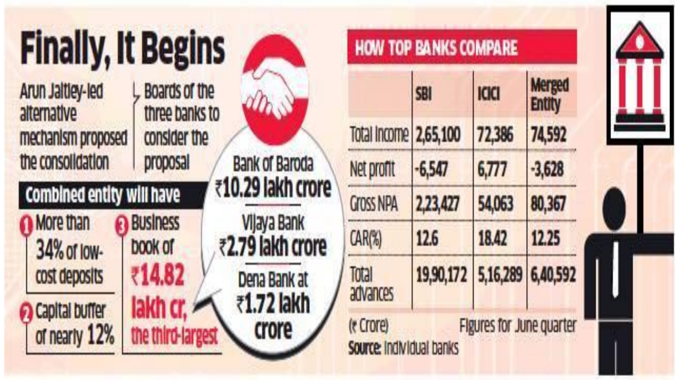
# GS PAPER 3

## *Economic Growth and Development – Sept'18*

### Bank of Baroda, Vijaya Bank & Dena Bank To Be Merged

*Syllabus: Indian Economy and Issues relating to mobilization of resources*

**In News**




- The government has proposed the merger of three banks *i.e.* Bank of Baroda, Vijaya Bank and Dena Bank aimed at creating the country's third biggest lender.
- This is also seen as preparing the ground for consolidation among the remaining 17 state-owned lenders that have been a drain on the exchequer and marking the next big move in banking reforms.
- The combined entity will have a strong presence across the nation with more than 34% of low-cost deposits, a capital buffer of nearly 12% and a business book of Rs. 14.82 lakh crore. The Bank of Baroda is the biggest of the three with Rs. 10.29 lakh crore of total business, followed by Vijaya Bank at Rs. 2.79 lakh crore and Dena Bank at Rs.1.72 lakh crore.
- Previously, the govt had pushed through consolidation of the State Bank of India group, with SBI absorbing five associate banks and Bharatiya Mahila Bank. That process was completed last year.

**Benefits**

- ***Overall benefits:*** The consolidation will help create a strong global competitive bank with economies of scale and enable realisation of wide-ranging synergies.
- ***Increased lending capacity:*** The merger gives more room to lend to the top companies and makes capital requirements simpler.
- ***Reduced capital requirement under Basel-III:*** The amalgamation will mitigate the pressure on government to set aside money to meet recapitalization needs of Basel III norms. Since April 2017, government has already set aside Rs 99,476 crore for recapitalization.
- ***Geographical synergy:*** The Vijaya Bank and Dena Bank have reasonable presence in the southern and western regions, respectively, which should complement the more pan-Indian spread of Bank of Baroda.
- ***Moving to a sensible strategy:*** For long, it has been recognised that having several banks that are majority-owned by the government, virtually doing the same business and competing for the same pie of customers wasn't a sensible strategy.
- ***Other advantages:*** Rationalization of branches, re-deployment of manpower and cost-reduction, efficiency in its treasury operations, enhanced customer base and market reach and lower operating costs are seen as main advantages.

**Challenges**

- ***Imposition from above:*** The amalgamation of the three PSBs has been decided through the Alternative Mechanism for consolidation of public sector banks constituted in November 2017, comprising three cabinet ministers. As per the provisions of *Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970,* the Central government must consult with the RBI while formulating such amalgamation schemes for the banks and place them before both Houses of the Parliament for their endorsement. The final power to decide on the merger/amalgamation scheme rests with Parliament. Decision-making on bank mergers through the ministerial mechanism amounts to an imposition from above. This attenuates the functional autonomy of the bank boards and could adversely impact the concerned bank's business operations, financial health, morale of the officers and employees and the confidence of the customers.
- ***Penalization for better performing bank:*** The Union Government seems to be penalizing Vijaya Bank for its better performance in terms of better managed NPA, profit *etc.* by terminating its independent existence through the amalgamation proposal.
- ***NPAs remain the same:*** The amalgamation of the balance sheets of the three PSBs will only alter the NPA and capital adequacy ratios through financial engineering, without helping in the process of actual NPA recovery.
- ***Shifting focus away from NPA issue:*** The bank merger proposal is more of a digression, which seeks to turn attention away from the core issue of NPA recovery, in which the govt has floundered.
- ***Human resource issue:*** The combined entity will have a total of 85,675 employees, thus handling the human resources will be a challenge.
- ***Reduction of bank branches in hinterland:*** Bank branch penetration continues to remain low in India compared to our developing country peers, which warrants an expansion of bank branches and activities. M&As, on the other hand would cause greater concentration in banking, which will curb domestic competition and lead to reduction in bank branches.
- ***Other banking activities of banks will suffer:*** The organizational disruption caused in these PSBs through the merger would relegate every other activity to the backstage. The banks concerned will have to do fire-fighting for the next few years, adversely affecting other banking activities, merely in order to integrate people, processes and procedures.
- ***Decision not based on efficiency:*** The Centre's big bang bank merger plan has not been driven by complementarities, growth potential or cost efficiency. Instead, the weak state of small PSBs and the Centre's tight finances that deter massive capital infusion, appear to have triggered off the hasty amalgamation of the three PSU banks.
- ***Creation of systemic risk:*** Gigantism will add to systemic risks, harming the economy and the industry. The goal should be to keep banking competitive and to prevent the creation of banks that are too big to fail.
- ***Need banks of varying size:*** A few big banks are fine, but we need new banks of varying sizes that can compete for custom and achieve functional financial inclusion.

