GS PAPER - 3

Economic Growth and Development – Dec'18

Centre Gives More Power To SFIO

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

In News

- To rein in wilful defaulters and prevent high profile economic offenders like Nirav Modi and Vijay Mallya from leaving the country, the Centre has allowed the Serious Fraud Investigation Office (SFIO) powers to request **look-out circulars (LoCs)** against loan defaulters.
- The Parliament has also passed the **Fugitive Economic Offenders Bill, 2018**, giving authorities powers to attach and confiscate the proceeds of crime and properties of economic offenders, like bank fraudsters or loan defaulters fleeing the country.

About SFIO and LOC

- ***Introduction:*** The SFIO is a statutory body, under the **Ministry of Corporate Affairs** and investigates matters related to serious fraud in a company.
- ***Power to arrest:*** The SFIO also enjoys the power to make arrests under **Section 212 (8)** of the **Companies Act, 2013**.
- ***About LOC:*** These LoCs were **valid only for one year** until the agency seeking the LoC specified a longer duration. The agency seeking the extension of LoCs after one year will have to inform Indian Check Posts (ICP) with valid documentation. LoCs are broadly classified into **three categories** and can be changed by the agency at any stage.
- ***Three tyoes of LOCs:*** The **first LoC** says that the alleged criminal should be detained if he tries to leave India. The **second LOC** says that only action to be taken when offender reached any port to leave India is to simply inform the CBI and let him travel. The **third LoC** category is mostly used for terror suspects with immediate arrest.

Rationale For Grant Of Such Power

- ***Background:*** Earlier, an LoC to keep watch on the arrival or departure of Indians or foreigners could only be issued at the request of the **Home Ministry, External Affairs, Custom and Income Tax, CBI, DRI, Intelligence Bureau (IB), Regional Passport Offices (RPOs) and state police authorities**. However, more white collar crime in recent years has meant commensurately greater involvement of the SFIO in criminal investigations. Moreover, the Home Ministry has recently also empowered the **chairman or managing director and CEOs of all public sector banks (PSBs)** to request LoCs against bank fraud suspects and loan defaulters.
- ***Prevention of accused fleeing:*** The SFIO, often begins investigations soon after a crime is detected, ahead of the CBI or Customs. The SFIO had investigated several willful defaulters such as Jatin Mehta, Vijay Mallya or Nirav Modi before the CBI and other agencies stepped in. Had SFIO been empowered to seek an LOC, the escape from the country of these accused could conceivably have been prevented.
- ***Logical step:*** Giving the SFIO similar powers was the next step as it was argued that the LoCs sought by CEOs of public sector bank can be challenged in court in the absence of an FIR or investigations against the suspects.

Way forward

- The common thread running through the recent cases of financial fraud is that these economic offenders not only gamed the system, but also how brazen violations of rules and non-payment of statutory dues were flagged off by some of the agencies, yet the escape route was open.
- Therefore, India's investigation agencies and financial regulators need to work more closely and share information at an early stage without indulging in oneupmanship. For this the **Regional Economic Intelligence Council**, which is a designated platform for sharing of information between various law enforcement agencies should be used.
- The quality of economic investigation and regulation is a key factor in fostering an enabling environment for investment and for the emergence of a competitive industry.

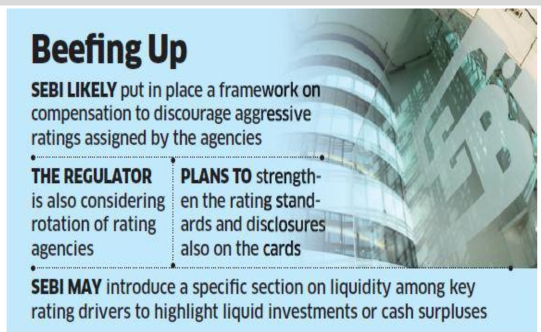
SEBI's New Norm For Credit Rating Agencies

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

In News

- After the IL&FS crisis, the Securities and Exchange Board of India (SEBI) is now trying to increase the level of scrutiny on credit rating agencies (CRA) that failed to warn investors about it.
- SEBI has come out with new guidelines to improve the quality of disclosures made by CRA.

SEBI's Norm For Credit Rating Agencies



- ***Information on liquidity situation:*** The CRA will have to inform investors about the liquidity situation of the companies they rate through parameters such as their cash balance, liquidity coverage ratio, access to emergency credit lines, asset-liability mismatch *etc.*
- ***Additional information:*** CRAs will now also be required to furnish information whether the rating is factoring in support from a parent, group or government, with an expectation of infusion of funds towards timely debt servicing. They are required to name of such entities, along with rationale for such expectation.
- ***Information on historical rating:*** Further, rating agencies will have to disclose their own historical rating track record by informing clients about how often their rating of an entity has changed over a period of time.
- ***Consolidation of rating:*** When subsidiaries or group companies are consolidated to arrive at a rating, list of all such companies, along with the extent (*e.g.* full, proportionate or moderate) and rationale of consolidation, will be required to provide by CRAs.
- ***Disclousre of ratings:*** All CRA would require furnish data on sharp rating actions in investment grade rating category, to stock exchanges and depositories for disclosure on website on **half-yearly basis**, **within 15 days** from the end of the half-year.
- ***Enhanced standards for CRA:*** SEBI has been working hard to improve transparency and credibility among rating agencies for some time now, including through a **circular issued in November 2016** calling for enhanced standards for rating agencies.

Final Analysis

- ***Positive step:*** While rating agencies already make at least some of these disclosures one way or the other, mandating the formal disclosure of these facts is still welcome. The ready availability of information can help investors make better decisions.

- ***Need for resolving structural issue:*** The latest regulations can only help to a certain extent as a lot of the problems with the credit rating industry have to do with structural issues rather than the lack of formal rules.
- ***Issuer pays model:*** The primary structural issue is the flawed **issuer-pays model** where the entity that issues the instrument also pays the ratings agency for its services. This often leads to a situation of **conflict of interest**, with tremendous potential for rating biases.
- ***Need for removal of market barrier:*** The credit rating market in India has high barriers to entry, which prevent competition that is vital to protecting the interests of investors. Better disclosures can increase the amount of information available to investors, but without a sufficient number of alternative credit rating providers, quality standards in ratings will not improve.
- ***Resolving other issues:*** Structural reform should aim to solve another severe problem plaguing the industry, which has to do with **rating shopping** and the **loyalty of credit rating agencies** in general.
- ***Final aim:*** Rating agencies will have to come up with lucrative business models that put the interests of investors above those of borrowers. Such a change requires a policy framework that allows easier entry and innovation in the credit rating industry.

