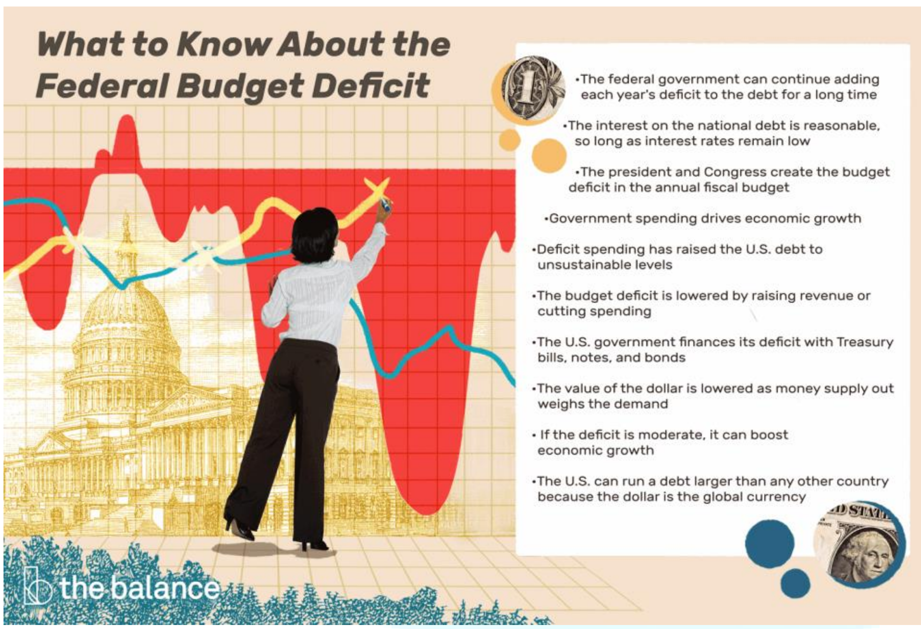
ECONOMICS MODULE 6 PART1

Fiscal, Financial and External Sector/ Issues

Fiscal Deficit, Trend and Significance



Fiscal Deficit definition:

Fiscal Deficit is the difference between the total income of the government (total taxes and non-debt capital receipts) and its total expenditure. A fiscal deficit situation occurs when the government’s expenditure exceeds its income.

This difference is calculated both in absolute terms and also as a percentage of the Gross Domestic Product (GDP) of the country. A recurring high fiscal deficit means that the government has been spending beyond its means.

What do you mean by Fiscal Deficit?

The government describes the 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".

What constitutes the government's total income or receipts? It has two components: revenue receipts and non-tax revenues.

1. Revenue receipts of the government

- **Corporation Tax**
- **Income Tax**
- **Custom Duties**
- **Union Excise Duties**
- **GST and taxes of Union territories.**

2. Non-tax revenues

- **Interest Receipts**
- **Dividends and Profits**
- **External Grants**
- **Other non-tax revenues**
- **Receipts of union territories**
- **Expenditures of the government:**
- **Revenue Expenditure**
- **Capital Expenditure**
- **Interest Payments**
- **Grants-in-aid for creation of capital assets**

Fiscal Deficit formula: How is Fiscal Deficit calculated?

Fiscal Deficit = Total expenditure of the government (capital and revenue expenditure) – Total income of the government (Revenue receipts + recovery of loans + other receipts)
If the total expenditure of the government exceeds its total revenue and non-revenue receipts in a financial year, then that gap is the fiscal deficit for the financial year.

The fiscal deficit is usually mentioned as a percentage of GDP. For example, if the gap between the Centre's expenditure and total income is Rs 5 lakh crore and the country's GDP is Rs 200 lakh crore, the fiscal deficit is 2.5% of the GDP.

What causes Fiscal Deficit?

Sometimes, the governments spend on handouts and other assistance to the weak and vulnerable sections of the society such as the farmers and the poor. A high fiscal deficit can also be good for the economy if the money spent goes into the creation of productive assets like highways, roads, ports and airports that boost economic growth and result in job creation.

How is Fiscal Deficit met?

The government meets the fiscal deficit by borrowing money. In a way, the total borrowing requirements of the government in a financial year is equal to the fiscal deficit in that year.

SIGNIFICANCE AND TRENDS OF FISCAL DEFICIT

Politicians and policymakers rely on fiscal deficits to expand popular policies, such as welfare programs and public works, without having to raise taxes or cut spending elsewhere in the budget. In this way, fiscal deficits also encourage politically motivated appropriations.

The fiscal deficit of the government for 2022-23 is estimated to be Rs 16,61,196 crore. The Revised Estimate for 2021-22 indicates a fiscal deficit of Rs 15,91,089 crore as against the Budget Estimate of Rs 15,06,812 crore.

The fiscal deficit for 2020-21 was 9.3 per cent of the Gross Domestic Product (GDP).

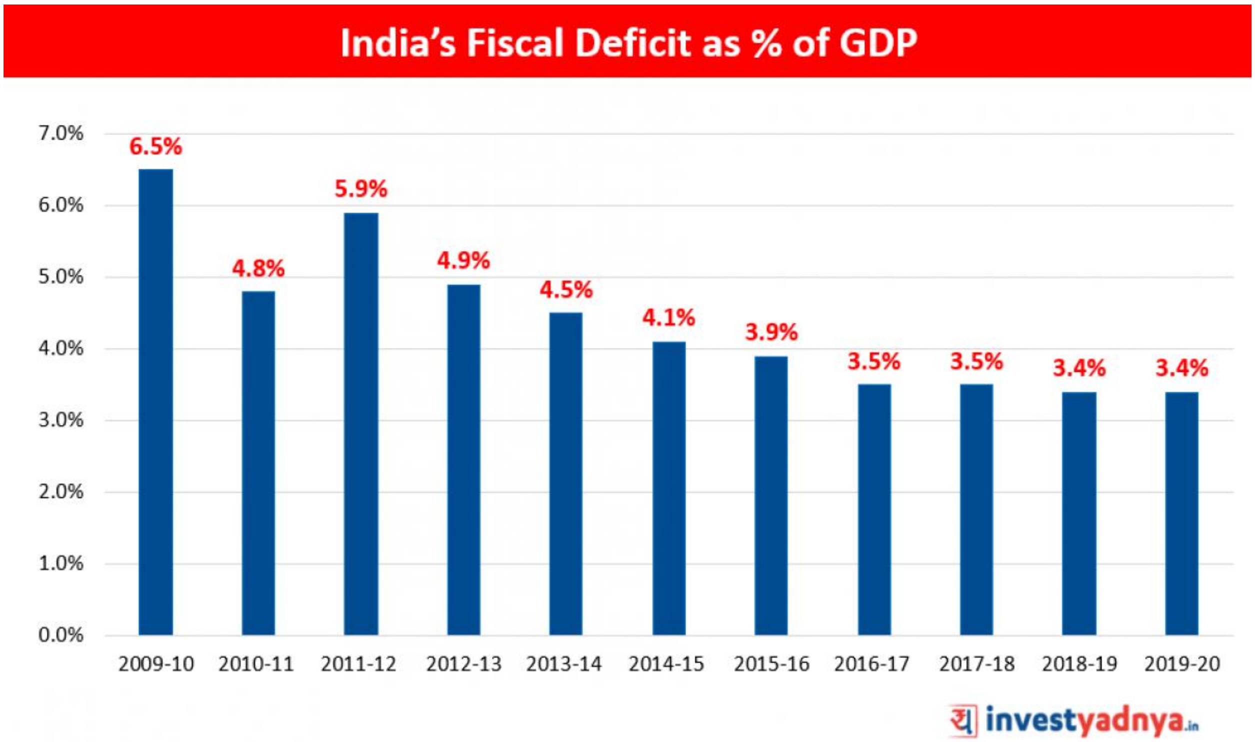


Table 2. Deficits of the Central Government as Percentage of GDP(1990-91 to 2002-03)

Years	Gross Fiscal Deficit	Revenue Deficit	Gross Primary Deficit
1990-91	7.61	3.17	3.95
1991-92	5.39	2.41	1.44
1992-93	5.19	2.4	1.17
1993-94	6.76	3.67	2.64
1994-95	5.52	2.97	1.3
1995-96	4.91	2.42	0.83
1996-97	4.7	2.3	0.51
1997-98	5.66	2.95	1.48
1998-99	6.29	3.71	1.97
1999-00	5.18	3.34	0.72
2000-01	5.46	3.91	0.9
2001-02	5.98	4.25	1.42
2002-03	5.72	4.25	1.08

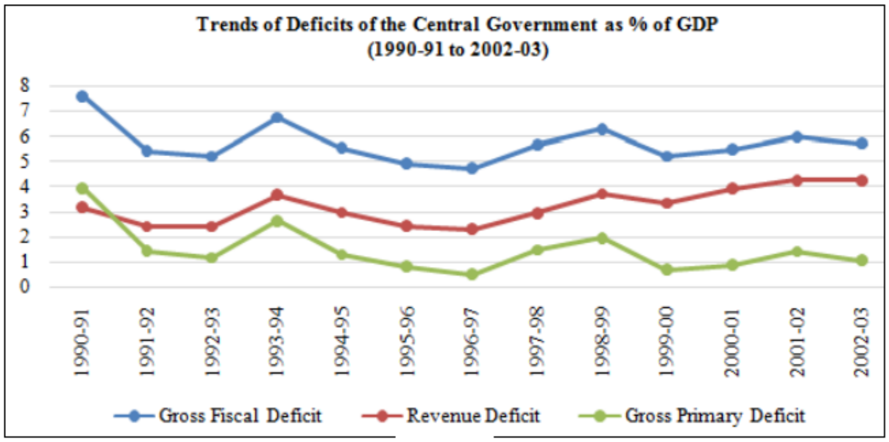


Figure 5

What Is Fiscal Policy?

Fiscal policy refers to the use of government spending and tax policies to influence economic conditions, especially macroeconomic conditions, including aggregate demand for goods and services, employment, inflation, and economic growth.

Fiscal policy is often contrasted with monetary policy, which is enacted by central bankers and not elected government officials

Understanding Fiscal Policy

Fiscal policy is largely based on the ideas of British economist John Maynard Keynes (1883-1946), who argued that economic recessions are due to a deficiency in the consumer spending and business investment components of aggregate demand. Keynes believed that governments could stabilize the business cycle and regulate economic output by adjusting spending and tax policies to make up for the shortfalls of the private sector.1

His theories were developed in response to the Great Depression, which defied classical economics' assumptions that economic swings were self-correcting. Keynes' ideas were highly influential and led to the New Deal in the U.S., which involved massive spending on public works projects and social welfare programs.