**Way forward**

- Creating a large bank via forced mergers is simple. Ensuring that it is globally competitive and ring-fenced from political interference is the real challenge.

- The government's decision to merge Bank of Baroda, Dena Bank and Vijaya Bank will yield the desired results only if these lenders rationalized their branches, looked to reduce costs and handled people issues well.
- An amalgamation may partially offset some immediate problems. But as long as the incentive structure for bankers remains similar to what existed in the past, banks will remain vulnerable.
- Moreover, the visible impact of this move will take time to fructify but the ultimate test will be how they scale up business and fasten credit growth, which has been an issue with banks.
- Even if one concedes that consolidation is possibly the only way to handhold weaker PSU banks, the Centre should have also hastened governance reforms.
- There is a need for taking concrete action on creating autonomous boards, for which government needs to dilute its stake to below 51 per cent, is imperative. Other constraints such as dual regulation and board constitution have to be dealt with.

## Post Payment Bank

*Syllabus: Indian Economy and Issues relating to mobilization of resources*

### In News

Prime Minister recently launched the ***India Post Payments Bank (IPPB),*** a financial service provider that will operate under the country's postal department.

### About Payment Bank

- ***Can accept deposit only:*** The government-owned payments bank will be able to accept *deposits of up to Rs. 1 lakh* from customers but cannot lend these funds to advance risky loans at higher interest rates.
- ***Provider of other services:*** It, however, plans to offer a variety of other financial services to people, including the holders of postal savings accounts that are worth over Rs. 85,000 crore.

### Purpose

- ***Financial inclusion:*** The primary rationale behind the public payments bank idea is to help in the government's goal of achieving financial inclusion by providing savings, remittance, and payments services to the rural and unorganised sectors of the economy.
- ***Reinvigorate postal system:*** It is also hoped that the payments bank idea will help reinvigorate the postal system, which has a wide network of branches across India. All the 155000 post offices in the country are expected to be linked to the IPPB system by December 2018.

### Challenges

- ***Viability:*** A big challenge facing the new public payments bank is whether it can manage to earn the profits required to survive as a standalone business entity. Given the severe restrictions imposed by the Reserve Bank of India on how payments banks in general can employ their funds, the odds seem to be stacked against the IPPB at the moment.
- ***Competition from private sector:*** The IPPB is also likely to face stiff competition from private companies, which are generally more nimble in adapting to business realities and far more customer-friendly compared to the government-owned behemoths. And with increasing competition, the IPPB's revenues and margins are also likely to come under pressure.

## Mudra Loans Credit Risks

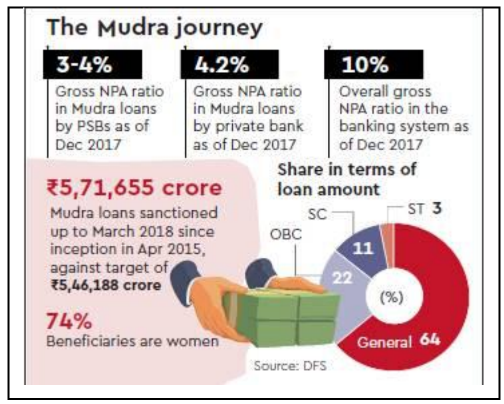
*Syllabus: Indian Economy and Issues relating to mobilization of resources.*

### In News

- Former RBI Governor Raghuram Rajan, in his report to Parliament recently, said that while non-performing assets (NPA) stemming from corporate loans are a current problem, the government should focus on sources of the next crisis. In particular, he warned the government should refrain from setting ambitious credit targets or waiving loans. He called out Mudra loans as those with potential credit risks.
- He particularly flagged the culture of meeting credit targets, which are sometimes achieved by abandoning appropriate due diligence, creating the environment for future NPAs. Both Mudra loans as well as the Kisan Credit Card, while being popular have to be examined more closely for potential risk.

