity shares of the company
Rate of Interest	Usually low rate of interest	High rate of interest
Value at maturity	The value of maturity of convertible debentures is dependent on the stock price of the company at that time, which means a high stock price will give higher returns while a low stock price will give low returns	The value of non-convertible debentures is fixed and hence they will receive fixed returns on maturity
Effect of market	During bad market conditions, the holders of the convertible debentures have the	During bad market conditions, the non-convertible debentures cannot be converted

conditions	option to convert into equity shares	and can only be redeemed at maturity
Status	Holders of the convertible debentures enjoy dual status as they can be creditor as well as owner of the company	Holders of the non-convertible debentures are only creditors of the company
Risk factor	Less Risky	Riskier compared to convertible debenture

385. Domestic Systematically Important Insurers (DSIIS) and DSIBs

- The Life Insurance Corporation of India (LIC), General Insurance Corporation of India and The New India Assurance Co have been identified as Domestic Systemically Important Insurers (D-SIIs) for 2020-21 by insurance regulator,IRDAI
- The IRDAI would identify D-SIIs on an **annual basis** and disclose the names of such insurers for public information

Domestic Systemically Important Insurers (DSII):

- D-SIIs refer to insurers of such size, market importance and domestic and global interconnectedness whose distress or failure would cause a significant dislocation in the domestic financial system.
- D-SIIs are perceived as insurers that are **'too big or too important to fail' (TBTF)**.
- Thus, the continued functioning of D-SIIs is critical for the uninterrupted availability of insurance services to the national economy.
- D-SIIs are subjected to **additional regulatory measures** to deal with the systemic risks and moral hazard issues.
    - **Systemic risk** is the possibility that an event at the company level could trigger severe instability or collapse an entire industry or economy.
    - **Moral hazard** is a situation in which one party gets involved in a risky event knowing that it is protected against the risk and the other party will incur the cost. It arises when both the parties have incomplete information about each other.

Domestic Systemically Important Bank (D-SIBs)

- D-SIB means that the bank is **too big to fail.**
- According to the Reserve Bank of India (RBI), some banks become systemically important due to their size, cross-jurisdictional activities, complexity and lack of substitute and interconnection. Banks whose **assets exceed 2% of GDP** are considered part of this group.
- Presently, the State Bank of India (**SBI), ICICI Bank, and HDFC Bank** have been identified as DSIBs in India.
- Significance:
    - Should such a bank fail, there would be significant disruption to the essential services they provide to the banking system and the overall economy.
    - The too-big-to-fail tag also indicates that in **case of distress, the government is expected to support these banks.**
    - Due to this perception, these banks enjoy certain advantages in funding. It also means that these banks have a different set of policy measures regarding systemic risks and moral hazard issues.

386. IPO and FPO & Qualified Institutional Placements

- Initial public offering or IPO is the first time a company goes public. When we say a company has gone public, it means it has offered its shares to the public at large and is ready to get listed at the stock exchanges of the country.
- We have two exchanges: Bombay Stock Exchange (BSE) and National Stock Exchange (NSE). The first time a company gets listed at BSE, NSE, or both and offers its shares to be publicly traded the offering is called an IPO.

FPO

- A follow-on public offer (FPO) is the issuance of shares to investors by a company that has already been listed on a stock exchange.
- A follow-on offering is an issuance of additional shares made by a company after an initial public offering (IPO).
- Follow-on offerings are also known as secondary offerings.
- Companies usually announce FPOs to raise equity or reduce debt.
- The two main types of FPOs are
    - **Dilutive FPO:** In dilutive FPO, the company issues an **additional number of shares** in the market for the public to buy however the value of the company remains the same. This reduces the price of shares and automatically reduces the earnings per share also.
    - **Non-dilutive FPO:** Here larger shareholders of the company like the board of directors or founders sell their privately held shares in the market. This technique **does not increase the number of shares** for the company, just the number of shares available for the public increases.
- An at-the-market offering (ATM) is a type of FPO by which a company can offer secondary public shares on any given day, usually depending on the prevailing market price, to raise capital.