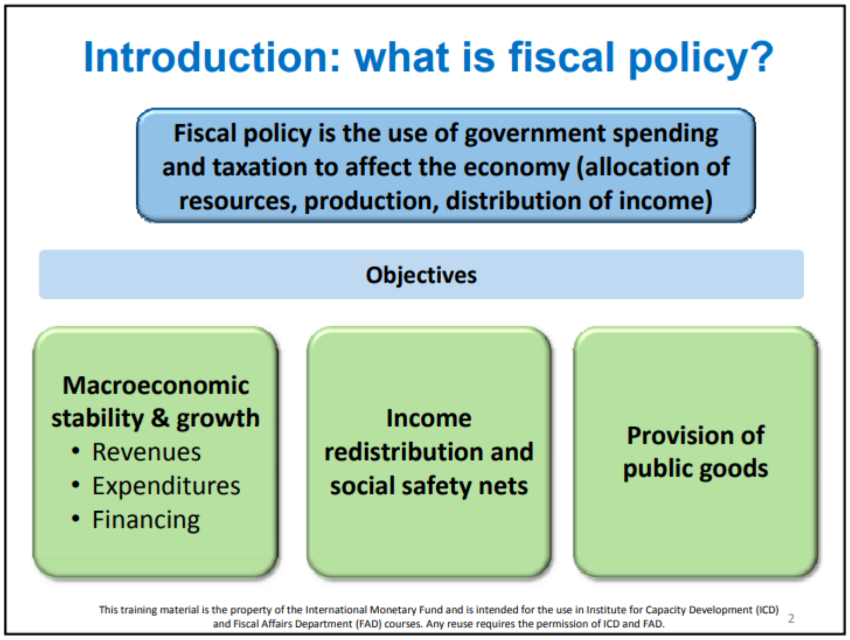
In Keynesian economics, aggregate demand or spending is what drives the performance and growth of the economy. Aggregate demand is made up of consumer spending, business investment spending, net government spending, and net exports. According to Keynesian economists, the private-sector components of aggregate demand are too variable and too dependent on psychological and emotional factors to maintain sustained growth in the economy.

Special Considerations

Pessimism, fear, and uncertainty among consumers and businesses can lead to economic recessions and depressions, and excessive exuberance during good times can lead to an overheated economy and inflation. However, according to Keynesians, government taxation and spending can be managed rationally and used to counteract the excesses and deficiencies of private-sector consumption and investment spending in order to stabilise the economy.

When private-sector spending turns down, the government can spend more and/or tax less in order to directly increase aggregate demand. When the private sector is overly optimistic and spends too much, too fast on consumption and new investment projects, the government can spend less and/or tax more in order to decrease aggregate demand.

This means that to help stabilise the economy, the government should run large budget deficits during economic downturns and run budget surpluses when the economy is growing. These are known as expansionary or contractionary fiscal policies, respectively.



Criticism of Fiscal Policy

- **Disincentives of Tax Cuts.**
  Increasing taxes to reduce AD may cause disincentives to work, if this occurs, there will be a fall in productivity and AS could fall.
  However higher taxes do not necessarily reduce incentives to work if the income effect dominates the substitution effect.
- **Side effects on public spending.** Reduced government spending (G) to decrease inflationary pressure could adversely affect public services such as public transport and education causing market failure and social inefficiency.
- **Poor information.** Fiscal policy will suffer if the government has poor information. E.g. If the government believes there is going to be a recession, they will increase AD, however, if this forecast was wrong and

the economy grew too fast, the government action would cause inflation.

- **Time lags.** If the government plans to increase spending – this can take a long time to filter into the economy, and it may be too late. Spending plans are only set once a year. There is also a delay in implementing any changes to spending patterns.
- **Budget Deficit.** Expansionary fiscal policy (cutting taxes and increasing G) will cause an increase in the budget deficit which has many adverse effects. A higher budget deficit will require higher taxes in the future and may cause crowding out.
  Other components of AD. If the government uses fiscal policy, its effectiveness will also depend upon the other components of AD, for example, if consumer confidence is very low, reducing taxes may not lead to an increase in consumer spending.
- **Depends on the Multiplier effect.** Any change in injections may be increased by the multiplier effect, therefore the size of the multiplier will be significant. If consumers save any extra income, the multiplier effect will be low and fiscal policy less effective.
- **Crowding Out.**
  Expansionary fiscal policy of increased government spending (G) to increase AD may cause "Crowding out" Crowding out occurs when increased government spending results in a decrease in the size of the private sector.
    - For example, if the government increase spending it will have to increase taxes or sell bonds and borrow money, both methods reduce private consumption and investment. If this occurs, AD will not increase or increase only very slowly.
        - Also classical economists argue that the government is more inefficient in spending money than the private sector, therefore, there will be a decline in economic welfare

- Increased government borrowing can also put upward pressure on interest rates. To borrow more money the interest rate on bonds may have to rise, causing slower growth in the rest of the economy.

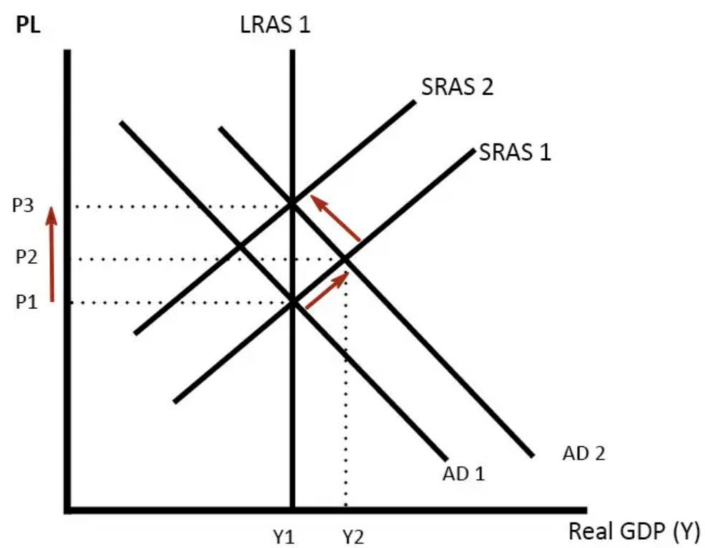
Monetarist critique.

Monetarists argue that the LRAS is inelastic therefore an increase in AD will only cause inflation to increase.

Monetarists are generally skeptical of fiscal policy as a tool to boost economic growth. They argue that the economy

Real business cycle critique

The real business cycle argues that macroeconomic fluctuations are due to changes in technological progress and supply-side shocks. Therefore, using demand-side policy to influence economic growth fails to address the issue and just makes the situation worse.



CENTRE STATE FISCAL RELATIONSHIP

Generally, in a typical federation along with the distribution of legislative and administrative powers, the financial resources of the country are also distributed to ensure the financial independence of the units. However, the Indian Constitution does not make a clearcut distribution of the financial resources and leaves much to be decided by the Central Government from time to time. The financial resources which have been placed at the disposal of the state are so meager that they have to look up to the Union Government for subsidies and contributions. This article throws light on the distribution of financial resources in India.

Taxes Exclusively Assigned to the Union

Income from certain subjects like customs and export duties, income tax, excise duty on tobacco, jute,' cotton, etc., corporation tax, taxes on the capital value of assets of individuals and companies; Estate duty and succession duty in respect of the property and other than agricultural land; and income from the earning departments like the railways and postal departments have been exclusively assigned to the Union Government by the Constitution.

Taxes Exclusively Assigned to States

Income from land revenue, stamp duty except on documents included in the Union List; succession duty and Estate duty in respect of agricultural land; income tax on agricultural lands; taxes on goods and passengers carried by road or inland water; taxes on vehicles used on roads, animals, boats, taxes on the consumption or sale of electricity, tolls, taxes on lands and buildings; taxes on professions, traders, calling and employment; duties on alcoholic liquors for human consumption, opium, Indian hemp, and other narcotic drugs, taxes on the entry of goods into local areas, taxes on luxuries, entertainments, amusements, betting and gambling, etc. has been assigned to the States.

Taxes Levied by Union but Collected and Appropriated by the State

The taxes on the following items are levied by the Union Government but the actual revenue from them is collected and appropriated by the States;

stamp duties on bills of exchange, cheques, promissory notes, bills of landing, letters of credit, policies of insurance, transfer of shares, etc.;

Excise duties on medicinal toilet preparation containing alcohol or opium or Indian hemp or other narcotic drugs.

Taxes Levied and Collected by the Union but assigned to States

The taxes in this category are levied and collected by the Union Government although they are subsequently handed over to the states from where they have been collected. Such taxes included duties in respect of succession to property other than agricultural land; state duty in respect of property other than agricultural land terminal taxes on goods or passengers carried by railways, sea or air, taxes on railway freights and fares; taxes other than stamp duties on transactions in stock exchanges and futures markets; taxes on the sale or purchase of newspapers and advertisements published therein; taxes on purchase or sale of goods other than newspapers where such sale or purchases take place in the course of interstate trade or commerce.

Taxes Levied and Collected by the Union but Shared

Taxes on income other than agricultural income and excise duties other than those on medicinal and toilet preparations are levied and collected by the Union Government but shared with the states on an equitable basis. The basis of distribution is determined by the Parliament through a law.

The Thirteenth Finance Commission

It submitted its report to the President in December 2009. The report was submitted by the Chairman of Commission Dr. Vijay Kelkar. The main task of the Finance Commission is to make recommendations on sharing tax revenues between centre and states.

The commission has made recommendations for the fiscal consolidation for a five year period from 2010 to 2015. The report additionally calls for climate linked fiscal incentive to states, calls for enhanced royalty for mineral resources of states and suggests a framework for output at the state level. Broadly speaking, the report maintains the centre-state share of net tax proceeds.

Recommendations

The major recommendations of the Commission were:

- The share of states in the net proceeds of the shareable Central taxes should be 32%. This is 1.5 percentage-points higher than the recommendation of the 12th Commission.
- Revenue deficit to be progressively reduced and eliminated, followed by revenue surplus by 2013–2014.
- Fiscal deficit to be reduced to 3% of the gross domestic product (GDP) by 2014–2015. A target of 68% of GDP for the combined debt of centre and states.
- The Medium-Term Fiscal Plan (MTFP) should be reformed and made the statement of commitment rather than a statement of intent. Fiscal Responsibility and Budget Management Act, 2003 need to be amended to mention the nature of shocks which shall require targets relaxation.
- Both centre and states should conclude 'Grand Bargain' to implement the model Goods and Services Act (GST).
- (Task force recommended a single positive GST rate of 12% comprising 5% CGST and 7% SGST) To incentivize the states, the commission recommended a sanction of the grant of Rs 500 billion.
- Initiatives to reduce the number of Central Sponsored Schemes (CSS) and to restore the predominance of formula-based plan grants. States need to address the problem of losses in the power sector in a time bound manner.

ENTRI

RECENT BUDGET 2022-23

The Union Budget seeks to complement macro-economic level growth with a focus on micro-economic level all inclusive welfare. The Union Minister for Finance & Corporate Affairs, Smt Nirmala Sitharaman tabled the Union Budget 2022-23 in Parliament today.
The key highlights of the budget are as follows:

PART A

- India's economic growth is estimated at 9.2% to be the highest among all large economies.
- 60 lakh new jobs to be created under the productivity linked incentive scheme in 14 sectors.
- PLI Schemes have the potential to create an additional production of Rs 30 lakh crore.
- Entering Amrit Kaal, the 25 year long lead up to India @100, the budget provides impetus for growth along four priorities:
- The key highlights of the budget are as follows:

PM GatiShakti

- Inclusive Development
- Productivity Enhancement & Investment, Sunrise opportunities, Energy Transition, and Climate Action.
- Financing of investments

PM GatiShakti

The seven engines that drive PM GatiShakti are Roads, Railways, Airports, Ports, Mass Transport, Waterways and Logistics Infrastructure.