### About Mudra

- ***Aim:*** The Micro Units Development & Refinance Agency Ltd. (Mudra) was set up in 2015 under the **Pradhan Mantri Mudra Yojana (PMMY)** to help develop and refinance the non-corporate business sector by supporting finance institutions that lend to micro/small business entities engaged in manufacturing, trading and service activities.
- ***Focus on microfinance:*** It is aimed at using micro finance as an economic development tool that helps to provide income-generating opportunities to the people at the bottom of the pyramid, targeting small manufacturing units, shopkeepers, fruits and vegetable vendors, truck and taxi operators, food-service units, repair shops, machine operators, artisans and food processors.




### Challenges

- ***Neglecting the best practices:*** Critics of the scheme say that too many best practices in loan origination have been neglected, while authorizing and disbursing loans. Earlier this year, the CBI registered a case against a former official of Punjab National Bank for alleged abuse of official position in sanctioning and disbursing 26 Mudra loans amounting to Rs. 65 lakh.
- ***Lack of collateral:*** Even, if loans are sought by business owners genuinely seeking growth and bankers disburse them with an eye on economic development, ensuring repayment is still a challenge. As these loans are unsecured, thus a collateral that could protect the interests of the bank is not required, unless an asset that is purchased can itself serve as collateral.
- ***Volatility in business:*** The scheme is meant for those who need small amounts, but do not have access to such funds, but the very nature of the business of such borrowers is susceptible to volatility and annual cycles, not to mention the itinerant ways of some business owners, such as vegetable vendors. They may choose one location for their place of business on a day and another elsewhere in their city the next day.

- ***Banks understaffed to monitor:*** Further, the public banking system may not be staffed for work this may entail. When it comes to collection, bank staff may choose to go after one loan with outstanding of Rs. 10 lakh, for example, rather than 10 loans of Rs. 1,00,000 each.

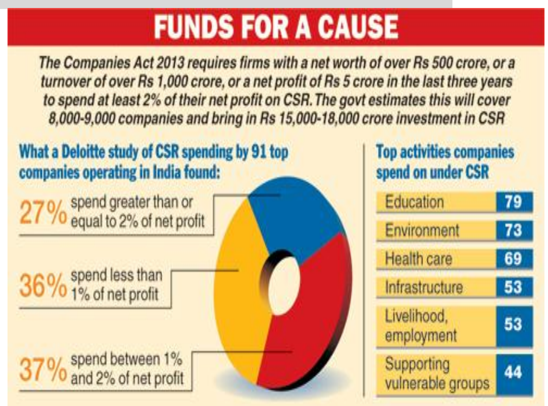
## Corporate Social Responsibility

*Syllabus: Indian Economy and Issues relating to mobilization of resources.*

### Introduction

- Indian Companies Act (2013) under **Section 135** mandates that Indian corporates, public and private, must allocate at **least 2 per cent of their net profits** for CSR (Corporate Social Responsibility).
- The Act defines broadly the social framework within which companies should spend their CSR funds but beyond that, companies have the freedom to identify the projects and determine the modalities of implementation.
- The Act was gazetted in 2014 and since then, according to the Ministry of Corporate Affairs (MCA), companies have spent Rs 5922 crore, Rs 7549 crore and Rs 8446 crore in 2014, 2015 and 2016 respectively on eligible CSR activities.

### Problems Faced In Implementing CSR




- ***Limited experience:*** The corporates have limited experience and expertise in addressing the complexities of social development.
- ***Concentration of funds in few sectors:*** The MCA data shows that the bulk of the CSR money *(almost 75 per cent)* is allocated to just three sectors *i.e.* education, health (including sanitation and water) and rural poverty.
- ***Skewed distribution of funds:*** The MCA data also reveals a skew in the distribution of the CSR funds. *Almost 40 per cent* of the money goes to just a few relatively well-developed states such as Maharashtra, Gujarat, Karnataka, Tamil Nadu, Andhra Pradesh and Telangana. Thus, this model in short aggravates rather than alleviates existing regional and social disparities.