RBI Makes LEI Mandatory

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

In News

- ***Introduction:*** The Reserve Bank of India (RBI) has decided to make **Legal Entity Identifier (LEI) code** mandatory for all market participants regulated by the central bank.
- ***About LEI:*** The LEI is a **20 character unique identity code** assigned to entities who are parties to a financial transaction. Globally, use of LEI has expanded beyond derivative reporting and it is being used in areas relating to banking, securities market, credit rating and market supervision.
- ***Purpose of LEI:*** The LEI code has been conceived of as a key measure to improve the quality and accuracy of financial data systems for better risk management post the global financial crisis.
- ***Applicability:*** Thus, all participants, other than individuals, undertaking transactions in the markets regulated by the RBI government securities markets, money markets (markets for any instrument with a maturity of one year or less) and non-derivative forex markets (transactions that settle on or before the spot date) shall obtain LEI codes by the due date. Thus, the transactions undertaken on **recognised stock exchanges** are outside the purview of the LEI requirement.

Proposal For Conversion Of J&K Bank Into A PSU

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

In News

- The **State Administrative Council (SAC)** under the chairmanship of J&K Governor Satya Pal Malik approved a proposal for treating Jammu and Kashmir Bank (J&K Bank) Ltd. as a public sector undertaking.
- Thus, it will be accountable to the state legislature and the Finance Department will be required to place the bank's annual report before the Assembly.
- The SAC also approved a proposal that provisions of the **J&K Right to Information Act, 2009**, shall be applicable to the bank just like other state-owned undertakings. It will have to follow guidelines of the **Central Vigilance Commission**.

About J&K Bank

- ***Introduction:*** It was incorporated on October 1, 1938 as a limited liability company to offer banking facilities in the state. The bank is licensed as an old private-sector bank under **Section 22 of the Banking Regulation Act, 1949**.
- ***Registered as a state government company:*** Classified as a state government company, it is registered with Registrar of Companies, Jammu. It launched a public issue in 1998 and is listed on both the Bombay and National stock exchanges. While RBI as the regulator supervises J&K Bank, the Comptroller and Auditor General (CAG) audits the books of banks.
- ***Unique feature:*** It is the only bank in India in which a state government holds a **majority stake (59.3%)**, but is not considered as a PSU. In all public sector banks, the majority stake is held by the Centre. As per the **Banking Companies (Acquisition & Transfer of Undertakings) Act**, the central government holding in public-sector banks **cannot drop below 51%.** This unique status needs to be seen in the context of **Article 370** of the Constitution, which gives special autonomous status to the state of Jammu & Kashmir.
- ***Important function:*** J&K Bank is the largest employer among all state-promoted entities. Among the 10 PSUs out of 30 that earned profit, J&K Bank accounted for Rs 416 crore (50% of the total profits of all PSUs). Till 2011, J&K Bank was the sole banker to the state government. In fact, **akin to RBI** for all other states and the Centre, J&K Bank was the **lender of last resort in the state**. Thus, the bank performed the role of a commercial bank, a developmental financial institution, financial services provider as well as a central bank.
- ***Loss of status:*** It lost some of this status in **April 2011**, when Omar Abdullah was Chief Minister; the state government gave RBI the mandate to carry out general banking business of the state and be the sole agent for investment of state funds.

Reason For The Said Move

- ***Enhancing public trust:*** The State government holds a majority stake of 59.3% in J&K Bank. A need was felt that it should have the character of a PSU, which is subject to general supervision and access for enhanced transparency in transaction of business to promote public trust.
- ***Promoting good governance:*** Extension of the RTI Act and CVC guidelines is only aimed at promoting good governance and transparency in the functioning of the bank.
- ***Non-interference:*** The purpose of the SAC decision is not to question the day to day activities of the bank management but a step towards strengthening better corporate governance.
- ***Corporate governance issues:*** There were complaints that the bank was not responding to RBI queries on time and its internal checks and balances had weakened.

Challenges

- ***A part of Union list:*** *Prima facie*, given the existing laws, treating J&K Bank as a PSU faces a couple of obstacles. According to **Article 246** of the **Seventh Schedule**, banking as a subject comes under the **Union list**.
- ***RBI purview not state governments:*** Changing its character to that of a J&K PSU will be akin to empowering the state to have powers over banking. According to provisions of the Banking Regulations Act, applicable to Jammu & Kashmir since 1956, J&K Bank is licensed as an old private-sector bank and comes under the regulatory purview and supervision of RBI. Making it a PSU and bringing it under state legislature could be seen as being in contravention to these provisions.
- ***Possible challenge by minority shareholders:*** As on December 31, 2017, in J&K bank, foreign portfolio investors and foreign institutional investors held 15.98%, Indian mutual funds 4.98%, Indian residents 12.69 per cent, insurance companies 2.76%, and NRIs a little less than 1%. The move to treat it like a PSU could be challenged by the minority shareholders and they may even exit, leading to a fall in share prices.
- ***Other criticism:*** The Governor, who is a caretaker administrator did not have the people's mandate to take such major decisions with far-reaching implications. Moreover, the timing of the move, when there is no elected government in place, and particularly a day after the Assembly was dissolved, has also been questioned.
- ***Fear of political interference:*** J&K Bank has an emotional connect with people in the state. In existence even before Independence, it has been a part of their lives for generations. Once it becomes a PSU, there are concerns that it will be open to interference by the political executive on not just recruitment, but also lending and loan settlement.

Way forward

The right approach would have been to bolster the corporate governance framework, such as strengthening the audit board and getting better professionals.

RBI's Monetary Policy Review

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

In News

The Reserve Bank of India (RBI) kept key policy rates unchanged as inflation eased significantly and pushed for steps to boost loan offtake while signalling that there is no liquidity crunch in the non-banking financial sector, obviating the need for opening up the tap for the sector immediately.

RBI Policy Instance

- ***Maintained Repo rate:*** While keeping the Repo rate (the rate at which RBI lends funds) steady at **6.50 per cent**, the central bank has decided to maintain the stance of calibrated tightening.
- ***Reduction in SLR requirement:*** The central bank also slashed the statutory liquidity ratio *i.e.* mandatory investment in government bonds by **150 basis points to 18 per cent** of total deposits over the next six quarters starting from January 2019.
- ***Easing inflation concerns:*** The RBI Governor said that the inflation projections have been revised downwards significantly and some of the risks have been mitigated, especially of crude oil prices. Therefore, the central bank also cut its inflation projection to 2.7-3.2 percent by March 2018 from its earlier view of 3.9-4.5 per cent.