PM GatiShkati National Master Plan

- The scope of PM GatiShakti National Master Plan will encompass the seven engines for economic transformation, seamless multimodal connectivity and logistics efficiency.
- The projects pertaining to these 7 engines in the National Infrastructure Pipeline will be aligned with PM GatiShakti framework.

Road Transport

- National Highways Network to be expanded by 25000 Km in 2022-23.
- Rs 20000 Crore to be mobilised for National Highways Network expansion.
- Multimodal Logistics Parks
- Contracts to be awarded through PPP mode in 2022-23 for implementation of Multimodal Logistics Parks at four locations.

Railways

- One Station One Product concept to help local businesses & supply chains.
- 2000 Km of railway network to be brought under Kavach, the indigenous world class technology and capacity augmentation in 2022-23.
- 400 new generation Vande Bharat Trains to be manufactured during the next three years.
- 100 PM GatiShakti Cargo terminals for multimodal logistics to be developed during the next three years.

Parvatmala

- National Ropeways Development Program, Parvatmala to be taken up on PPP mode.
- Contracts to be awarded in 2022-23 for 8 ropeway projects of 60 Km length.
- Inclusive Development
- Agriculture

- Rs. 2.37 lakh crore direct payment to 1.63 crore farmers for procurement of wheat and paddy.
- Chemical free Natural farming to be promoted throughout the county. Initial focus is on farmer's lands in 5 Km wide corridors along river Ganga.
- NABARD to facilitate fund with blended capital to finance startups for agriculture & rural enterprise.

'Kisan Drones' for crop assessment, digitization of land records, spraying of insecticides and nutrients.

Ken Betwa project

1400 crore outlay for implementation of the Ken – Betwa link project.

9.08 lakh hectares of farmers' lands to receive irrigation benefits by Ken-Betwa link project.

MSME

- Udyam, e-shram, NCS and ASEEM portals to be interlinked.
- 130 lakh MSMEs provided additional credit under Emergency Credit Linked Guarantee Scheme (ECLGS)
- ECLGS to be extended up to March 2023.
- Guarantee cover under ECLGS to be expanded by Rs 50000 Crore to total cover of Rs 5 Lakh Crore.
- Rs 2 lakh Crore additional credit for Micro and Small Enterprises to be facilitated under the Credit Guarantee Trust for Micro and Small Enterprises (CGTMSE).
- Raising and Accelerating MSME performance (RAMP) programme with outlay of Rs 6000 Crore to be rolled out.

Skill Development

Digital Ecosystem for Skilling and Livelihood (DESH-Stack e-portal) will be launched to empower citizens to skill, reskill or upskill through on-line training.

· Startups will be promoted to facilitate 'Drone Shakti' and for Drone-As-A-Service (DrAAS).

Education

'One class -One TV channel' programme of PM eVIDYA to be expanded to 200 TV channels.

• Virtual labs and skilling e-labs to be set up to promote critical thinking skills and simulated learning environment.

· High-quality e-content will be developed for delivery through Digital Teachers.

· Digital University for world-class quality universal education with personalised learning experience to be established.

Health

An open platform for National Digital Health Ecosystem to be rolled out.

· 'National Tele Mental Health Programme' for quality mental health counselling and care services to be launched.

- A network of 23 tele-mental health centres of excellence will be set up, with NIMHANS being the nodal centre and International Institute of Information Technology-Bangalore (IIITB) providing technology support.
- Saksham Anganwadi
- Integrated benefits to women and children through Mission Shakti, Mission Vatsalya, Saksham Anganwadi and Poshan 2.0.
- Two lakh angan wadis to be upgraded to Saksham Anganwadis.
- Har Ghar, Nal Se Jal
- Rs. 60,000 crore allocated to cover 3.8 crore households in 2022-23 under Har Ghar, Nal se Jal.

Housing for All

- Rs. 48,000 crore allocated for completion of 80 lakh houses in 2022-23 under PM Awas Yojana.

- Prime Minister's Development Initiative for North-East Region (PM-DevINE)
- New scheme PM-DevINE launched to fund infrastructure and social development projects in the North-East.
- An initial allocation of Rs. 1,500 crore was made to enable livelihood activities for youth and women under the scheme.

Vibrant Villages Programme

Vibrant Villages Programme for development of Border villages with sparse population, limited connectivity and infrastructure on the northern border.

Banking

100 per cent of 1.5 lakh post offices to come on the core banking system.
Scheduled Commercial Banks to set up 75 Digital Banking Units (DBUs) in 75 districts.

e-Passport

e-Passports with embedded chip and futuristic technology to be rolled out.

Urban Planning

Modernization of building bye laws, Town Planning Schemes (TPS), and Transit Oriented Development (TOD) will be implemented.
Battery swapping policy to be brought out for setting up charging stations at scale in urban areas.

Land Records Management

Unique Land Parcel Identification Number for IT-based management of land records.

Accelerated Corporate Exit

- Centre for Processing Accelerated Corporate Exit (C-PACE) to be established for speedy winding-up of companies.
- AVGC Promotion Task Force
- An animation, visual effects, gaming, and comic (AVGC) promotion task force to be set-up to realise the potential of this sector.
- Telecom Sector
- Scheme for design-led manufacturing to be launched to build a strong ecosystem for 5G as part of the Production Linked Incentive Scheme.

Export Promotion

Special Economic Zones Act to be replaced with a new legislation to enable States to become partners in 'Development of Enterprise and Service Hubs'.

AtmaNirbharta in Defence:

68% of capital procurement budget earmarked for domestic industry in 2022-23, up from 58% in 2021-22.

  - Defence R&D to be opened up for industry, startups and academia with 25% of defence R&D budget earmarked.
  - Independent nodal umbrella body to be set up for meeting testing and certification requirements.

Sunrise Opportunities

Government contribution to be provided for R&D in Sunrise Opportunities like Artificial Intelligence, Geospatial Systems and Drones, Semiconductor and its ecosystem, Space Economy, Genomics and Pharmaceuticals, Green Energy, and Clean Mobility Systems.

Energy Transition and Climate Action:

Additional allocation of Rs. 19,500 crore for Production Linked Incentive for manufacture of high efficiency solar modules to meet the goal of 280 GW of installed solar power by 2030.

- Five to seven per cent biomass pellets to be co-fired in thermal power plants:
- CO2 savings of 38 MMT annually,
- Extra income to farmers and job opportunities to locals,
- Help avoid stubble burning in agriculture fields.
  - Four pilot projects to be set up for coal gasification and conversion of coal into chemicals for the industry
  - Financial support to farmers belonging to Scheduled Castes and Scheduled Tribes, who want to take up agro-forestry.

Public Capital Investment:

- Public investment to continue to pump-prime private investment and demand in 2022-23.
  - Outlay for capital expenditure stepped up sharply by 35.4% to Rs. 7.50 lakh crore in 2022-23 from Rs. 5.54 lakh crore in the current year.
  - Outlay in 2022-23 to be 2.9% of GDP.
- 'Effective Capital Expenditure' of the Central Government is estimated at Rs. 10.68 lakh crore in 2022-23, which is about 4.1% of GDP.

GIFT-IFSC

World-class foreign universities and institutions to be allowed in the GIFT City. An International Arbitration Centre to be set up for timely settlement of disputes under international jurisprudence.

Mobilizing Resources

Data Centres and Energy Storage Systems to be given infrastructure status.

- Venture Capital and Private Equity invested more than Rs. 5.5 lakh crore last year facilitating one of the largest start-up and growth ecosystems. Measures to be taken to help scale up this investment.
- Blended funds to be promoted for sunrise sectors.

- Sovereign Green Bonds to be issued for mobilizing resources for green infrastructure.

Digital Rupee

Introduction of Digital Rupee by the Reserve Bank of India starting 2022-23.

- Providing Greater Fiscal Space to States
- Enhanced outlay for 'Scheme for Financial Assistance to States for Capital Investment':
- From Rs. 10,000 crore in Budget Estimates to Rs. 15,000 crore in Revised Estimates for current year
    - Allocation of Rs. 1 lakh crore in 2022-23 to assist the states in catalysing overall investments in the economy: fifty-year interest free loans, over and above normal borrowings
- In 2022-23, States will be allowed a fiscal deficit of 4% of GSDP, of which 0.5% will be tied to power sector reforms

Fiscal Management

Budget Estimates 2021-22: Rs. 34.83 lakh crore

· Revised Estimates 2021-22: Rs. 37.70 lakh crore

· Total expenditure in 2022-23 estimated at Rs. 39.45 lakh crore

· Total receipts other than borrowings in 2022-23 estimated at Rs. 22.84 lakh crore

· Fiscal deficit in current year: 6.9% of GDP (against 6.8% in Budget Estimates)

Fiscal deficit in 2022-23 estimated at 6.4% of GDP

PART B

DIRECT TAXES

To take forward the policy of stable and predictable tax regime:

Vision to establish a trustworthy tax regime.

To further simplify the tax system and reduce litigation.

Introducing new 'Updated return'

- Provision to file an Updated Return on payment of additional tax.
- Will enable the assesses to declare income missed out earlier.
- Can be filed within two years from the end of the relevant assessment year.
- Cooperative societies
- Alternate Minimum Tax paid by cooperatives brought down from 18.5 per cent to 15 per cent.
- To provide a level playing field between cooperative societies and companies.
- Surcharge on cooperative societies reduced from 12 per cent to 7 per cent for those having total income of more than Rs 1 crore and up to Rs 10 crores.
- Tax relief to persons with disability
- Payment of annuity and lump sum amount from insurance scheme to be allowed to be differently abled dependent during the lifetime of parents/guardians, i.e., on parents/ guardians attaining the age of 60 years.

Parity in National Pension Scheme Contribution

Tax deduction limit increased from 10 per cent to 14 percent on employer's contribution to the NPS account of State Government employees.
Brings them at par with central government employees.
Would help in enhancing social security benefits.

Incentives for Start-ups

Period of incorporation extended by one year, up to 31.03.2023 for eligible start-ups to avail tax benefit.
Previously the period of incorporation was valid up to 31.03.2022.
Incentives under concessional tax regime
Last date for commencement of manufacturing or production under section 115 BAB extended by one year i.e. from 31st March, 2023 to 31st March, 2024.

Scheme for taxation of virtual digital assets

Specific tax regime for virtual digital assets introduced.

Any income from transfer of any virtual digital asset to be taxed at the rate of 30 per cent.

No deduction in respect of any expenditure or allowance to be allowed while computing such income except cost of acquisition.