### Way Forward

- Thus the above issues have raised the need for a different model for CSR expenditure such as corporates pool their CSR funds into a common *CSR trust* and allow an autonomous body to manage and disburse the funds. This body should be a confederation of corporates, NGOs, domain experts and government. Its role should be to define the CSR agenda, identify the CSR projects, select the local partners, allocate the resources and oversee implementation. Such a collaborative model would be an improvement on the present individualistic approach.
- This will also enable the pooling of knowledge and experience, the sharing of best practice and the leveraging of scale economies. Moreover, it would provide a forum for learning from the grassroots experience of NGOs and the local community and facilitate back-office synergies & reduce duplication of efforts.

- The government is responsible for social development. Corporates cannot replace them in this role. But governments need help. Corporates can make a meaningful contribution especially if there is a platform that allows them to offer the totality of their skills, technology and resources.

## Commerce Ministry Carries Out Fresh Review Of Free Trade Pacts

*Syllabus: Indian Economy and Issues relating to mobilization of resources.*

**In News**

- The Commerce Ministry is carrying out a fresh review of all free trade agreements entered into by the country so far to analyze the impact of such agreements on various sectors.
- The idea is to examine each FTA and see where the Indian industry has gained and what challenges have cropped up due to the pacts.
- The review is being carried out at a time when the government is struggling to figure out whether India will benefit from the ambitious Regional Comprehensive Economic Partnership (RCEP) being negotiated between 16 nations, including India, China and the 10 members of ASEAN countries.

**The Analysis**

- ***Dual impact:*** The Indian industry and farmers have always been wary of free trade pacts. There have been complaints of cheap imports from countries with which India has signed FTAs rendering the domestic products uncompetitive. However, there are also instances where Indian exports have increased due to import duties lowered by FTA partner countries.
- ***Issues of different sector:*** Different sectors have had issues with different FTAs. **For instance**, the textile industry is not happy with concessions given to South Asia, especially Bangladesh; the electronic goods industry is not happy with concessions to South East Asia, Japan and South Korea; the spices sector is concerned about imports from Sri Lanka, while the vanaspati industry has problems with concessions to Malaysia and Indonesia.
- ***Lower utilization rate:*** The bigger issue with India is that utilisation of FTA by Indian exporters to send their goods to partner countries is very low. In fact, estimates made by the Asian Development Bank, places the utilisation rate of **India's FTAs between 5 per cent and 25 per cent,** which is one of the lowest in Asia.

## India Moving Towards Tax-Compliant Society

*Syllabus: Indian Economy and Issues relating to mobilization of resources.*

**In News**

- ***Increase of 70%:*** The total number of income tax returns (ITRs) e-filed up to August 31, 2018, was 5.42 crore as against 3.17 crore up to August 31, 2017, marking an increase of 70.86%. A remarkable increase was seen in the number of ITRs filed by salaried individuals and also those availing the benefit of the Presumptive Taxation Scheme.
- ***Presumptive income scheme:*** The government had Liberalised the presumptive income scheme for small traders and entrepreneurs with **annual turnover of less than Rs. 2 crore**

and introduced a similar scheme for professionals with annual turnover of **less than Rs. 50 lakh**, with the hope that there would be significant increase in compliance.

- ***Analysis:*** This is indicative of an India moving steadily towards a more tax compliant society, and reflects the impact of continuous leveraging of technology to improve taxpayer service delivery.

## WEF Future of Jobs Report

*Syllabus: Indian Economy and Issues related to employment.*

**In News**

- According to a 'Future of Jobs' report released by the World Economic Forum (WEF), by 2025, machines are projected to overtake humans in workplace task hours in 12 key industry sectors.
- Technological changes such as **Fourth Industrial Revolution, high-speed mobile Internet and cloud technology, artificial intelligence, robots and automation** will bring a significant shift to existing work tasks.
- In 2018, humans performed an average of 71% of total task hours across the 12 industries spanning manufacturing, services and high tech. **By 2025, that will drop to just 48%, Machines will perform the remaining 52%.**
- Jobs expected to become redundant include routine-based white-collar roles, such as data entry clerks, accounting and payroll clerks.
- **However, if sufficient reskilling is done, new jobs will still lead to a net gain in employment opportunities.** In India, 54% of employees in these sectors will need reskilling by 2022.