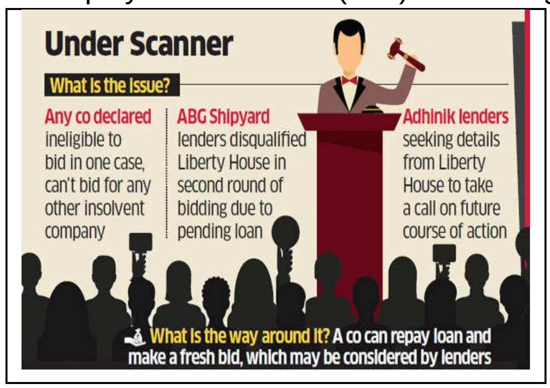
- ***Risk of inflation:*** However, it also forecast inflation picking up again to 3.8-4.2 per cent in the first half of fiscal 2019-20, with risks tilted to the upside as several uncertainties still cloud the inflation outlook.
- ***Growth projections:*** The RBI retained the GDP growth to 7.4 per cent for the year 2018-19 even as the government last week announced that the growth slowed down to 7.1 per cent year on year in the second quarter of 2018-19, after four consecutive quarters of acceleration.

Bidders To Face Jail Term For Backing Out Of Insolvency Process

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

In News

- ***Introduction:*** The government and the Insolvency & Bankruptcy Board of India (IBBI) are looking at using provisions of the Insolvency & Bankruptcy Code (IBC) against Liberty House and other companies, which have gone back on their plans to take over companies through the resolution process and derailing the entire process.



- ***Example of company's withdrawal:*** The plan could include **Adani Wilmar**, which pulled out of a deal to buy Ruchi Soya after the committee of creditors backed it. **Liberty House** has backed off from the resolution process of Adhunik Metals and Amtek Auto, citing various issues.
- ***Section 74, IBC:*** Lenders are also looking to invoke **Section 74** of the IBC against Liberty House, which provides for a penalty and a possible jail term.
- ***Planned provision:*** Apart from invoking Section 74 of the IBC, the government is also looking for imposition of a maximum **Rs. 1 crore penalty**.

Banks Request For Deposit Up To 1% Of Loan Amount From Bidders Going In Appeal

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

In News

- There have been several delays in the resolution of stressed assets due to repeated appeals by bidders under the Insolvency and Bankruptcy Code (IBC). To curb this, banks have requested the Insolvency and Bankruptcy Board of India (IBBI) to introduce deterrent provisions in IBC rules.
- This suggestion comes in the backdrop of recent cases where some bidders, to put a spoke in a rival's acquisition plans, went on appeal after the National Company Law Tribunal (NCLT) declared the rival as the successful bidder for a stressed asset. There have also been cases of promoters of stressed companies opting for an appeal after the NCLT's announcement of the successful bidder.

Suggestion By The Bankers

- ***Rationale:*** Where bank claims amounting to about Rs. 50,000 crore have been admitted by the NCLT, a delay in resolution can cost the lenders almost Rs. 14 crore a day in foregone interest. Further, resolution of stressed assets within the IBC timelines is important so that lenders can write back the provisions, strengthen the capital adequacy and lend to other assets.

- ***Data in support:*** ICRA, in a report said lenders to the **12 large companies** in RBI's initial list of June 2017, which were referred to NCLT are estimated to have lost out on about Rs. **4,000 crore** in additional income due to the delays in the resolution process beyond the **270 days period**. (There is a 270 day timeframe within which the resolution process is required to be completed under IBC.)

- ***Security deposit:*** The banks have suggested that bidders should be asked to cough up **0.5-1 per cent of the loan** owed by a company undergoing resolution as a deposit with the National Company Law Appellate Tribunal (NCLAT) each time they go on appeal.
- ***Cues from DRAT appeals:*** The **deposit to make an appeal** suggestion probably stems from such a provision in the **Recovery of Debts Due to Banks and Financial Institutions Act, 1993**. **Section 21** of this Act says that where an appeal is made by any person from whom debt is due to a lender, it shall not be entertained by the **Debt Recovery Appellate Tribunal (DRAT)** unless the person has deposited with the Tribunal **75 per cent** of the amount of debt due from him.
- ***Deterrence:*** If the requirement of putting money on the table is incorporated in the IBC rules, it will deter repeated appeals by some bidders and promoters of stressed companies who are bent on delaying or derailing the resolution process. If the appeal is successful, the deposit will get adjusted towards the settlement of dues of the company being acquired. Otherwise, it will get forfeited. Such a provision will deter the tendency to appeal at the drop of a hat.

Bimal Jalan Panel on RBI Reserves

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

In News

- ***Introduction:*** The Reserve Bank of India (RBI) has formed an expert committee under former governor **Bimal Jalan (Committee on Economic Capital Framework)** to decide the appropriate level of reserves that the regulator should hold. This comes more than a month after the bank's central board proposed the panel's formation following a dispute between then governor Urjit Patel and the government over that and various other issues, which eventually led to his departure.
- ***Panel members:*** The **six member panel** has former deputy RBI governor Rakesh Mohan as its vice chairman and comprises economic affairs secretary Subhash Chandra Garg, RBI central board members Bharat Doshi and Sudhir Mankad and deputy governor NS Vishwanathan.
- ***Function of the committee***: It will review the need and justification of various provisions, reserves and buffers that RBI has maintained for contingency purposes and suggest an adequate level of risk provisioning. The committee will also propose a suitable profits distribution policy taking into account all the likely situations of the RBI, including the situations of holding more provisions than required and the RBI holding less provisions than required.
- ***Final analysis***: Any decision should be taken keeping in mind RBI's long-term view for all periods, including high growth, low growth, forex inflows and outflows and have forethought in approaching the reserves matter.

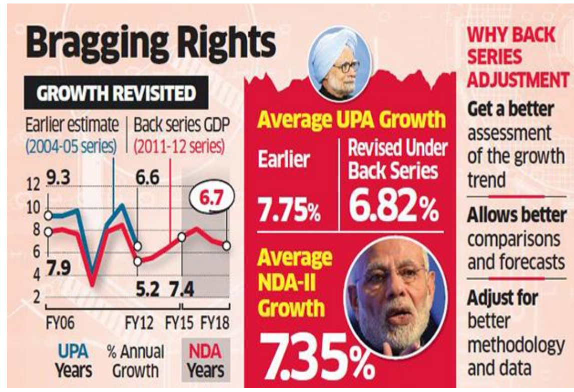
Issue About GDP Back Series Data

Syllabus: Indian Economy and Issues relating to growth.

In News

Three years after the shift to the **new base year of 2011-12**, the Central Statistics Office (CSO) and NITI Aayog, released the back series detailing growth numbers for 2005-06 to 2011-12. The re-estimation of the GDP using 2011-12 as the base year lowers the average growth during UPA regime from previous estimates while growth during NDA is pegged higher than during UPA.