Loss from transfer of virtual digital assets cannot be set off against any other income.

To capture the transaction details, TDS to be provided on payment made in relation to transfer of virtual digital assets at the rate of 1 percent of such consideration above a monetary threshold.

Gift of virtual digital assets also to be taxed in the hands of the recipient.

Litigation Management

In cases where the question of law is identical to the one pending in the High Court or Supreme Court, the filing of appeal by the department shall be deferred till such a question of law is decided by the court.

To greatly help in reducing repeated litigation between taxpayers and the department.

Tax incentives to IFSC

Subject to specified conditions, the following to be exempt from tax

Income of a non-resident from offshore derivative instruments.

Income from over-the-counter derivatives issued by an offshore banking unit.

Income from royalty and interest on account of lease of ship.

Income received from portfolio management services in IFSC.

Rationalization of Surcharge

Surcharge on AOPs (consortium formed to execute a contract) capped at 15 per cent.

Done to reduce the disparity in surcharge between individual companies and AOPs.

Surcharge on long term capital gains arising on transfer of any type of assets capped at 15 per cent.

To give a boost to the start up community.

Health and Education Cess

- Any surcharge or cess on income and profits not allowable as business expenditure.
- Deterrence against tax-evasion
- No set off of any loss to be allowed against undisclosed income detected during search and survey operations.
- Rationalizing TDS Provisions
- Benefits passed on to agents as a business promotion strategy taxable in the hands of agents.
- Tax deduction provided to the person giving benefits, if the aggregate value of such benefits exceeds Rs 20,000 during the financial year.

INDIRECT TAXES

- Remarkable progress in GST
- GST revenues are buoyant despite the pandemic – Taxpayers deserve applause for this growth.
- **Special Economic Zones**
- Customs Administration of SEZs to be fully IT driven and function on the Customs National Portal – shall be implemented by 30th September 2022.
- Customs Reforms and duty rate changes
- Faceless Customs has been fully established. During Covid-19 pandemic, Customs formations have done exceptional frontline work against all odds displaying agility and purpose.
- Project imports and capital goods
- Gradually phasing out of the concessional rates in capital goods and project imports; and applying a moderate tariff of 7.5 percent – conducive to the growth of the domestic sector and 'Make in India'.

- Certain exemptions for advanced machineries that are not manufactured within the country shall continue.
- A few exemptions were introduced on inputs, like specialised castings, ball screw and linear motion guide - to encourage domestic manufacturing of capital goods.
- Review of customs exemptions and tariff simplification
- More than 350 exemption entries proposed to be gradually phased out, like exemption on certain agricultural produce, chemicals, fabrics, medical devices, & drugs and medicines for which sufficient domestic capacity exists.
- Simplifying the Customs rate and tariff structure particularly for sectors like chemicals, textiles and metals and minimize disputes; Removal of exemption on items which are or can be manufactured in India and providing concessional duties on raw material that go into manufacturing of intermediate products – in line with the objective of 'Make in India' and 'Atmanirbhar Bharat'.
- Sector specific proposals
- Electronics
- Customs duty rates to be calibrated to provide a graded rate structure - to facilitate domestic manufacturing of wearable devices, hearable devices and electronic smart metres.
- Duty concessions to parts of the transformer of mobile phone chargers and camera lens of mobile camera module and certain other items – To enable domestic manufacturing of high growth electronic items.

- Gems and Jewellery
- Customs duty on cut and polished diamonds and gemstones being reduced to 5 per cent; Nil customs duty to simply sawn diamond - To give a boost to the Gems and Jewellery sector
- .

- A simplified regulatory framework to be implemented by June this year - To facilitate export of jewellery through e-commerce.

- Customs duty of at least Rs 400 per Kg to be paid on imitation jewellery import - To disincentive import of undervalued imitation jewellery.
- Chemicals
- Customs duty on certain critical chemicals namely methanol, acetic acid and heavy feed stocks for petroleum refining is being reduced; Duty is being raised on sodium cyanide for which adequate domestic capacity exists – This will help in enhancing domestic value addition.

MSME

- Customs duty on umbrellas being raised to 20 per cent. Exemption to parts of umbrellas being withdrawn.
- Exemption being rationalised on implements and tools for agri-sector which are manufactured in India
- Customs duty exemption given to steel scrap last year extended for another year to provide relief to MSME secondary steel producers
- Certain Anti- dumping and CVD on stainless steel and coated steel flat products, bars of alloy steel and high-speed steel are being revoked – to tackle prevailing high prices of metal in larger public interest.

Exports

- To incentivized exports, exemptions are provided on items such as embellishment, trimming, fasteners, buttons, zipper, lining material, specified leather, furniture fittings and packaging boxes.

- Duty being reduced on certain inputs required for shrimp aquaculture - to promote its exports.

Tariff measure to encourage blending of fuel

- Unblended fuel to attract an additional differential excise duty of Rs 2/ litre from the 1st of October 2022 - to encouraged biofuels
- The Union Budget seeks to complement macro-economic level growth with a focus on micro-economic level all inclusive welfare. The Union Minister for Finance & Corporate Affairs, Smt Nirmala Sitharaman tabled the Union Budget 2022-23 in Parliament today.

Parallel economy

- Parallel economy based on the black money or unaccounted money, is a big menace to the Indian economy. It is also a cause of big loss in the tax-revenues for the government. As such, it needs to be curbed. Its elimination will benefit the economy in more than one way.
- In a general way, we can define black economy as the money that is generated by activities that are kept secret, in the sense that these are not reported to the authorities. As such, this money is also not accounted to (he fiscal authorities i.e., taxes are not paid on this money.
- An estimate by Suraj B. Gupta had put the size of black money at over 50 percent of GDP (at factor cost) in 1987-88. It is also stated that the annual rate of growth of black economy is higher than the annual growth rate of GDP.
- According to the Global Financial Integrity Study of 2009, $ 1.4 trillion belonging to Indians were parked in safe havens abroad. $ 1.4 trillion is equivalent to Rs. 70 lakh crore, more than India's national income of around Rs. 50 lakh crore.
- A statement from the Swiss Central Bank declared that Indians have $2.5 billion deposits in various Swiss Banks. It is suspected that the deposits of Indians in tax havens are mostly being withdrawn and shifted to a third country; making it difficult for the government to gather any further details once the accounts are closed.

Harmful Effects of Parallel Economy:

- The circulation of black money has adversely affected the economy in several ways.
- First, is the misdirection of precious national resources? A part of black money is kept in a form that contributes nothing/little to productive activities. Again, much around half to two third is squandered away on ostentatious consumption of goods and services.
- Second, it has enormously worsened the income distribution, and has thereby undermined the fabric of the society.
- Third, the existence of a big-sized unreported segment of the economy is a big handicap in making a correct analysis and formulation of right policies for it. Nor. It is possible to monitor the development in the economy with precision.

What Is a Financial System?

A financial system is a set of institutions, such as banks, insurance companies, and stock exchanges, that permit the exchange of funds. Financial systems exist on firm, regional, and global levels. Borrowers, lenders, and investors exchange current funds to finance projects, either for consumption or productive investments, and to pursue a return on their financial assets. The financial system also includes sets of rules and practices that borrowers and lenders use to decide which projects get financed, who finances projects, and terms of financial deals.

KEY TAKEAWAYS

A financial system is the set of global, regional, or firm-specific institutions and practices used to facilitate the exchange of funds.

Financial systems can be organized using market principles, central planning, or a hybrid of both.

Institutions within a financial system include everything from banks to stock exchanges and government treasuries.

Understanding the Financial System

Like any other industry, the financial system can be organised using markets, central planning, or some mix of both.

Financial markets involve borrowers, lenders, and investors negotiating loans and other transactions. In these markets, the economic goods traded on both sides are usually some form of money: current money (cash), claims on future money (credit), or claims on the future income potential or value of real assets (equity). These also include derivative instruments. Derivative instruments, such as commodity futures or stock options, are financial instruments that are dependent on an underlying real or financial asset's performance. In financial markets, these are all traded among borrowers, lenders, and investors according to the normal laws of supply and demand.

BANKING

A bank is a financial institution that accepts deposits from the public and creates a demand deposit while simultaneously making loans. Lending activities can be directly performed by the bank or indirectly through capital markets.

Because banks play an important role in financial stability and the economy of a country, most jurisdictions exercise a high degree of regulation over banks. Most countries have institutionalized a system known as fractional reserve banking, under which banks hold liquid assets equal to only a portion of their current liabilities. In addition to other regulations intended to ensure liquidity, banks are generally subject to minimum capital requirements based on an international set of capital standards, the Basel Accords.

Insurance is a means of protection from financial loss. It is a form of risk management, primarily used to hedge against the risk of a contingent or uncertain loss.

An entity which provides insurance is known as an insurer, an insurance company, an insurance carrier or an underwriter. A person or entity who buys insurance is known as a policyholder, while a person or entity covered under the policy is called an insured. Policyholder and insured are often used as but are not necessarily synonyms, as coverage can sometimes extend to additional insureds who did not buy the insurance. The insurance transaction involves the policyholder assuming a guaranteed, known, and relatively small loss in the form of a payment to the insurer (a premium) in exchange for the insurer's promise to compensate the insured in the event of a covered loss. The loss may or may not be financial, but it must be reducible to financial terms. Furthermore, it usually involves something in which the insured has an insurable interest established by ownership, possession, or pre-existing relationship.

The insured receives a contract, called the insurance policy, which details the conditions and circumstances under which the insurer will compensate the insured, or their designated beneficiary or assignee. The amount of money charged by the insurer to the policyholder for the coverage set forth in the insurance policy is called the premium. If the insured experiences a loss which is potentially covered by the insurance policy, the insured submits a claim to the insurer for processing by a claims adjuster. A mandatory out-of-pocket expense required by an insurance policy before an insurer will pay a claim is called a deductible (or if required by a health insurance policy, a copayment). The insurer may hedge its own risk by taking out reinsurance, whereby another insurance company agrees to carry some of the risks, especially if the primary insurer deems the risk too large for it to carry.

Capital Markets

What Are Capital Markets?

Capital markets are where savings and investments are channeled between suppliers—people or institutions with capital to lend or invest—and those in need. Suppliers typically include banks and investors while those who seek capital are businesses, governments, and individuals.

Capital markets are composed of primary and secondary markets. The most common capital markets are the stock market and the bond market.

Capital markets seek to improve transactional efficiencies. These markets bring suppliers together with those seeking capital and provide a place where they can exchange securities.

- Capital markets refer to the venues where funds are exchanged between suppliers of capital and those who demand capital for use.
- Primary capital markets are where new securities are issued and sold. The secondary market is where previously issued securities are traded between investors.
- The best-known capital markets include the stock market and the bond markets.