## Atal Bimit Vyakti Kalyan Yojana

*Syllabus: Indian Economy and Issues related to employment.*

**In News**

- The Employee's State Insurance Corporation (ESIC) has launched **Atal Bimit Vyakti Kalyan Yojana** for Insured Persons (IP) covered under the Employees' State Insurance Act, 1948.
- It has been launched considering the change in employment pattern which has transformed from a long term employment to fixed short term engagement in the form of contract and temporary jobs.
- This scheme is a **relief payable in cash directly to the bank account in case of unemployment** and while they search for new engagement.
- The cash benefit given to the unemployed persons searching for new employment will be 25 percent of his average earning of 90 days.
- For super specialty treatment, the ESIC has reduced the requirement of insurable employment of two years to six months with contribution requirement of only 78 days.

**ESI**

- ESI is a self-financing social security and health insurance scheme for Indian workers.

- It is managed by the **Employees' State Insurance Corporation (ESIC)** which is an autonomous body under Ministry of Labour and Employment.
- It was established in **1952 as a statutory organisation under the Employee State Insurance Act, 1948.**
- ESIC is for establishments having more than 10 workers with monthly wage ceiling of Rs. 21,000**.**

## Punch Tantra

*Syllabus: Indian Economy and Issues relating to employment.*

### In News

- Union Minister for Tribal Affairs introduced the World Boxing Champion Ms. Mary Kom as the Brand Ambassador of “Tribes India” and also launched the “Punch Tantra” Diwali collection.
- **The Punch Tantra range of tribal artefacts** includes handlooms and handicrafts specially introduced for the coming Diwali and festival season.
- These are inspired and promoted by the **World Boxing Champion Mary Kom.** *The “punch” of Mary Kom represents the hard work and dedication of the tribal master craftpersons in creating such master prices of art and craft.*

### Tribes India

- In **March 2018**, Union Ministry for Tribal Affairs launched **‘e-Tribes: Tribes India’** as an initiative for digital commerce for Tribals. This includes **e-commerce portal of TRIFED, www.tribesindia.com and M-commerce, android app ‘Tribes India’.**
- The launch of **e-commerce site will help to eliminate intermediaries & bring artisans directly in touch with buyers.**

## Jan Dhan Yojana Extended Indefinitely

*Syllabus: Inclusive growth and issues arising from it.*

### In News

- The Union government has transformed the Pradhan Mantri Jan Dhan Yojana (PMJDY) into a **open-ended scheme** by approving its **indefinite continuation** to ensure all citizens have the same access to banking and financial instruments.
- Launched in 2014, the scheme aims at **improving access to financial services**, especially in the rural areas and among lower-income households, in a **mission for financial inclusion**.
- The scheme offers awareness and instruments of insurance, pension, and bank accounts.

### Amendments

- In its new avatar, the Jan Dhan Yojana will now have a r**elaxed age limit of 18-65 years** for availing overdraft facility as against the earlier 60 years upper limit.
- Further, the overdraft facility has been extended from Rs 5,000 to Rs 10,000 and there will be no conditions attached for an overdraft up to Rs 2,000.
- Under the **expanded coverage from ‘every household to every adult’**, the new accidental insurance cover for new RuPay cardholders stands at Rs.2 lakh instead of 1 lakh, for PMJDY accounts opened after August 28, 2018.

## Mauritius Tops India's FDI Chart

*Syllabus: Effects of liberalization on economy*

### In News

- ***Introduction:*** Mauritius remained the top source of foreign direct investment (FDI) into India in 2017-18 followed by Singapore, whereas **total FDI stood at $37.36 billion** in the financial year, a marginal rise over the $36.31 billion recorded in the previous fiscal, according to RBI data.
- ***Country wise FDI:*** While FDI from Mauritius totalled $13.41 billion as against $13.38 billion in the previous year, inflows from Singapore rose to $9.27 billion from $6.52 billion. FDI from the Netherlands declined marginally to $2.67 billion as against $3.23 billion a year earlier.
- ***Sector wise FDI:*** Provisional data for the fiscal ended March revealed that FDI into the manufacturing sector witnessed a substantial decline to $7.06 billion, as against $11.97 billion a year earlier. However, FDI into communication services rose to $8.8 billion in FY18 from $5.8 billion. The inflows into retail and wholesale trade also shot up to $4.47 billion as against $2.77 billion, while financial services too saw a rise to $4.07 billion from $3.73 billion in the previous year. The fact that these sectors accounted for more than 50% of total FDI of $37.36 billion in 2017-18 reflects the global interest in new areas, including online marketplaces and financial technologies.