	IPO	FPO
Meaning	The first issue of shares by a company	Issuance of shares by a company to raise additional capital after IPO
Price	Fixed or variable price range	Price is market driven and dependent on number of shares increasing or decreasing
Share capital	Increases because the company issues fresh capital to the public for listing.	Number of shares increases in dilutive FPO and remains the same in non-dilutive FPO
Value	Expensive	Cheaper in most cases because the value of the company is getting further diluted.
Risk	Riskier	Comparatively less risky
Status of the company	An unlisted company issues an IPO	An already listed company issues an FPO

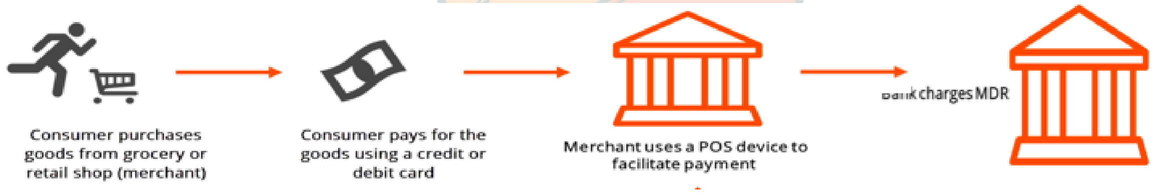
Qualified Institutional Placements

- A QIP is a capital raising tool wherein a **listed company** can issue equity shares, fully and partly convertible debentures, or any security (other than warrants) that is convertible to equity shares.
- It is a **method of private placement** whereby a listed company can issue shares or convertible securities to a **select group of investors**.
- The only parties eligible to purchase QIPs are **qualified institutional buyers (QIBs),** which are accredited investors, as defined by SEBI

- This limitation is due to the perception that QIBs are institutions with expertise and financial power that allows them to evaluate and participate in capital markets, at that level, without the legal assurances of FPO
- QIBs include mutual funds, domestic financial institutions such as banks and insurance companies, venture capital funds, foreign institutional investors, and others.

- QIP is, at its core, a way for listed companies to **raise capital without having to submit legal paperwork to market regulators**
  - QIPs follows a looser set of regulations but here allottees (QIBs) are more highly regulated.
- The primary reason for developing QIPs was to **keep India from depending too much on foreign capital** to fund its economic growth.
  - Before the QIP, there was a growing concern from Indian regulators that its domestic companies were accessing international funding too readily via American depository receipts (ADRs), foreign currency convertible bonds (FCCBs) and global depository receipts (GDR), rather than Indian-based capital sources.
- QIPs are helpful for a few reasons. Their use saves time as the issuance of QIPs and the access to capital is far quicker than through a follow-on public offer(FPO).

387. Merchant Discount Rate



- MDR is the cost paid by a merchant to a bank for accepting payment from their customers via digital means. The merchant discount rate is usually expressed in percentage of the transaction amount.
- Presently, it is applicable for online transactions and QR-based transactions.
- The amount that the merchant pays for every transaction gets distributed among three stakeholders—
  - The bank that enables the transaction,
  - Vendor that installs the point of sale (PoS) machine
  - The card network provider such as Visa, MasterCard, RuPay
- Merchant Discount Rate is also alternatively referred to as the Transaction Discount Rate.
- In June 2020, the government has mandated that neither the customers nor the merchants will have to pay the MDR while transacting digital payments **using BHIM UPI, UPI QR Code, Aadhaar Pay, Debit Cards, NEFT, RTGS, among others.**
  - Contrary to public perception, the MDR has not been made zero. The FM's decision has just shifted its incidence on to the RBI and banks.

388. LIBOR & SONIA

- **News:** Reserve Bank of India (RBI) issued an advisory to banks and other regulated entities on, emphasising the need for them to stop signing new financial contracts that reference the London Interbank Offered Rate (LIBOR) as a benchmark.