Understanding Capital Markets

- Capital market is a broad term used to describe the in-person and digital spaces in which various entities trade different types of financial instruments. These venues may include the stock market, the bond market, and the currency and foreign exchange markets. Most markets are concentrated in major financial centres such as New York, London, Singapore, and Hong Kong.
- Capital markets are composed of the suppliers and users of funds. Suppliers include households—through the savings accounts they hold with banks—as well as institutions like pension and retirement funds, life insurance companies, charitable foundations, and non-financial companies that generate excess cash. The "users" of the funds distributed on capital markets include home and motor vehicle purchasers, non-financial companies, and governments financing infrastructure investment and operating expenses.
- Capital markets are used primarily to sell financial products such as equities and debt securities. Equities are stocks, which are ownership shares in a company. Debt securities, such as bonds, are interest-bearing IOUs.
- These markets are divided into two different categories: primary markets—where new equity stock and bond issues are sold to investors—and secondary markets, which trade existing securities. Capital markets are a crucial part of a functioning modern economy

because they move money from the people who have it to those who need it for productive use.

Primary Market

When a company publicly sells new stocks or bonds for the first time—such as in an initial public offering (IPO)—it does so in the primary capital market. This market is sometimes called the new issues market. When investors purchase securities on the primary capital market, the company that offers the securities hires an underwriting firm to review it and create a prospectus outlining the price and other details of the securities to be issued.

All issues on the primary market are subject to strict regulation. Companies must file statements with the Securities and Exchange Commission (SEC) and other securities agencies and must wait until their filings are approved before they can go public.

Small investors are often unable to buy securities on the primary market because the company and its investment bankers want to sell all of the available securities in a short period of time to meet the required volume, and they must focus on marketing the sale to large investors who can buy more securities at once. Marketing the sale to investors can often include a roadshow or dog and pony show, in which investment bankers and the company's leadership travel to meet with potential investors and convince them of the value of the security being issued.

Secondary Market

The secondary market, on the other hand, includes venues overseen by a regulatory body like the SEC where these previously issued securities are traded between investors. Issuing companies do not have a part in the secondary market. The New York Stock Exchange (NYSE) and Nasdaq are examples of secondary markets.

The secondary market has two different categories: the auction and the dealer markets. The auction market is home to the open outcry system where buyers and sellers congregate in one location and announce the prices at which they are willing to buy and sell their securities. The NYSE is one such example. In dealer markets, though, people trade through electronic networks. Most small investors trade through dealer markets.

Critical Appraisal of Monetary and Financial Sector Reforms

In identifying critical issues, it is necessary to recognise the strengths of the Indian banking sector. These include, long history of regulation, early start of financial reforms, stability imparted by reserve requirements, limited exposure to risky assets such as real estate or stocks or foreign currency, strict control over off-balance sheet transactions, and relatively well diversified credit exposures, rather than undue concentrations. However, greater efficiency can be brought about, only and only if coordinated efforts are made by the RBI, Government of India and banks themselves.

Reserve Bank of India

- First, the medium-term objective of reducing pre-emptions will be pursued, subject to reduction in fiscal deficit by the Government, monetary developments vis-à-vis growth in real output, and uncertainties in forex markets. Reduction in CRR will help improve profitability of banks. No doubt, reduction in the refinance window will give greater flexibility in this regard.
- Second, on interest rate regime, reform objectives continue to be further deregulation and enabling an environment for reduction in interest spreads. These would again depend on the progress in reduction of fiscal deficit; reduction in non-performing assets which in turn needs changes in debt recovery system as also improvement in credit appraisal systems by banks themselves; and rationalisation of interest rates in small savings, bonds, etc., which are alternatives for savers. Furthermore, inflationary expectations do play a critical role in determining interest rates, and these in turn, are dependent on credibility of price stability.
- Third, the RBI will pursue with implementation of the first phase of reform announced in

- October, 1998 and mount the second phase of reform on prudential requirements soon. These requirements would, however, warrant significant additions to the capital of the banking system as a whole. Further progress will depend on resolution of issues in Government relating to budgetary support, permitting access to capital markets, the strategy for weak banks, mergers, possible changes in the percentage of public ownership, etc.
- Fourth, the RBI will continue to foster competition between banks and in due course between banks and other financial intermediaries. The issue of competition with other financial intermediaries has to recognise the level playing field argument warranting special treatment to banks as long as they have large preemptions, especially CRR - again linked to fiscal deficit.
- As regards competition among banks, the issues relating to diversified ownership, incentive structure and reorganisation of public sector banks have to be addressed by the Government to enable the RBI to pursue measures to enhance competition without serious systemic implications. RBI will intensify consultations with Centre and States, on issues relating to cooperatives and Regional Rural Banks.
- Fifth, the RBI would also vigorously pursue improvements in transparency, disclosure standards as also accounting standards to attain the best international practices. Similarly, compliance with Core Principles is being expedited. To focus on the criticality of payment and settlement systems, the October 1998 statement on Monetary Policy has laid out a concrete programme of implementing the banking sector reforms.
- Sixth, credit-delivery systems will be improved to ensure smooth credit flow but this is facilitated only when legal systems and judicial processes are reviewed to replace cumbersome, and time consuming procedures. In addition to laws relating to debt recovery, changes in bankruptcy law, tenancy laws, urban land ceilings, etc. would be

needed to ensure that the collateral offered is in reality a realisable collateral.

- Seventh, improvements in financial markets are being so attempted by the RBI as to address both technological and procedural/documentation issues. Development of money and debt markets would also require, among other things, reduction in preemptions, amendments to Securities Contract Act, replacement of Public Debt Act and resolution of Stamp Duty issue.

Government of India

- It is very clear that further progress in the financial sector would, to a significant extent, depend on the resolution of fiscal, legal, and structural issues.
- First, a sustainable level of fiscal deficit is of paramount importance. Furthermore, cost of raising resources, viz., interest payment for small savings and tax treatment on income from Government securities need to be reviewed. A view has to be taken on budgetary support for recapitalisation of banks and contingent liabilities in case Asset Reconstruction Company route is favoured. An appropriate approach is also needed on how the Government sponsored subsidised special programmes of employment generation would operate in the new milieu.
- Second, legislative changes that are essential for successful reform are many and CBSR had attempted to address these issues. In particular, legislative changes affecting debt recovery and growth of financial markets, as already listed, are very critical. Legislative changes may also be needed for greater flexibility in change of public ownership.
- Third, structural issues affecting public sector banks have been dwelt at length by CBSR, and suffice to say that the reordering of relationship between Government as principal/owner and banks as agents, through legislative changes or otherwise, would influence the further direction of reform, introduction of competitive pressures and incentive-structures

for efficiency enhancement. Key to financial sector reform is banking reform; key to banking reform is public sector banking reform; and key to public sector banking sector reform is Government's initiative.

Banks

- It is clear that actions of RBI and initiatives of Government provide an enabling environment, incentive framework and to some extent punitive measures. The outcome will depend on the response of banks, i.e., boards of banks, management, officers and staff. There are, in particular, four broad areas of internal systems which may need thorough overhauling and which need to be facilitated by the Government and the RBI.

❖ First, the internal control systems in the banks, especially Public Sector Banks.

❖ Second, the placement, work practices etc., which inhibit incentives for efficiency and improved customer service.

❖ Third, flexibility in obtaining and enhancing highly skilled or talented people.

❖ Fourth, introduction and effective use of technology in banks, especially public sector banks.

Financial Inclusion

Financial inclusion definition

Financial inclusion is the process of ensuring access to financial products and services needed by vulnerable groups at an affordable cost in a transparent manner by institutional players.

The concept of financial inclusion was first introduced in India in 2005 by the Reserve Bank of India.

Objectives of financial inclusion

❖ A basic no-frills banking account for making and receiving payments

- Saving products (including investment and pension)
- Simple credit products and overdrafts linked with no-frills accounts
- Remittance, or money transfer facilities
- Micro insurance (life) and non-micro insurance (life and non-life)
- Micro pension

Financial inclusion in India

PMJDY: Around 192.1 million accounts have been opened under the Pradhan Mantri Jan Dhan Yojana (PMJDY). These zero-balance bank accounts have been accompanied by 165.1 million debit cards, a life insurance cover of Rs 30,000 and an accidental insurance cover of Rs 1 lakh.

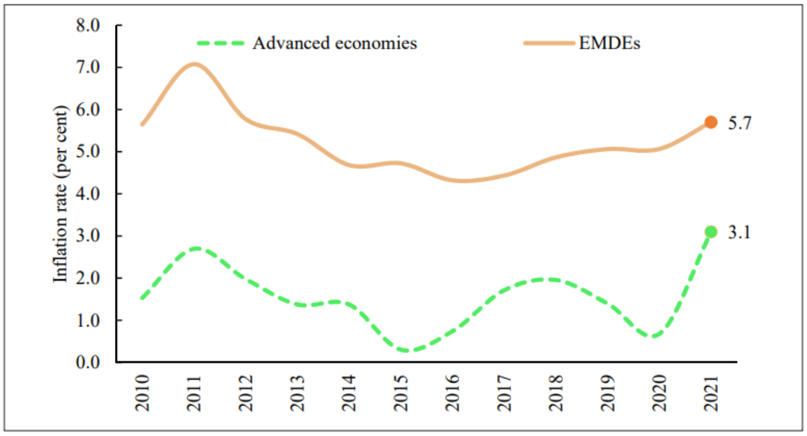
Other than PMJDY, there are several other financial inclusion schemes in India — **Jeevan Suraksha Bandhan Yojana, Pradhan Mantri Vaya Vandana Yojana, Pradhan Mantri Mudra Yojana, Stand Up India scheme, Venture Capital Fund for Scheduled Castes under the social-sector initiatives, Pradhan Mantri Suraksha Bima Yojana (PMSBY), Atal Pension Yojana (APY), Varishtha Pension Bima Yojana (VPBY), Credit Enhancement Guarantee Scheme (CEGS) for scheduled castes, and Sukanya Samriddhi Yojana**.

Why is financial inclusion important?

Financial inclusion strengthens the availability of economic resources and builds the concept of savings among the poor. Financial inclusion is a major step towards inclusive growth. It helps in the overall economic development of the underprivileged population. In India, effective financial inclusion is needed for the uplift of the poor and disadvantaged people by providing them with the modified financial products and services.

Analysis of Price Behavior, Inflationary Trends- Petroleum Product Pricing

Figure 1: Consumer Price Inflation Rates



Source: World Economic Outlook, January 2022 Update, IMF
Note: The figure are annual averages.
Advanced Economies include 40 economies and Emerging Markets and Developing Economies (EMDEs) include 156 economies as per IMF classification

Retail inflation, as measured by Consumer Price Index-Combined (CPI-C) inflation, in India, which was slightly above 6 per cent in 2020-21 owing to supply chain disruptions caused by COVID-19 restrictions, lockdowns, and night curfews, moderated during the current financial year. Retail inflation during 2021-22 (April-December) stood at 5.2 per cent (Table 1).