## SEBI's FPI Circular

*Syllabus: Effects of liberalization on economy*

### In News

- A fresh row broke out with Foreign Portfolio Investors (FPI) protesting over the provisions in SEBI's circular of April 10 2018, alleging implementation of the rules could lead to around **$75 billion** of funds flowing out of the country.
- SEBI has asked the working group headed by **Harun R. Khan** to look into the concerns expressed by the FPIs and give suggestions.

### The Issue


- ***April 10 Circular:*** SEBI issued a circular directing certain categories of FPIs such as trusts, banks, mutual funds, and investment managers to disclose their beneficial owners within six months. A beneficial owner is a person who, directly or indirectly, derives the benefits of ownership. The circular said that Non Resident Indians (NRIs), Persons of Indian Origin (PIOs), Overseas Citizens of India (OCIs) and Resident Indians (RIs) couldn't be beneficial owners of a fund investing in India. The regulator also asked FPIs to disclose names and addresses of beneficial owners; whether they were acting alone or together through one or more natural persons as a group; tax residency jurisdiction and beneficial owner group's percentage shareholding capital or profit ownership in the FPI.
- ***OCI/NRI ownership of FPI entities:*** The April 10 circular clearly states that NRIs and OCIs could own FPI entities that managed foreign money, as a strictly non-investing entity. The circular also says that if an FPI is Category II investment manager of other FPIs and is a non-investing entity, it may be promoted by NRIs/ OCIs. The April circular was in fact, only repeating the rules in the FPI regulations framed in 2014. These permitted entities owned by NRIs and resident Indians to be registered as non-investing FPIs for the purpose of acting as an investment manager for other FPIs. In other words, SEBI never had an objection to NRIs and RIs managing FPI funds, provided they did not invest their own funds through such entities.
- ***NRIs as beneficial owners:*** Another grouse of the FPIs with the April circular was that it laid down that NRIs and OCIs couldn't be beneficial owners in FPIs. The circular says that any structure that has these entities as beneficial owners has to be wound down or liquidated. SEBI is not wrong in asking these entities not to hold significant stake in FPI structures. According to FPI regulations 2014, NRIs and OCIs cannot register as FPIs with SEBI. Allowing these investors to hold substantial stake in FPIs would be akin to allowing them a back-door entry into Indian markets.
- ***Entry not totally disallowed:*** The maximum permissible ceiling for investment in a stock is also different for FPIs and NRIs *i.e.* the limit is **24 %** of the paid-up capital of the Indian company for FPIs and **10 %** for NRIs. It needs to be noted that NRIs and OCIs can invest in Indian markets through FPIs, provided their investment does not cross a specified threshold. Hence, the perception in many sections that the SEBI circular barred FPI entities with NRI investments is also not correct.
- ***Identifying beneficial owners:*** The RBI and the SEBI are worried about money round tripping through multi-layered FPI entities, where the ultimate beneficiary is not identifiable. The primary intention of the April 10 circular was to identify a natural person, which means a human as the ultimate owner of each FPI. The owner's details such as passport number, address, ID proof and so on were to be disclosed. Thus, the regulator wanted to tighten KYC norms to prevent money laundering and round tripping of funds, especially if an investment is made *via* a ***high-risk jurisdiction***. Typically, countries with a known history of money laundering and funding terrorism activities are considered as high-risk jurisdictions.

- ***Circular was implementing PMLA:*** The April circular tried to pin the beneficial owner (BO) of each FPI by using the rules laid down in the Prevention of Money Laundering Act (PMLA) that says, the BO is a person/persons owning or controlling ***25 %*** of the FPI if the investor is a company and ***15 %*** if the investor is a partnership firm, trust and unincorporated association of persons.
- ***Other view:*** The move to characterize fund managers as beneficial owners of FPIs where their actual owners aren't identifiable, can be avoided because most offshore funds investing in India are bound to hire locals or persons of Indian origin to oversee their portfolios. Given that high-risk jurisdictions haven't been defined, this categorization can be dropped.