Background/ Need For The Back Series



- ***Lack of MCA-21 data:*** When the CSO moved to a new base year of 2011-12 for national accounts in January 2015, it was faced with a peculiar situation. The CSO faced issues in evaluating GDP with the new base year for years preceding 2011-12 due to lack of availability of the **MCA-21 database**.
- ***About MCA-21:*** MCA-21, an e-governance initiative of the **Ministry of Company Affairs** was launched in 2006, to allow firms to electronically file their financial results.
- ***Three changes for GDP calcualtion:*** Three changes that have occurred in the revision that was first announced in 2015: **first**, in the base year (the use of 2011-12 base year from 2004-05); **second,** in the methodology from **GDP at factor cost to GDP at market price** (this is the international norm and the basis of the current government's claim that this is what CSO has followed) and **third,** in the method of estimating company output/revenue, which has been done in a much more detailed manner using new data collected by the Ministry of Corporate Affairs (MCA 21) in addition to the **volume index of Index of Industrial Production (IIP)** and **establishment based dataset** of **Annual Survey of Industries (ASI).**

Finding Of The Newly Released Back Series Data

- ***Lowering of the growth rate:*** The back series released has trimmed the growth numbers for the UPA government's nine years (2005-06 to 2013-14), with the Indian economy growing at an **average 6.7%** in four years of the UPA's first term (2005-06 to 2008-09) as well as the UPA's second term (2009-10 to 2013-14), which are lower than the earlier estimates of 8.1% and 7.0% (2004-05 base) respectively.
- ***Increase in growth during 2014-18:*** These growth rates compare with an average 7.4% growth rate (2011-12 base year) seen during the first four years of the present NDA government.

Positive Features About The New Series Data

- ***Wide coverage:*** The new method is statistically more robust as it tries to relate the estimates to more indicators such as **consumption, employment and the performance of enterprises** and also incorporates factors that are more responsive to current changes, unlike the old series that usually took 2-3 years to register an underlying change.
- ***A regular exercise:*** Backcasting or reworking past national accounts statistics based on the latest base year, is a regular exercise that governments carry out. Mainly done to enable precise comparison and analysis, it is a difficult exercise prone to contestation as it involves the inclusion of newer data sources, exclusion of outdated ones and making some subjective assumptions in the process.

- ***Expert driven calculation of data:*** Any criticism of the data has to take into account the fact that it has been generated by a thoroughly professional organisation, the CSO and the methods have been scrutinised by experts, including past chief statisticians and the Advisory Committee on National Accounts Statistics.
- ***International accepted methodology:*** The method of computation reflects the latest **United Nations System of National Accounts**. The use of the gross value added in the new series data instead of gross domestic product at factor cost is internationally accepted norm. Moreover, it make India's GDP data globally comparable.

The Grey Areas

- ***Conflict in GDP findings:*** Three months ago, the **Committee on Real Sector Statistics** submitted its report to **the National Statistical Commission (NSC)** offering an alternative. It stated that the economy grew at a faster pace under the UPA government from 2004-05 to 2013-14, compared with the average growth during the first four years of the current government. The average GDP at market prices was 8.37% during UPA-I (2004-05 to 2008-09), and 7.69% during UPA-II (2009-10 to 2013-14). The government had, at that time, termed the estimates as unofficial.
- ***Not enough explaination for use of particular database:*** There is not enough explanation for the choice of datasets and proxies, especially those datasets that didn't exist before 2011-12. Though the CSO release mentioned usage of several proxies, there were no details about why those were selected over other datasets. For instance, for years preceding 2006, when the MCA-21 database did not exist, the CSO has used ASI data for estimating manufacturing growth whereas economists say there could have been other indicators for the same metric.
- ***Role of NITI Aayog:*** The role of the NITI Aayog in the release of the statistical exercise of CSO, which comes under **Ministry of Statistics and Programme Implementation (MoSPI)**, has also been questioned as it brought political considerations into the fray.
- ***Use of volume data:*** Also, the use of volume data for calculation of the back series, which could have potentially underestimated growth, has been questioned by the economists. The big difference between the **volume index approach** and the **financial data approach** is that the financial data captures changes in quality which the volume approach does not. So if a substantial part of the growth has been coming from quality, then if one take the volume approach he would underestimate the growth.
- ***Consonance with other data:*** The high growth as evidenced by the new series data is not in consonance with the slowing growth trends in the Index of Industrial Production (IIP). Slower industrial production recently is also suggested by other indicators. In no year between 2004-05 and 2013-14 did bank credit grow less than 14% (range 14.1 to 37%). Moreover, since then, in no year has bank credit grown faster than 10.9% (range 8.2% to 13.9%). **Plant load factor** (PLF, or the ratio of actual energy produced to maximum possible energy that could have been produced) averaged 68.5% from 2004-05 to 2013-14. By contrast, the PLF from 2014-15 to 2017-18 has been 57%. Moreover, it is the much lower job growth in the non-agricultural sector that really shows the difference in the real economy.

Final Analysis

- It cannot be denied that this government has managed to bring a section of the informal economy into the formal fold. As a result, the share of organised private sector output has increased in relation to the informal sector, reducing inaccurate estimates for the latter. It is, hence, plausible, as the new series suggests, that the size of the service sector economy was overstated in the past.

- Moreover, India's economic statistics have been considered reliable, more so than China's. While the Centre is right in arguing that changes in methodology are required to align India's systems with global standards, frequent chopping and changing of data, cannot do India's image much good.
- Further, a basic question that remains unaddressed is why a change in base year should sharply affect GDP growth rates, when it should, in principle, only alter absolute GDP levels. A consistent application of either the MCA or ASI database should not lead to a swings in industry growth rates. The CSO and NITI Aayog need to look into such issues.
- There is little doubt that India needs to invest more in data collection and integration and do informal sector surveys more frequently. Robust, updated data are, in fact, insurance against politicians hijacking what is essentially an economic exercise. Thus, the issue of data unreliability must be seriously addressed as decision making in a modern economy is increasingly data dependent.

ILO's Global Wage Report 2018

Syllabus: Indian Economy and Issues relating to employment.

In News

The International Labour Organisation has released Global Wage Report 2018-19. It puts into sharp relief one of the biggest drags on global economic momentum - slowing wage growth.