Table 1. General inflation based on different price indices (in per cent)

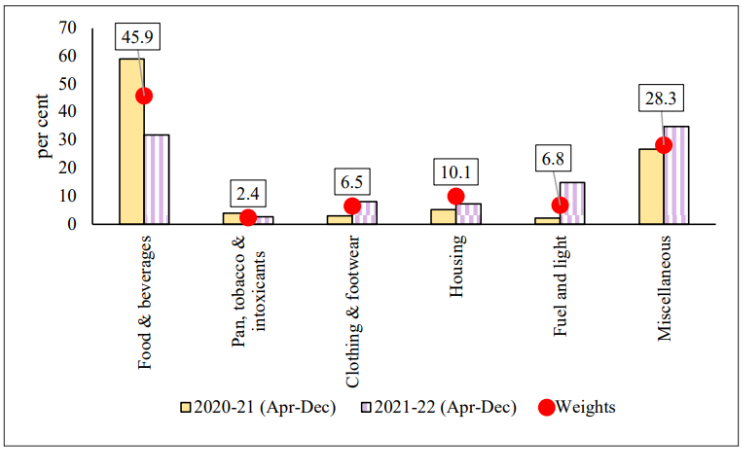
Indices	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2020-21^	2021-22*
WPI	-3.7	1.7	3.0	4.3	1.7	1.3	0.0	12.5
CPI - C (Headline Inflation)	4.9	4.5	3.6	3.4	4.8	6.2	6.6	5.2
CPI – IW#	5.6	4.2	2.9	5.6	7.3	5.2	5.2	5.0
CPI - AL	4.4	4.2	2.2	2.1	8.0	5.5	7.0	3.2
CPI - RL	4.6	4.2	2.3	2.2	7.7	5.5	6.8	3.5

Source: Office of the Economic Adviser, Department for Promotion of Industry, and Internal Trade (DPIIT) for WPI, National Statistical Office (NSO) for CPI-C and Labour Bureau for CPI-IW, CPI-AL and CPI-RL.
Notes: #CPI-IW inflation for 2020-21 onwards is based on new series 2016=100; (P) - Provisional; C stands for Combined, IW stands for Industrial Workers, AL stands for Agricultural Labourers and RL stands for Rural Labourers. *2021-22 (April to December) and CPI-IW, CPI-AL, RL (April to November)
^2020-21 (April to December) and CPI-IW, CPI-AL, RL (April to November)

Wholesale inflation, based on Wholesale Price Index (WPI), after remaining benign during the previous financial years, saw a sharp uptick during 2021-22 (April-December). A part of the observed rise in wholesale inflation could be attributed to the low base in the previous year. However, rising input costs and global commodity prices also contributed to the rise in wholesale prices.

What has driven retail inflation and why?

Figure 5: Contribution of groups to overall CPI-C inflation in 2020-21 (April-December) and 2021-22 (April-December) in per cent



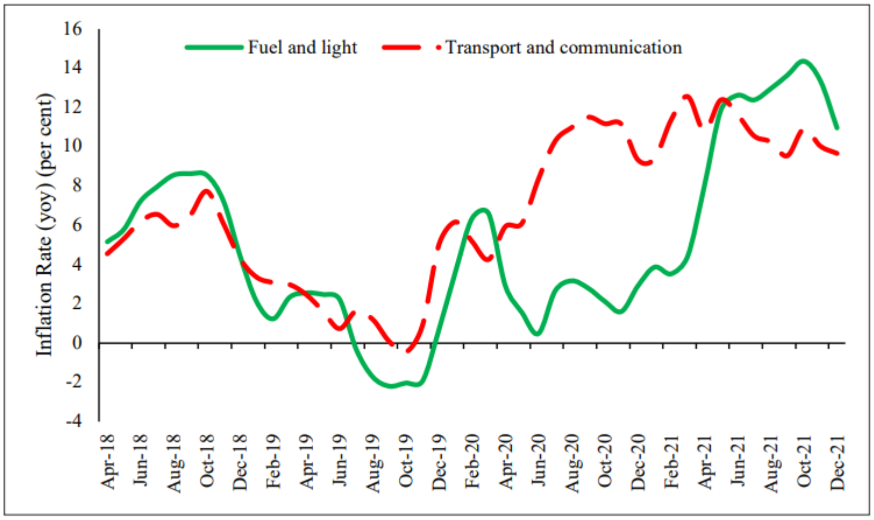
Source: NSO, MoSPI

Unlike 2020-21 (April-December) when ‘food and beverage’ drove inflation, during 2021-22 (April to December) the major drivers of retail inflation have been miscellaneous and ‘**fuel and light’ groups**. Contribution of miscellaneous group has increased from 26.8 per cent in 2020-21 (April-December) to 35 per cent in 2021-22 (April-December) and the contribution of ‘fuel and light’ increased from 2.3 per cent to 14.9 percent On the other hand, during the same period, the contribution of ‘food and beverages’ declined from 59 per cent to 31.9 per cent. Within the ‘miscellaneous group’, the sub-group ‘transport and communication’ contributed the most, followed by health.

‘Fuel and light’ and ‘Transport and communication’:

In 2021-22 (April-December), inflation in ‘fuel and light’ and ‘transport and communication’ was mostly driven by high international crude oil, petroleum product prices, and higher taxes (Figure 6). In April 2020, in response to subdued global demand because of COVID-19 induced restrictions, the price of Indian basket of crude oil dipped to $19.9/bbl. However, thereafter, the prices have been on an uptrend (Figure 7).

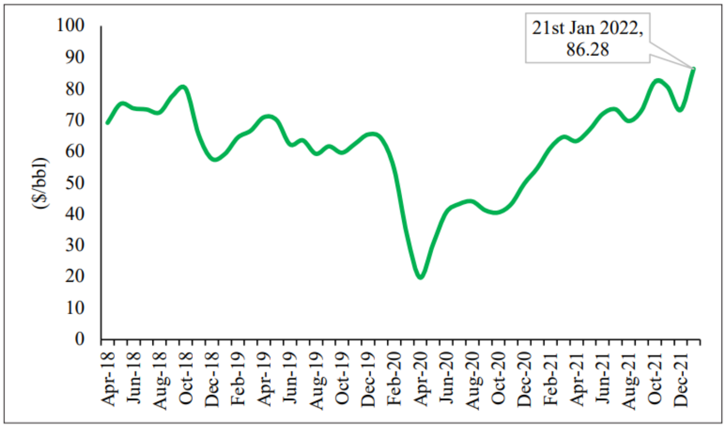
Figure 6: 'Fuel and light' and 'transport and communication' inflation



The upward trend was on account of unprecedented cuts in crude oil supply by OPEC and other oil producing countries. The upward trend continued in 2021 as well, as demand picked up with easing of COVID-19 restriction in most regions of the world. Besides, the unwinding of production cuts made last year by OPEC countries have been gradual and have not kept pace with the recovery in demand. However, since the second half of October 2021 crude oil prices had softened, due to factors including rising COVID-19 cases in Europe, and possibility of release of crude oil from strategic reserves by the USA and other countries.

Further, cut in central excise duty on petrol and diesel followed by reduction in VAT by majority of the State Governments, led to moderation of retail selling price of petrol and diesel in India in 2021 (Figure 8). However, crude oil price again witnessed an uptick in January 2022 with tight supply amid concerns about rising geopolitical uncertainties in Eastern Europe and the Middle East.

Figure 7: International Crude Oil Price (Indian Basket)



Source: PPAC, MoPNG

BALANCE OF PAYMENT: CONCEPT AND USES

The principal tool for the analysis of the monetary aspects of international trade is the balance of international payments settlement.

This statement, also simply known as the 'balance of payments' (BOP), is a systematic record of all international Foreign Trade and Balance of Payment External Sector and Trade Policy 14 economic transactions, visible and invisible, of a country during a given period, usually a year. In other words, the statement is a device for recording all the economic transactions within a given period between the residents of a country and the residents of other countries.

The BOP of each of the individual countries, technically speaking, always 'balances'. Such equality in the debit and credit sides of the BOP, known as equilibrium, has no economic significance.

It simply results from the double entry book-keeping procedure which is used to record the transactions.

The analysis of the BOP can be done in terms of its two major subdivisions: **(a) Current Account, and (b) Capital Account.**

Current Account

The Current Account can be broken down into two parts, viz., one, balance of trade, and, two, balance on invisibles. The Balance of Trade (BOT) deals only with exports and imports of merchandise (or visible items). The Balance on Invisibles (BOI) shows net receipts on account of invisibles. These include remittances, net service payments, etc. It is not necessary that the BOT should always balance; more often than not, it will show either a surplus or a deficit on BOI. If the surplus on BOI equals the deficit on BOT, the current account will show a net balance. But then there is no reason why these two balances should always be equal, again, always in opposite directions. As a matter of fact, the balance on current account can always show a deficit or a surplus.

A surplus on current account leads to an acquisition of assets or repayment of debts previously contracted, and a deficit involves withdrawal of previously accumulated assets or is met by borrowings.

Capital Account

The capital Account presents transfers of money and other capital items and changes in the country's foreign assets and liabilities resulting from the transactions recorded in the current account. The deficit on the current account and on account of capital transactions can be financed by external assistance (loans and grants) drawn from the International Monetary Fund and allocation of the Special Drawing Rights. The BOP accounts provide a link between the increase in gross external debt and the portfolio and spending decisions of the economy.

Thus, increase in gross external debt = Current account deficit (CAD) – direct and long-term portfolio capital inflows + official reserve increases + other private capital outflows

The above equation shows that an increase in external debt can have three broad sources: current account deficits not financed by long-term capital inflows, borrowing to finance a reserve build-up or private outflows of capital.

Balance of Payments and Developing Economies

- It is well-known in development economics that UDCs invariably start as debtor economies. In the process of development itself, these economies have to import 15 a great deal of capital goods, consumer goods, food and raw materials and spares and components.
- They also have to import some new technologies and, hence, the total exchange outgo cannot be matched by export earnings. But, it is expected that in a decade or two, as the new capital goods and technologies begin to become effective and their products are directed towards exports, export goods and services become competitive in cost and quality. In that case, the volume of exports expands and, in due course, begins to overtake imports.
- A developing economy then moves on from being a debtor economy to a balanced one in terms of BOP and finally becomes a creditor economy, exporting more than it imports and giving credit to buyers. Thus, from being a net debtor in the beginning, it becomes a net creditor in the end and, in fact, begins to invest abroad rather than have others lending to and investing in it.

Current Account Deficit (CAD): Boon or Bane

The general belief is that high CADs are dangerous. In general, this is correct. But the converse – that low CADs are good – is no

As seen above, a CAD is nothing but a measure of a country's saving gap, i.e., the excess of investment over savings. It represents the net transfer of resources from the rest of the world to the country running the deficit. Therefore, in a developing country, with a huge needs for funds for investment, a CAD makes sense. It allows it to finance investments that would have been well beyond what it could hope to finance with its own savings.

On the flip side, CADs are to be financed by foreign capital inflows. The capital flows are fickle, can be reversed, and have to be serviced. The right CAD for any country, therefore, depends on its ability to absorb and service capital inflows. If these resources can be deployed productively and in ways that enhance its ability to repay, a high CAD to GDP ratio is nothing to worry about

But if they cannot, then it is inviting trouble. Too high a ratio can prove unsustainable in the long run as it did in East Asian economies in 1998 and in Mexico earlier. To that extent, low ratio has its advantages. But, very low ratio carries with it an opportunity cost – of not being able to benefit from resources that could be drawn from outside.