### Suggestion of HR Khan Committee

- ***Threshold limit:*** The working group has acknowledged that it might not be right to use the PMLA rules for identifying beneficial ownership. It has, therefore, recommended that the threshold for identifying BOs can be **25 per cent** of the assets under management in case of a single NRI/OCI/RI. Aggregate holdings of these entities should be below **50 per cent** of the AUM. The increased threshold appears reasonable enough. In case these entities hold more than the prescribed limit, all they would have to do is to liquidate the portion of assets exceeding the limit or transfer it to someone else.
- ***Other suggestions:*** The Khan committee has also proposed that NRIs, OCIs and RIs should be allowed to hold a non-controlling stake in FPIs and no restrictions should be imposed on them to manage non-investing FPIs or SEBI registered offshore funds. It has recommended that erstwhile PIOs should not be subjected to any restrictions and clubbing of investment limits should be allowed for well regulated and publicly held FPIs that have common control.
- ***New Timelines:*** The panel has suggested that the time for compliance with the new norms should be extended by **six months**, after they are finalized and non-compliant investors should be given another **180 days** to wind down their existing positions.
- ***KYC Norms:*** It has also asked Sebi to do away with additional KYC requirements for beneficial owners in case of government-related FPIs.
- ***Creation of parity:*** The committee has recommended changes in the norms pertaining to the identification of senior managing officials of FPIs and for beneficial owners of listed entities. It has suggested changes in the disclosure of personal information of beneficial owners. It has said however, that all new rules should apply equally to investors using participatory notes (P-Notes).

### Way Forward

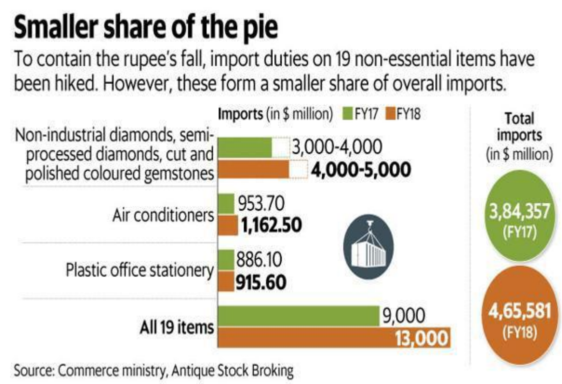
- This controversy could not have broken out at a worse time for the economy. With a sinking Rupee, tightening global liquidity and skyrocketing oil prices, India badly needs foreign fund flows at this juncture to bridge its runaway trade deficit.
- Overall, this controversy clearly underlines the need for regulators to engage in a public consultation process and clearly spell out their rationale, whenever they attempt a substantial overhaul of their ground-rules for the Indian markets.
- In respect of above controversy, recently SEBI announced that an NRI can now **hold up to 25%** of a foreign fund's assets; while collectively, their holdings should be **below 50%** of the corpus. NRIs can bring down their holdings in a foreign fund to these levels **within two years**. Moreover, there will be no restrictions even beyond 2 years if the FPI invests only in Indian

mutual funds. The regulator also said FPIs can be controlled by investment managers owned by an NRI or OCI as long as the investment manager is regulated in its home jurisdiction and registers itself with SEBI as non-investing FPI. Else, it should be registered with SEBI.

## Centre Plans Minimum Import Price Among Options to Curb Non-essential Goods

*Syllabus: Effects of liberalization on economy*

### In News




- The Center has recently decided to increase the custom duty on 19 non-essentials item including air-conditioners, refrigerators, washing machines, footwear, jewellery, furniture fittings and tableware besides imposing it on aviation turbine fuel (ATF). Moreover, it is also looking at imposing minimum import prices (MIP) or safeguard duties on some goods as it attempts to cut non-essential imports and compress the current account deficit to halt rupee depreciation. Restricting entry of some goods to certain ports and selective duty increases could also be considered.
- India's current account deficit deteriorated to 1.9% of GDP in FY18 from 0.6% in the year before and is forecast to rise to around 2.8% in the current year. The trade deficit has widened to $80.4 billion in the first 5 months of the current fiscal year from $67.3 billion in the same period last year.
- On import substitution, it is an irony that despite the abundance of coal reserves, thermal coal is one of India's fastest-growing imports. This is a consequence of under-investment in modernizing the entire coal production and utilisation chain and must be addressed expeditiously.