Report Findings

- Global wage growth in real terms (adjusted for price inflation) in 2017 fell to its lowest rate since 2008 – to 1.8% in 2017 from 2.4% in 2016 - far below levels before the global financial crisis. The findings are based on data from 136 countries.
- In advanced G20 countries, real wage growth declined from 0.9 per cent in 2016 to 0.4 per cent in 2017. By contrast, in emerging and developing G20 countries, real wage growth fluctuated between 4.9 per cent in 2016 and 4.3 per cent in 2017.
- In the last 20 years, average real wages have almost tripled in emerging and developing G20 countries, while in advanced G20 countries they have increased by just 9 per cent. But, in many low- and middle-income economies, wage inequality remains high and wages are frequently insufficient to cover the needs of workers and their families.
- The report observes that the acceleration of economic growth in high-income countries in 2017 was led mainly by **higher investment spending rather than by private consumption**.
- The **intensification of competition in the wake of globalisation**, accompanied by a worldwide decline in the bargaining power of workers, has **resulted in a decoupling between wages and labour productivity**.
- The obvious impact of this low pace has been on global economic growth with consumption demand hurt by restrained spending by wage-earners.

Gender Pay Gap

- The report finds that globally women continue to be paid approximately 20 % less than men.
- In high-income countries, it is at the high end of the pay scale where the gender pay gap is wider; while in low- and middle-income countries, the gender pay gap is wider amongst the lower paid workers.
- Using empirical evidence, the report also shows that traditional explanations such as **differences in the levels of education between men and women, who work in paid employment,** play a limited

role in explaining gender pay gaps. In many countries, women are more highly educated than men but earn lower wages, even when they work in the same occupational categories

- Another factor which weighs on the gender wage gap is **motherhood**. **Mothers tend to have lower wages compared to non-mothers**. This may be related to a host of factors, including labour market interruptions, reductions in working time, employment in more family-friendly jobs with lower wages, or stereotypical promotion decisions at enterprise level.
- The **lack of programmes supporting women's return to work after childbirth** also contributes to the wage penalty that women face when resuming work after a prolonged period of absence from the labour market.

Way Forward

- The report ***emphasizes the importance of good data and highlights the need in many countries for better data*** on the distribution of wages. In particular, low- and middle-income countries have very limited statistics on the average wages of women and men.
- Further, it recommends **going beyond summary measures to inspect in more detail the respective wage structures of women and men**, analyse gender pay gaps in more homogeneous subgroups of wage earners and calculate factor-weighted gender pay gaps which control for some of the major composition effects.
- Countries should also look into possible ways to address the undervaluing of women's work in highly feminized occupations and industries, including by raising wages in the latter. Eliminating this bias is not only a way to narrow the gender pay gap directly, it is also a condition to reducing occupational segregation, for example by attracting more men into the education and health sectors
- **More equitable sharing of family duties between women and men**, as well as adequate childcare and eldercare services, would in many instances lead to women making different occupational choices. Adequate company policies on flexible working-time arrangements would also help.
- Accelerating progress will **require both political commitment and social transformation**. While public policies to enhance education, labour and social protection, and to improve social infrastructure, are necessary to close the gender pay gap, their effectiveness depends at least in part on shifting social norms and gender stereotypes.
- Hence measures to reduce or eliminate gender pay gaps **should be embedded in a broader overall gender equality policy**.

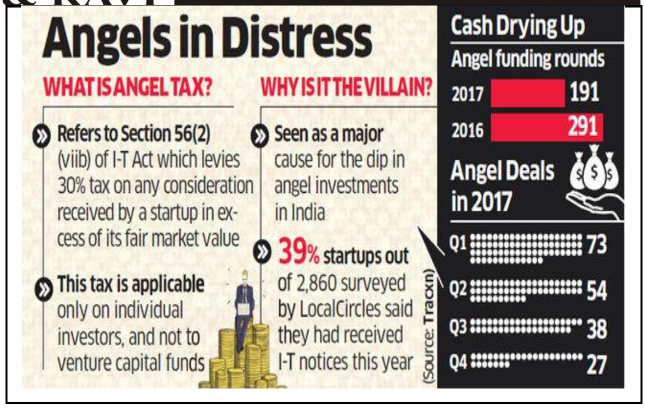
Tax on Angel investment

Syllabus: Government Budgeting.

In News

- Many tax laws in India seem to be framed on the premise that every citizen is guilty of tax evasion unless he proves otherwise. The **angel tax provisions** contained in **Section 56(2) of the Income Tax Act** fall squarely in this category.
- The levy is back in the news after scores of domestic start-ups have complained about tax notices. The Centre has now gone into damage-control mode, promising that angel tax demands would not be raised on genuine start-ups and coercive measures would be in abeyance, while an expert committee reviews these rules.

About The Provision



- ***Meaning of Angel tax:*** Angel tax is a term used to refer to the income tax payable on capital raised by unlisted companies *via* issue of shares where the share price is seen in excess of the fair market value of the shares sold. Thus, the section states that when any closely-held company issues shares to domestic investors at a price higher than its fair market value, the excess must be characterised as other income and taxed at **30 per cent**. The tax was introduced in the 2012 to **arrest laundering of funds**. It has come to be called angel tax since it largely impacts angel investments in start-ups.
- ***FMP determination:*** Fair market value is to be determined only through book value or discounted cash flow methods, failing which the assessing officer must be satisfied with it.

The View Against Such Tax

- ***Not conducive:*** In a country like India that relies so heavily on its start-up ecosystem to innovate, create jobs and drive the next leg of economic growth, it is a moot question why a tax on angel investments must even exist in the first place.
- ***No profit generation:*** Further, treating the equity capital received by a business as income for tax purposes is plainly wrong, as accounting income arises only when the business uses this capital to create a product which yields a profit.
- ***Issue of valuation:*** The share issued to an investor has to be valued to decide whether the price is in excess of fair value. The industry has demanded that the discounted cash flow (DCF) method of valuation be used to calculate angel tax instead of the net asset value (NAV) method, though even that may not capture the true value of a start-up. The valuation of a start-up is usually based on a commercial negotiation between the company and the investor. However, since start-ups operate in a highly uncertain environment, many companies are not always able to perform as per their financial projection. Equally, some companies exceed the projection by a long mile if they are doing well.
- ***Fear of misuse:*** Further, the valuation of a business is an issue best left to a venture and its investors. Expecting new-age start-ups to use textbook valuation methods and seek their assessing officer's blessings every time they raise funds is draconian and opens the doors to misuse.
- ***Relocation of start-ups:*** This tax on domestic investors gives home grown start-ups every incentive to offshore their holding company and source capital through circuitous routes to subvert this rule.
- ***Problem with the conditions:*** For start-ups to get exemption from this tax, they are required to jump through multiple hoops. The government issued a notification in April 2018 to give exemption to start-ups under Section 56 of the Income Tax Act, where the total investment including funding from angel investors did not exceed **Rs. 10 crore**. The investor is also required to have a minimum returned income of **Rs. 25 lakh** or **net worth of Rs. 2 crore** and the start-up needs to meet the DIPP's definition of an innovative start-up. The final approval for the tax exemption is to be given by an **Inter-Ministerial board**. Given this battery of conditions, it is no surprise that **only two start-ups have so far qualified**.