TREND IN INDIA'S BALANCE OF PAYMENTS

India had faced pressures on BOP from time to time either due to certain domestic compulsions or due to external factors. The whole period, covering nearly six decades, can be divided into two sub-periods, viz.

(i) Before 1991, and (ii) since 1991. i) Period I (Before 1991)

The entire period was very difficult for India's BOP, partly because of slow growth of exports in relation to import requirements and partly because of adverse external factors. Foreign exchange reserves were at a low level, generally less than necessary to cover three months' imports. Almost the entire CAD (92 per cent) was financed by inflows of external assistance.

Table 18.5: Key indicators of India's Balance of Payments (As per cent of GDP).

Year Annual Average	Exports	Imports	Net Invisibles	Trade Balance	Current Account Balance
1985-90	5.10	8.30	0.90	–3.20	–2.30
1990-95	7.81	9.51	0.20	–1.70	–1.50
1995-00	8.50	12.04	2.38	–3.54	–1.18
2000-01	9.9	12.6	2.1	–2.7	–0.6
2001-02	9.4	11.8	3.1	–2.4	0.7
2002-03	10.6	12.7	3.4	–2.1	1.3
2003-04	11.1	13.3	4.5	–2.3	2.3
2004-05	11.8	16.5	4.3	–4.7	–0.4
2005-06	12.6	18.8	5.0	–6.2	–1.2
2006-07	13.6	20.1	5.5	–6.5	–1.0
2007-08	13.5	21.0	6.1	–7.4	–1.3
2008-09	15.4	25.1	7.4	–9.7	–2.4
2009-10	13.2	21.7	5.8	–8.6	–2.8
2010-11	14.5	23.2	5.1	–8.8	–3.7

After 1991 The prominent features of the BOP situation as it has emerged over the last two decades can be briefly summarised as follows:

1) On the current account:

(i) Trade deficits have been widening. Both exports and imports have multiplied fast, but imports have risen at a faster rate than exports. Expanding imports in turn reflect

(a) the impact of liberalisation measures, and

(b) increasing manufacturing activity in the domestic economy.

(ii) There has been a phenomenal increase in net surplus on account of invisibles. This, in turn, is principally due to

(a) buoyancy in private transfers (i.e., inward remittances), and fast expansion in exports of services, especially software. India is unique among emerging economies to have a sizable invisible surplus that substantially offsets the merchandise trade deficit. As a result, although India has been running a current account deficit (except during 2002-04 when India experienced a current account surplus), the deficit has been conveniently manageable, largely because of the huge surplus on the capital account.

2) On the capital account, India has been running a big surplus. The size of the surplus has been much more than what is required to finance the current account deficit. As a result, India has been rapidly building up its foreign exchange reserves. The capital account demonstrates following features:

(i) Both inflows and outflows of capital have increased, especially since 2003.

(ii) The composition of capital flows is undergoing a change:

- Official external assistance has been gradually losing out its significance;
- FDI and portfolio investment have surged, and among the two, the inflows on account of FDI have been more than on account of portfolio investment (except 2010-11 when the trend got reversed).

- With easing of controls, external commercial borrowings have been coming back into prominence. 17 Overall, India's balance of payments (current account plus capital account) has been in surplus, resulting in rapid build-up of foreign exchange reserves.

This has been due largely to massive inflows of foreign capital. Indeed, the acceleration in India's growth momentum since 2003 owes partly to the exceptionally easy global liquidity conditions that have increased risk-taking and also amplified the volume of capital inflows into India.

What Is an Exchange Rate?

An exchange rate is the value of one nation's currency versus the currency of another nation or economic zone. For example, how many U.S. dollars does it take to buy one euro? As of June 3, 2022, the exchange rate is 1.0721, meaning it takes $1.0721 to buy €1.

- An exchange rate is the value of a country's currency vs. that of another country or economic zone.
- Most exchange rates are free-floating and will rise or fall based on supply and demand in the market.
- Some exchange rates are not free-floating and are pegged to the value of other currencies and may have restrictions

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Understanding the Exchange Rate

- Typically, an exchange rate is quoted using an acronym for the national currency it represents. For example, the acronym USD represents the U.S. dollar, while EUR represents the euro. To quote the currency pair for the dollar and the euro, it would be EUR/USD. In the case of the Japanese yen, it's USD/JPY, or dollar to yen. An exchange rate of 100 would mean that 1 dollar equals 100 yen.
- Typically, exchange rates can be free-floating or fixed. A free-floating exchange rate rises and falls due to changes in the foreign exchange market. A fixed exchange rate is pegged to the value of another

currency. For instance, the Hong Kong dollar is pegged to the U.S. dollar in a range of 7.75 to 7.85.This means the value of the Hong Kong dollar to the U.S. dollar will remain within this range.

- Exchange rates can have what is called a spot rate, or cash value, which is the current market value. Alternatively, an exchange rate may have a forward value, which is based on expectations for the currency to rise or fall versus its spot price.
- Forward rate values may fluctuate due to changes in expectations for future interest rates in one country versus another. For example, let's say that traders have the view that the eurozone will ease monetary policy versus the U.S. In this case, traders could buy the dollar versus the euro, resulting in the value of the euro falling.
- Exchange rates can also be different for the same country. Some countries have restricted currencies, limiting their exchange to within the countries' borders. In some cases, there is an onshore rate and an offshore rate. Generally, a more favourable exchange rate can often be found within a country's border versus outside its borders. Also, a restricted currency can have its value set by the government.
- China is one major example of a country that has this rate structure. Additionally, China's yuan is a currency that is controlled by the government. Every day, the Chinese government sets a midpoint value for the currency, allowing the yuan to trade in a band of 2% from the midpoint.

Trends – Policies-India

The Department of Commerce has the mandate to make India a major player in global trade and assume a role of leadership in international trade organisations commensurate with India's growing importance. The Department devises commodity and country-specific strategy in the medium term and strategic plan/vision and India's Foreign Trade Policy in the long run.

- India's Foreign Trade Policy (FTP) provides the basic framework of policy and strategy for promoting exports and trade. It is periodically reviewed to adapt to the changing domestic and international scenario.
- The Department is also responsible for multilateral and bilateral commercial relations, special economic zones (SEZs), state trading, export promotion and trade facilitation, and development and regulation of certain export oriented industries and commodities.
- In 2018, then Commerce & Industry Minister Shri Suresh Prabhu envisaged a strategy to double India's exports by 2025.
- The approach included devising a commodity-specific strategy for key sectors like gems and jewellery, leather, textile & apparel, engineering sector, electronics, chemicals and petrochemicals, pharma, agri and allied products and marine products. Territory specific strategy will cover North American Free Trade Agreement (NAFTA), Europe, North East Asia, ASEAN, South Asia, Latin America, Africa and WANA, Australia, New Zealand, and CIS.
- The Foreign Trade Policy 2015-20 has formulated a number of incentive schemes for Indian exporters.

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The major schemes announced for exporters are
Merchandise Exports from India Scheme (MEIS) and Services Exports from India Scheme (SEIS).

Merchandise Exports from India Scheme (MEIS)

MEIS replaced multiple incentive schemes for Indian exporters that were available previously – Focus Product Scheme (FPS), Focus Market Scheme (FMS), Market Linked Focus Product Scrip (MLFPS), Vishesh Krishi and Gram Udyog Yojana (VKGUY), Agri.

Infrastructure Incentive Scrip.

Export of goods through courier or foreign post office, as notified in Appendix 3C, of FOB value up to Rs 500,000 per consignment shall be entitled for rewards under MEIS. If the value of exports is more than Rs 500,000 per consignment, then MEIS reward would be calculated on the basis of FOB value of Rs 5,00,000 only. MEIS cannot be availed for the following categories:

Supplies made from DTA units to SEZ units

Export of imported goods covered under paragraph 2.46 of FTP;

Exports through trans-shipment, meaning thereby exports originating in third country but trans-shipped through India;

Deemed exports;

SEZ/ EOU/EHTP/BTP/FTWZ products exported through DTA units;

Export products, which are subject to Minimum Export Price or export duty.

Exports made by units in FTWZ.

MEIS incentives are available at 2, 3, 4 and 5% and 7, 10 and 20% of the FOB value of exports. At the time of introduction on April 1, 2015, MEIS covered 4914 tariff lines at 8 digits. Keeping in mind the global economic downturn, it was expanded to 7,914 lines, all with global coverage. As of 2019, the scheme covers 8,057 tariff lines at 8-digit level. The total annual financial cover for MEIS during 2018-19 was Rs 30,819.91 crore.

Services Exports from India Scheme (SEIS)

The scheme was launched to promote exports of notified services from India. Service providers should have minimum net free foreign exchange earnings of US$ 15,000 during the year of rendering service to be eligible for Duty Credit Scrip. For individual service providers and sole proprietorships, the net free foreign exchange earnings should be over US$ 10,000 a year.

following points need to be noted for these schemes:

Additional Customs duty specified under Sections 3(1), 3(3) and 3(5) of the Customs Tariff Act, 1975/Central excise duty paid in cash or through debit under Duty Credit scrip shall be adjusted as CENVAT Credit or Duty Drawback as per DoR rules or notifications. Basic custom duty paid in cash or through debit under Duty Credit scrip shall be adjusted for Duty Drawback as per DoR rules or notifications.

Duty credit scrip shall be permitted for payment of duty in case of import of capital goods under lease financing.

Export performance cannot be transferred from one IEC holder to another.

MEIS rewards can be claimed either by the supporting manufacturer (along with disclaimer from the company/firm who has realised the foreign exchange directly from overseas) or by the company/ firm who has realised the foreign exchange directly from overseas.

Duty credit scrip can be utilised/debited for payment of custom duties in case of EO defaults for authorisations issued under Chapters 4 and 5 of Foreign Trade Policy.

Duty credit scrips can also be used for payment of composition fee under FTP, for payment of application fee under FTP

Export Promotion Capital Goods (EPCG) Scheme

The EPCG scheme is aimed at facilitating imports of capital goods to produce quality goods and services and improve India's manufacturing competitiveness.

The EPCG Scheme permits imports of capital goods for pre-production, production and post-production at zero customs duty. Capital goods imported under EPCG Authorisation for physical exports are also exempt from IGST and Compensation Cess up to March 31, 2020.

Interest Equalisation Scheme

The Interest Equalisation Scheme came into effect on April 1, 2015. The scheme provides for interest equalisation @ 3% per annum on pre-shipment and post-shipment rupee export credit. The scheme is available to all exports under 416 specified tariff lines [at ITC (HS) code of 4 digit, largely covering labour intensive sectors] and to all exports made by Micro, Small & Medium Enterprises (MSMEs) across all ITC (HS) codes. The sector coverage mostly comprises agriculture or food items, auto components, handicraft, electrical engineering items, and telecom equipment.In November 2018, the RBI increased the interest subsidy under IEC to 5% for MSMEs. Furthermore, in January 2019, the scheme was extended to merchant exporters.