### Benefits

- ***Encourage domestic investment:*** This could have salutary effect of fostering greater investment in the domestic production of some of these goods.
- ***Checking forex drain:*** The significant increases in customs duties of selective items, which the government perceives to be non-essential imports appears to be aimed at reducing the drain of currency reserves and boost domestic demand.
- ***Revenue generation:*** The increased duty is likely to yield about Rs 4,000 crore in revenue.
- ***Protectionism rising everywhere:*** Some policymakers within the government feel that when protectionism is on the rise globally, India should not hesitate in providing some assurance to its domestic industry while also cutting imports of non-essential goods.
- ***Avoid goods routed through FTA Countries:*** MIP measures have been seen to be more effective than simply raising duties, which lead to goods being routed *via* countries with which India has free trade agreements (FTAs).

### Challenges

- ***Little impact:*** The aggregate value of these imported items in the last fiscal year was just Rs. 86,000 crore. At that level, these imports constituted a little less than 3% of the country's merchandise import bill in 2017-18. Thus, the impact of this tariff increase in paring the import bill and thus containing the CAD is at best going to be short-term and marginal.
- ***Dampen consumption based growth:*** On the other hand, the decision to double import duties on a clutch of consumer durables to 20% could dampen consumption of these products, especially at a time when the rupee's slide against the dollar is already likely to have made these goods costlier.
- ***Difficult to justify the action at WTO:*** India will find it difficult to substantiate reasons for the measures it takes to restrict imports of certain products at the World Trade Organization (WTO). New Delhi has the option of invoking the clauses that relate to protecting national security, public morals or safeguarding human, animal and plant life or health and conservation of exhaustible natural resources to stop some imports. As per WTO norms, the measures can't be arbitrary or mean unjustifiable discrimination between countries or constitute disguised restriction on international trade. Further, the outright bans run afoul of the World Trade Organisation (WTO) rules that emphasize ***National treatment principle.***
- ***Impact on airline sector:*** The tariff on aviation turbine fuel (ATF), which will now attract 5% customs duty instead of nil may add to the stress of domestic airline operators, the rupee and rising oil prices having already hurt their wafer-thin margins.

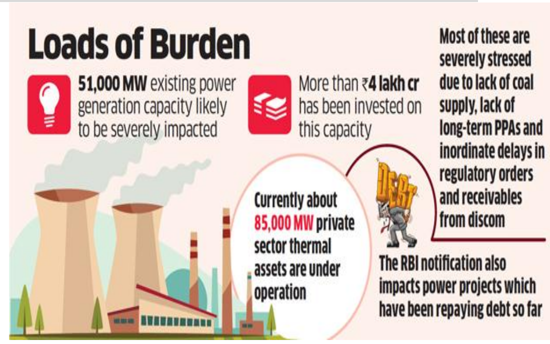
**Way forward**

- It is strange that the government's stress is more on curbing imports than on promoting exports. Making imported inputs costly with high tariffs, even as the rupee's decline has made them more expensive, will not help exports grow. Restrictive trade practices by India will add to the anti-globalization narrative taking hold in the wake of trade wars and mercantilist policies by the US. India must champion, not oppose, globalization.
- Thus, a more robust approach in addressing the widening CAD would be to institute wide-ranging measures to boost exports and simultaneously reduce the import-intensity of the economy. Policymakers must renew efforts to ensure that export growth starts outpacing the expansion in merchandise imports. This includes expediting the refunds on GST to exporters, to working to woo some of the labor-intensive supply chains that are moving out of China to countries such as Vietnam and Bangladesh.
- The Centre's decision to increase customs duty on imports of 19 non-essential items amounts to tinkering at the margins to address a structural macro-economic issue.

## Power Sector NPAs

*Syllabus: Infrastructure: Energy*

## In News




- Flawed politics has stricken the power sector, and its woes have spilt over into banking by constituting **a fifth of whose non-performing assets**, currently estimated at **Rs. 10.3 lakh crore**.
- A RBI circular that came into effect on March 1, 2018 mandated banks to identify power projects with even one day's default as stressed assets and conclude their resolution proceedings **within 180 days.**

## Final Analysis

- The Reserve Bank of India is right to insist on their prompt resolution, but we also need to boost power infrastructure to remove energy poverty without handing over prize assets to some select industrialists at throwaway prices.
- This calls for fixing the power sector so that power assets can generate revenue. Moreover, there is a need for improving transparency in power utility finances, ending unbudgeted giveaways in distribution and clamping down on electricity theft.