Final Analysis

Overall, the angel tax provisions make a mockery of the government's thrust on Start Up India, Stand Up India and ease of doing business. It is ironic that while developed economies in the Euro zone and the

US woo angel investors with tax rebates and capital gains tax exemptions, India should be tying such investors and the ventures they bet on, in swathes of red tape.

Lowering of GST Rates

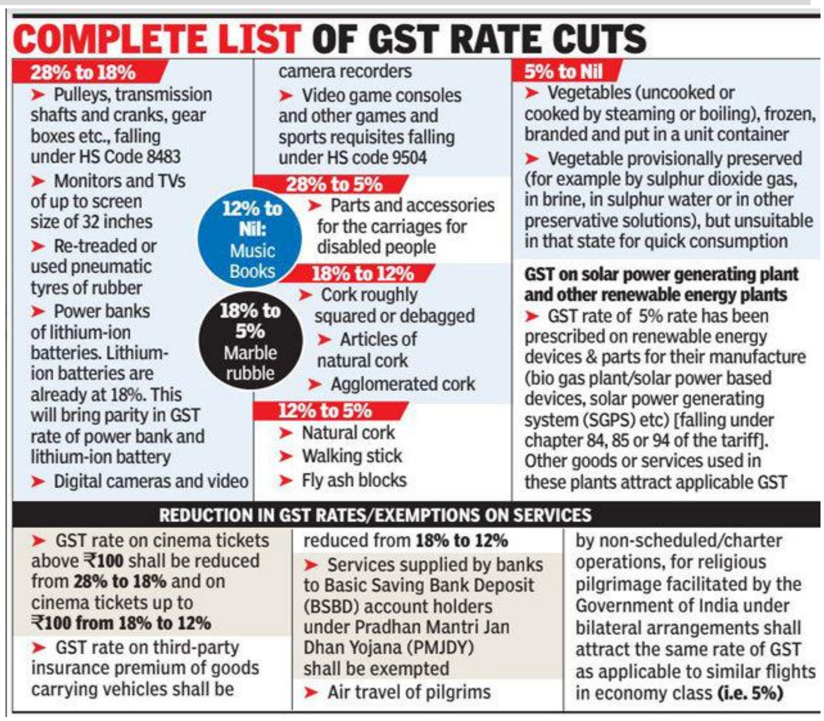
Syllabus: Government Budgeting.

In News

- ***Introduction:*** The Goods and Services Tax (GST) Council cut the rates on **17 items and six types of services** during its **31st meeting**, leaving only one common use item *i.e.* cement in the 28% bracket.
- ***Slashing of the GST rates:*** Seven items that saw tax rates being slashed from the 28% bracket are certain vehicle parts used in agriculture, monitors and TVs up to 32 inches, retreaded tyres, power banks, digital cameras, videogame consoles (all from 28% to 18%) and parts and accessories for the carriages for disabled persons (from 28% to 5%). The GST rate on cinema tickets above Rs. 100 was cut from 28% to 18% and on tickets up to Rs. 100 from 18% to 12%.
- ***Single appellate panel:*** The GST Council took decision aimed at putting to rest a large part of the confusion surrounding the applicability of the tax. At the moment, each State has an **Advance Ruling Authority (ARAs)** that can issue a ruling on any issue pertaining to GST rates and their applicability. Often, different ARAs deliver conflicting judgements. The GST Council has decided to create a Centralised ARA that will provide a ruling in such cases.

Analysis Of The Decision

- ***Trend:*** The reductions show two clear trends *i.e.* a number of goods and services are being pushed into lower category of tax slabs and the **peak rate of 28%** is on its way to being rendered almost irrelevant.
- ***Rate cut post revenue stabilization:*** It also indicates that the process of rate rationalisation would continue where necessary in the GST stabilisation phase.
- ***Rate prior to GST:*** With this round of rate reductions, the GST rates on virtually every product is lower or equal to the indirect tax impact prior to GST.
- ***Improve compliance:*** Worries that a reduction in the number of items in the 28% slab would lead to a significant dent in collections are misplaced. Lower rates will improve compliance. It will boost not just GST collections but also revenues in direct taxes as the levy creates multiple audit trails in the income and production chain that have the potential to tap untaxed income.



COMPLETE LIST OF GST RATE CUTS

28% to 18%
- Pulleys, transmission shafts and cranks, gear boxes etc., falling under HS Code 8483
- Monitors and TVs of up to screen size of 32 inches
- Re-treaded or used pneumatic tyres of rubber
- Power banks of lithium-ion batteries. Lithium-ion batteries are already at 18%. This will bring parity in GST rate of power bank and lithium-ion battery
- Digital cameras and video camera recorders
- Video game consoles and other games and sports requisites falling under HS code 9504

12% to Nil: Music Books

18% to 5% Marble rubble

28% to 5%
- Parts and accessories for the carriages for disabled people

18% to 12%
- Cork roughly squared or debagged
- Articles of natural cork
- Agglomerated cork

12% to 5%
- Natural cork
- Walking stick
- Fly ash blocks

5% to Nil
- Vegetables (uncooked or cooked by steaming or boiling), frozen, branded and put in a unit container
- Vegetable provisionally preserved (for example by sulphur dioxide gas, in brine, in sulphur water or in other preservative solutions), but unsuitable in that state for quick consumption

GST on solar power generating plant and other renewable energy plants
- GST rate of 5% rate has been prescribed on renewable energy devices & parts for their manufacture (bio gas plant/solar power based devices, solar power generating system (SGPS) etc) [falling under chapter 84, 85 or 94 of the tariff]. Other goods or services used in these plants attract applicable GST

REDUCTION IN GST RATES/EXEMPTIONS ON SERVICES
- GST rate on cinema tickets above ₹100 shall be reduced from **28% to 18%** and on cinema tickets up to **₹100 from 18% to 12%**
- GST rate on third-party insurance premium of goods carrying vehicles shall be reduced from **18% to 12%**
- Services supplied by banks to Basic Saving Bank Deposit (BSBD) account holders under Pradhan Mantri Jan Dhan Yojana (PMJDY) shall be exempted
- Air travel of pilgrims by non-scheduled/charter operations, for religious pilgrimage facilitated by the Government of India under bilateral arrangements shall attract the same rate of GST as applicable to similar flights in economy class **(i.e. 5%)**

- ***Reduced burden on common people:*** The changes are welcome and are an important step in reducing the indirect tax burden on people. Once the latest reductions take effect, it would mean the Council has reduced the rates on nearly 360 items since GST was rolled out.
- ***Fiscal implication:*** The revenue impact of the rate cuts over the full fiscal year would be **Rs. 5,500 crore**.
- ***Removal of confusion:*** The Centralized Appellate Authority would aid in resolving the worries of taxpayers present pan-India in cases of varied rulings in different states.