About LIBOR

- The London Interbank Offered Rate (LIBOR) is a benchmark interest rate at which major global banks lend to one another in the **international interbank market** for short-term loans
- It is the interest rate average submitted by **leading UK banks.**

- It indicates borrowing costs between banks
- The rate is calculated and will continue to be published each day by the Intercontinental Exchange (ICE), but due to recent scandals and questions around its validity as a benchmark rate, it is being phased out.
- According to the Federal Reserve and regulators in the UK, **LIBOR will be phased out by June 30, 2023,** and will be replaced by the Secured Overnight Financing Rate (SOFR).

Secured overnight financing rate (SOFR

- It is a benchmark interest rate for dollar-denominated derivatives and loans that is replacing the London interbank offered rate (LIBOR).
- SOFR is based on transactions in the Treasury repurchase market and is seen as preferable to LIBOR since it is based on data from **observable transactions** rather than on estimated borrowing rates.
- While SOFR is becoming the benchmark rate for dollar-denominated derivatives and loans, other countries have sought their own alternative rates, such as SONIA

About SONIA

- **SONIA** is short for 'Sterling Overnight Interbank Average Rate'.
- It is the **effective overnight interest rate** paid by the banks **for unsecured transactions in the British sterling market**.
- It is used for overnight funding for trades that occur in off-hours and represents the depth of overnight business in the marketplace.
- The SONIA rate is based on **actual overnight interest rates** in active and liquid wholesale cash markets. It is administered by the Bank of England
- LIBOR is based on estimates, not actual transactions, of surveyed global banks whereas SONIA is based on actual transactions and vetted by the Bank of England, giving it a greater credibility.
- Another key difference is that LIBOR is forward-looking – it is agreed at the **start of an interest period.** SONIA is backward-looking – it cannot be determined until the **end of an agreed interest period**
- SONIA is also (virtually) risk free as it does not incorporate any **credit risk/liquidity premium** which is inherent in the calculation of LIBOR because LIBOR is predicated on banks lending to each other over **longer time periods.**

389. Circuit Breaker

- Circuit breakers are mechanism to prevent markets from crashing, which happens when market participants start to panic sell their stocks.
- The index based market-wide circuit breaker system was introduced by the SEBI (Securities and Exchange Board of India) in 2001.
- The circuit breakers brings about a coordinated halt in the trade of equities and equity derivative markets. The system is applied differently at 3 stages of the index movement:
    - When the index falls >10% before 1PM: trading is halted for 45 minutes.
    - When index falls >15% on or after 2PM: trading is halted for remainder of the day.
    - When index falls >20% at any time of the day: trading is halted for remainder of the day.

390. Offshore Rupee Market

News: The Reserve Bank of India allowed offshore units of Indian banks to participate in the offshore rupee derivative market to curtail volatility in currency markets

About Offshore Rupee Market

- Currency trading in the domestic market is quite straight forward. You can trade in currency derivatives in NSE or BSE exchanges. When currencies are sold within the local market, it is called an onshore market.
- The onshore market is regulated and monitored by market regulators like RBI and SEBI.
- But when foreign currencies or Indian Rupee based derivatives are exchanged in the overseas market, it's called offshore market.
- Trading in a foreign location makes it particularly challenging for regulators like RBI and SEBI to monitor, which is why the regulators are wary of offshore currency trading.

Key Changes announced by RBI are:

- Banks will now be allowed to participate in the offshore Rupee derivative market. Till now it has primarily been **dominated by offshore traders** in the Indian foreign exchange market.
- Participants in the offshore rupee market can bet on the direction of the Indian currency **without undergoing stringent documentation** and regulatory requirements prescribed by Indian regulators.
- It's a step in getting the rupee derivative market **back to the shores of India.**
- These steps were based on the recommendations of a task force, chaired by former deputy governor Usha Thorat, on offshore rupee markets
- It will **augment liquidity** in the offshore rupee market.
- It will help **RBI to intervene in the market** to calm down volatility.