Deemed exports

The government categorises certain transactions wherein goods supplied do not leave the country and payment is received in Indian rupees or free foreign exchange as deemed exports, provided the goods are manufactured within India. In the case of manufacturers, the following categories shall be regarded as "Deemed Exports":

(a) Supply of goods against Advance Authorisation/Advance Authorisation for annual requirement /DFIA;

(b) Supply of goods to EOU/STP/EHTP/BTP;

(c) Supply of capital goods against EPCG Authorisation

Deemed exports shall be eligible for any/all of following benefits in respect of manufacture and supply of goods, qualifying as deemed exports, subject to terms and conditions.

INDIAN AND WTO

- India's association with the World Trade Organization goes back to the days of GATT, its predecessor. India has often steered discussions in favour of the less developed and developing countries, right since its membership in the GATT.
- During the Uruguay talks, India & Brazil were not too keen on negotiating on services on an equal footing with the industrialised world. They also pointed out that the industrialised nations failed to live up to their commitments w.r.t. trade in textiles and agrarian products.
- India & Brazil urged the members to rescind the measures that contradict GATT and not to introduce new measures. Over time, however, India softened its stance towards the First World Countries. Eventually India and other developing countries (G-10) succumbed to the US position of inclusion of new issues – services, intellectual property and investment measures – in the discussions.

- A major turning point in India's approach to trade occurred in 1991. Crippled with severe economic challenges and trade deficits, India was forced to open its doors to the outside world.

Liberalisation, privatisation and globalisation became the governing principles of India's foreign policy. The dismantling of trade barriers and welcoming foreign investors was in sharp contrast to India's earlier protectionist stance. This proved to be a game changing year for India's economy.
After its integration with the global economy, India made efforts to emerge as a growing economy. The WTO membership was one such platform, which seemed to be promising for India's growth. Thus, India joined the WTO on 1st January, 1995. Some of the major areas where India has benefited from this membership include granting access to various markets, reduction of tariff and non-tariff barriers, peaceful resolution of disputes on an equal footing, granting of concessions and getting an impetus for trade.

MAJOR WTO AGREEMENTS & IMPLICATIONS FOR INDIA

India is governed by a number of major agreements like Agreement on Subsidies & Countervailing Measures, GATS, SPS, TRIPS, TRIMS, Agreement on Agriculture & Agreement on Textiles, as a member of the WTO.

- Agreement on subsidies and countervailing measures –
- General Agreement on Trade in Services – GATS
- Trade-Related Aspects of Intellectual Property Rights – TRIPS
- Agreement on Textiles & Clothing – ATC
- Sanitary & Phyto-Sanitary Measures

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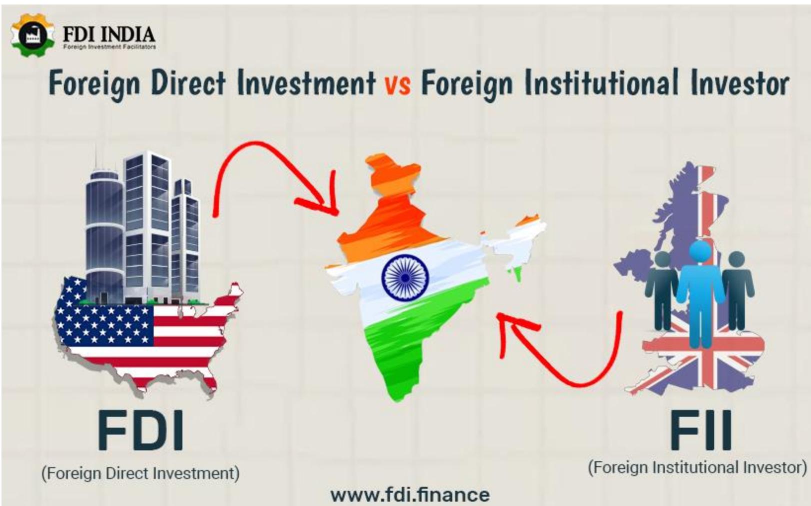
ROLE OF FDI AND FDI IN INDIA



- **Foreign direct investment (FDI)** is when a company takes controlling ownership in a business entity in another country. With FDI, foreign companies are directly involved with day-to-day operations in the other country. This means they aren't just bringing money with them, but also knowledge, skills and technology.
- Generally, FDI takes place when an investor establishes foreign business operations or acquires foreign business assets, including establishing ownership or controlling interest in a foreign company.
- Foreign Direct Investments are commonly made in open economies that have skilled workforce and growth prospects. FDIs not only bring money with them but also skills, technology and knowledge.
- FDI or Foreign Direct Investment is when a foreign individual or company invests in countries situated abroad. The Reserve Bank of

India oversees the Foreign Exchange Management Act (FEMA) 2000, which governs India's foreign direct investment policy (RBI).

- Foreign direct investment (FDI) is critical to a country's economic development. The entry of foreign cash has allowed India to improve its infrastructure, increase productivity, and increase employment. FDI also serves as a vehicle for acquiring sophisticated technology and mobilising foreign exchange reserves.
- Moreover, foreign exchange reserves in the country enable the RBI (India's central banking institution) to interfere in the foreign exchange market and limit any unfavourable movement to keep foreign exchange rates stable.
- As a result, it creates a more favourable economic climate for India's economic development. Tracing back the FDI'S history in India If we trace down the FDI history, we have to go to the pre-independence era when the East India Company had arrived. Following independence, policymakers began to pay attention to concerns connected to foreign finance and MNC operations.
- The FDI strategy was created to keep national interests in mind, and it intends to use FDI to acquire sophisticated technology and mobilise foreign exchange resources. The FDI policy has changed over time and according to economic and political regimes.

Why do we need FDI?

Certain factors show the importance of FDI in India.

- **Boost in employment**
- **Increment in exports**
- **Advancement in various fields**
- **Competitive market**

How has FDI benefited India?

If we look back upon it, FDI has proven to be a successful thing. During the pandemic, the FDI inflow has increased around 19%, compared to last year. According to the latest foreign direct investment (FDI) data issued by the Ministry of Commerce, India received a record $81.72 billion in FDI in the fiscal year 2020-21, up from $74.39 billion in 2019-20.

What Is a Foreign Institutional Investor (FII)?

A foreign institutional investor (FII) is an investor or investment fund investing in a country outside of the one in which it is registered or headquartered. The term foreign institutional investor is probably most commonly used in India, where it refers to outside entities investing in the nation's financial markets.1 The term is also used officially in China

Understanding Foreign Institutional Investors (FIIs)

- ✓ FIIs can include hedge funds, insurance companies, pension funds, investment banks, and mutual funds. FIIs can be important sources of capital in developing economies, yet many developing nations, such as India, have placed limits on the total value of assets an FII can purchase and the number of equity shares it can buy, particularly in a single company.
- ✓ This helps limit the influence of FIIs on individual companies and the nation's financial markets, and the potential damage that might occur if FIIs fled end masse during a crisis.
- ✓ Foreign Institutional Investors (FIIs) in India
- ✓ Some of the countries with the highest volume of foreign institutional investments are those with developing economies, which generally provide investors with higher growth potential than mature economies. This is one reason FIIs are commonly found in India, which has a high-growth economy and attractive individual corporations to invest in. All

FIIs in India must register with the Securities and Exchange Board of India (SEBI) to participate in the market.

- ✓ A foreign institutional investor is an investor in a financial market outside its official home country.
- ✓ Foreign institutional investors can include pension funds, investment banks, hedge funds, and mutual funds.
- ✓ Some countries place restrictions on the size of investments by foreign investors.
- ✓ Example of a Foreign Institutional Investor (FII)
- ✓ If a mutual fund in the United States sees a high-growth investment opportunity in an India-listed company, it can take a long position by purchasing shares in an Indian stock market. This type of arrangement also benefits private U.S. investors who may not be able to buy Indian stocks directly. Instead, they can invest in the mutual fund and take part in the high-growth potential.

ROLE OF MNCS IN ECONOMIC DEVELOPMENT

- ❖ MNCs are often considered as engines of growth by the global institutions..
- ❖ Potentially, the MNCs can contribute in various areas such as capital formation, human resources, environment, technology, and trade of home as well as the host countries.
- ❖ Through their linkages with local companies, they can contribute to capital formation and boost efficiency.
- ❖ Presence of MNCs can help generate employment, bring in world-class managerial skills, provide training, and can have learning effects also. It is also believed that MNCs can help utilise underemployed or unemployed resources
- ❖ It can lead to creation of enclave economics. It is a known fact that MNEs are a huge repository of modem technology, established R&D, and can be a boon for industrial upgrading.

- Parent firms usually provide the best managerial skills and practices, technology, and equipment to firms in host countries. Unless some degree of management control is allowed, technology owners are normally reluctant to make their technology available.
- Thus in multinational 3-6 activities where the investor retains some management control over the resources, host countries have the benefits of access to best technologies available.
- It not only provides modern technology but also brings in cleaner environment-friendly ms,as organisations provide resources of various kinds, provide capabilities, and even markets. They help to create not only jobs and wealth but also supply foreign currency through their involvement in different types of ventures.
- Presence of MNEs also leads to expansion of export and low cost imports. Last but not the least, MNEs bring in world-class, time-tested global standards.
- Multinational activities not only contribute to local value added, but also enhance the competitiveness and capabilities of the local resources.
- MNEs can have significant political, economic, and social impact on an economy. First of all, MNEs help in easing the trade deficit in terms of capital flow for a host country that runs a trade deficit.
- It is observed that initially the balance of payments effects of MNEs is favourable to the host country and unfavourable to the home country. However, it gets reversed later. There are certain genuine fears of host countries. It is said that local entrepreneurs are at a disadvantage vis-a-vis MNEs when it comes to raising resources.
- Thus they have the potential to wipe out the local entrepreneurs or companies and have the capability to take away the best local resources available. After a certain level of development in a country the involvement of MNEs can even lead to reduction in R&D activities in the host country.

- The effect of MNEs does not remain confined to host countries alone. It can have an impact on the home country also. It leads to job losses in home countries due to FDI in some other countries. One of the arguments cited is the possible loss of technological superiority of the home/ country.
- Another possible effect on the home country could be the loss of tax revenue due to the shifting of operational bases of the companies from the home country to some other country where the tax structure is lenient or the tax incidence is low.
- Further, the MNEs can have the potential to make government's control virtually ineffective by accessing the international capital. markets and circumventing the domestic monetary policies.
- In spite of local customs and macro-economic policies controlling/regulating the employment, MNEs have the potential to impact on various aspects of labour force or employment such as level and growth of employment, reward/compensation, working conditions, human resource development, industrial relations, and quality of the labour force also.
- When it comes to the effect of MNEs on the trade, the available literature is not generalisable about the impact of MNEs on trade. However, the empirical studies strongly support that MNEs, over the years, have changed the structure of composition of world trade.