Final Analysis

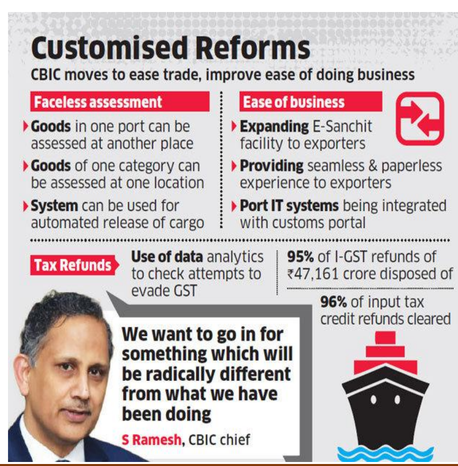
- The GST Council deserves praise for being consistent in its attempt over 18 months to iron out flaws in GST architecture. Lower taxes, in fact, will help the economy improve, thereby boosting revenues in the long run. GST Council should proceed on this path to compress the number of tax slabs and make the system simpler.
- Further, a comprehensive GST calls for widening the base to include sectors such as petroleum, real estate and electricity, to raise transparency within the sectors in those that use them as inputs. It will complete the credit chain and make production more efficient.
- The dispute resolution mechanism needs to be strengthened, given the contrary advance rulings in different states. An **audit manual** to ensure uniform practices across states also makes eminent sense.
- But at the same time the frequent tweaks to the structure and an impression that rates can be altered by lobbying the powers-that-be, risk ruining the promise the GST held for investors wary of India: a predictable, simple and stable tax regime.

Revamping India's Customs Architecture

Syllabus: Effects of liberalization on economy

In News

- After rolling out the most comprehensive indirect tax reform *i.e.* the goods and services tax the government is set to unleash the next generation of changes to the customs duty architecture to speed up India's trade and improve the ease of doing business.
- The purpose is to work towards getting into the **top 50 ranking** of the **World Bank's Ease of Doing Business**. In the **'trading across borders' category**, India leapt to **80th rank from 146th**.
- Already as part of the **National trade facilitation programme**, the cabinet secretary has written to ports to streamline their infrastructure for smooth and speedier cargo movement. Port IT systems are being integrated with the customs portal.



Proposed Changes

- ***Introduction:*** It seek to do away with face to face contact with tax officials, automate the release of goods and ensure e-traceability of shipments, measures that can substantially reduce corruption and allow faster movement of merchandise.
- ***Faceless interface:*** The proposed faceless assessment is a situation where the goods landing at some port can be assessed in other places and shipments in one category, say motorcars, can be assessed at one location, allowing

development of specialisation and expertise. Thus, it will not require physically get in touch with the local customs.

- ***Automated release of cargo:*** The faceless interface would also be used for automated release of cargo, which will allow an importer or an agent to receive an email or an SMS alert that the goods are ready for collection, without having to interact with any customs officer at the port. This would be done for low risk and trusted traders and low risk commodities.
- ***Online uploading:*** The Custom department also proposes to expand the **E-Sanchit facility**, which allows importers to upload all documents online to exporters.
- ***Collaboration:*** The government also plans to bring **export promotion councils** and the **Directorate General of Foreign Trade** on board the customs portal to make the whole experience seamless and paperless for exporters.

Impact

- ***Overall benefits:*** These are some of the best practices of the **World Customs Organisation** and the scope for rent seeking will absolutely vanish and speed of clearance will go up manifold. It will also lower the costs, improve business efficiency and shore up revenues for the government.
- ***Benefits of centralisation***: For starters, assessments of import consignments will be centralised. It is an established principle that centralisation of assessment improves efficiency and reduces disputes over product categorisation. The idea is also to ensure that the same product is given the same tax treatment across locations. Incorrect classification also results in revenue losses for government.
- ***Removal of arbitrariness***: The proposed changes also involve doing away with face to face interaction between tax officials and importers. This will end the scope for arbitrariness and rent-seeking opportunities. There is a need to move away from physical checks to electronic filings and riskbased physical checks of goods.

Final Analysis

- India is a signatory to **WTO's Trade Facilitation Agreement** for cross border commerce in goods and has also improved its ranking to 80^{th} in the 'trading across borders' category of the World Bank's Doing Business (DB) rankings. But there is no room for complacency.
- The time-release study 2018 showed that the average time taken to clear import consignments stood at around **144 hours in 2018**, compared to the **target of 72 hours** proposed in the National Trade Facilitation Action Plan. Similarly, the average time taken to clear export consignment is **about 84 hours**, against the target of **48 hours**.
- Further, India's customs officials need intensive training to implement these reforms. In the mid-term, India should also restart the reform to lower peak customs to 7% from 10%, instead of raising tariff walls that breed domestic inefficiency.

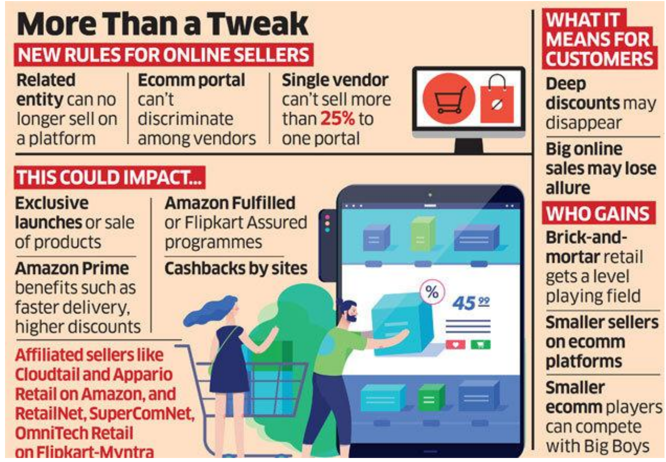
Review of FDI Press Note for E-commerce Sector

Syllabus: Effects of liberalization on economy

In News

In a major jolt to Walmart and Amazon, the government announced changes to the foreign direct investment policy for the e-commerce sector. The new norms will come into effect from **February 1, 2019.**

Background



- ***2017 Policy:*** The 2017 Foreign Direct Investment (FDI) Policy Circular clearly stated that 100% FDI under an automatic route is permitted only in the **e-commerce marketplace model** and not in the **inventory-based one**. Earlier, even though the e-commerce companies called themselves the marketplace but many of them were actually dependent on inventory-based sales for a sizeable part of their businesses.
- ***Meaning of different models:*** Further, as per the 2017 policy, the **inventory-based model** of e-commerce is when the inventory of goods and services is owned by the e-commerce entity and sold to consumers directly. The **marketplace model** is when an e-commerce company simply provides an information technology platform in order to act as a facilitator between the buyer and the seller. Further, the sales value for one vendor or their group companies, was restricted to **25% of sales value a year**. But as it turned out, companies like Amazon and Flipkart found a way around these restrictions by setting up multiple entities through which sales on their platform could be routed.
- ***Flipkart deal:*** The noise around this started to amplify post the Flipkart-Walmart deal. There was a feeling that small and medium-sized sellers and traders were hurt and were crowded out on the big ecommerce sites. Further, Policy makers believe that despite drafting the regulations announced through **Press Note 3**, they were being circumvented.

Provisions Under New Press Note

- ***Control over inventory:*** The e-commerce marketplace entities cannot exercise ownership or control over inventory. Further, it says that the inventory of a vendor will be deemed to be controlled by ecommerce marketplace entity if more than **25% of purchases** of such vendor are from the marketplace entity or its group companies. This will prevent any brand or supplier aligning exclusively with one marketplace, as is usually the case with mobiles or white goods. Thus, the new FDI rules state that an online marketplace cannot sell products from a vendor in which they have a stake.
- ***Ban on selling at platforms:*** The new guidelines explicitly state that an entity having equity participation by e-commerce marketplace entity or its group companies will not be permitted to sell its products on the platform run by such a marketplace entity. The wording of the clause is clearly meant to plug the loopholes of the earlier policy.
- ***Ban on exclusivity clause:*** The new policy also specifies that an e-commerce marketplace entity will not mandate any seller to sell any product exclusively on its platform only. The intention of this clause is to ensure that the e-commerce marketplace player doesn't arm twist a vendor into exclusive arrangements.
- ***Prevent preferential treatment:*** The e-commerce marketplaces or entities in which they have direct or indirect equity participation or shared control have to provide services to vendors on the platform at arm's length and in a fair and non-discriminatory manner. This could put to an end selective promotional schemes such as cashbacks or faster delivery, which will be deemed unfair and discriminatory under the new policy. Thus, the policy also prohibits e-commerce platforms from giving any preferential treatment to any supplier.

- ***Cashback offers:*** The guidelines state that cashbacks provided by group companies of the ecommerce entity should be **fair and non-discriminatory**, adding that providing a service to any vendor in terms of cashbacks should be made available to other vendors in similar circumstances.
- ***Submission of certificate:*** Besides e-commerce marketplace entity will also be now required to furnish a certificate along with a report of statutory auditor to Reserve Bank of India, confirming compliance of all the guidelines by **September 30 every year** for the preceding financial year.

Positive Impact

- ***Remove confusion:*** The measures will wipe out confusion and the communication gap in the e-commerce policy and will further promote investment into the sector.
- ***Plugging loopholes:*** The updated norms for foreign direct investment in ecommerce will not impact the stability and predictability of the country's regulatory environment as there is no change in law and it merely plug the loopholes in the current law.
- ***Solve the long pending grievance:*** India's retailers have repeatedly complained that e-commerce companies were violating the ban on **business to consumer (B2C) e-commerce**. The current policy allows 100% FDI under the automatic route in **business-to-business (B2B) e- commerce** but prohibits any foreign investment in B2C ecommerce.
- ***Better implementation:*** The changes were aimed at better enforcement of the policy as enunciated by **Press Note 3 of 2016**, which had banned FDI in the inventory model of ecommerce and laid down the conditions for ecommerce marketplaces. FDI is only allowed in the marketplace model, offering a platform for vendors to sell to customers.
- ***Fair competition:*** The move to tighten the noose around major e-commerce players will culminate into a fair market competition.
- ***Help local players:*** The norms, will help protect domestic players such as Reliance that are eyeing a share of the e-commerce market in the country. Thus, Indian companies would get opportunities similar to what Chinese companies had received initially, which led to the building of Chinese giants such as **Alibaba, Tencent, and JD**.

Negative Impact

- ***Abrupt policy change:*** The move has rattled top global retailers such as Walmart and Amazon, who have made significant investments in the country, as they grapple with the abrupt policy change and jobs in the sector could also be at risk. Further, this is detrimental to the concept of ease of doing business.
- ***Not possible to offer consumer friendly initiatives:*** The key differentiators such as online exclusive brands, cashbacks and priority deliveries, among others, may not be possible anymore. As the cashback offer will become expensive to execute for platforms, especially in terms of providing logistics and wallet services that have to be made equally available to all vendors.
- ***Difficulty in implementing exclusivity clause:*** The ban on exclusivity may be difficult to implement where a seller wants exclusivity. Further, once there is an exclusive arrangement, it is difficult to judge if this was mandated by the marketplace entity or the seller.
- ***Difficulty in monitoring:*** Some of the changes are prescriptive and can be difficult to monitor, especially for small and mid-size ecommerce players.
- ***Impact on private label:*** For Flipkart and Amazon, private labels (the product brand owed by e-commerce companies themselves and sold on online platform) contribute around **10% of the business** and is growing as a category with a wider assortment and attractive price points as these marketplaces control the full spectrum *i.e.* from contract manufacturing to logistics and pricing. But

with new norms, the in-house brands may face the heat. **For example-** Amazon's in-house brands include Symbol, Mix, Amazon Basics. Flipkart has SmartBuy, MarQ, Perfect Homes. Over the past two years, these companies have been investing in the private label business to reduce dependence on third-party brands, so that they have a better negotiating power with other brands.

- ***No justification for banning private labels:*** It is hard to justify why online stores should not be allowed to display their own labels, when offline ones are allowed to do so.
- ***Guidelines are discriminatory:*** Since such restrictions do not apply to brick-and-mortar sales, the guidelines are discriminatory against e-commerce.

Way forward

- The best way to do that in the age of globally mobile capital is to allow shares with **differential voting rights**, not to carve out sanctuaries of protection within an economic sector. The Centre should also promote easy access to finance. Thus, allowing online start-ups to retain control in the face of expansion and capital infusion.
- Moreover, the policy goes against the government's initial assurance of minimum government, maximum governance. As for anti-competitive practices such as deep discounts, the marketplace can provide its own checks and balances. The **Competition Commission of India** can step in to check such practices.
- Further, there is a need to have a policy on e-commerce, which will gives a road map for what the private sector and the government want.