Crux of Indian Economy for IAS Prelims 2019 Book

Economy Supplementary Notes

Capital Conservation Buffer (CCB) (Basel III Capital Regulations)

In the backdrop of the global financial crisis that started in 2007, the Basel Committee on Banking Supervision (BCBS) proposed certain reforms to strengthen global capital and liquidity regulations with the objective of promoting a more resilient banking sector.

The Basel Accord recommends **minimum Capital Adequacy Ratios** that banks should meet so as to safeguard depositors' interest and ensure continued existence of banks.

As per RBI, Scheduled commercial banks (excluding LABs and RRBs) operating in India shall maintain a minimum total capital (MTC) of 9% (8% as per Basel III) of total risk weighted assets (RWAs) i.e. capital to risk weighted assets ratio(CRAR). Out of which, Common Equity Tier 1 (CET 1) capital must be at least 5.5% of RWAs (4.5% as per Basel III)

Bank's capital consists of tier 1 capital ((going-concern capital) and tier 2 capital (gone-concern capital). Tier 1 capital is a bank's core capital , whereas tier 2 capital is a bank's supplementary capital.

Going-concern capital is the capital which can absorb losses without triggering bankruptcy of the bank. Gone-concern capital is the capital which will absorb losses only in a situation of liquidation of the bank.

The **capital conservation buffer (CCB)** is designed to ensure that banks build up capital buffers during normal times (i.e. outside periods of stress) which can be drawn down as losses are incurred during a stressed period.

As per RBI, Banks are required to maintain a capital conservation buffer of 2.5% (as on 31-03-2020), comprised of Common Equity Tier 1 capital, above the regulatory minimum capital requirement of 9% to withstand future periods of stress

Countercyclical Capital Buffer (CCCB) (Basel III Capital Regulations)

The aim of the Countercyclical Capital Buffer (CCCB) regime is twofold. Firstly, it requires banks to build up a buffer of capital in good times which may be used to maintain flow of credit to the real sector in difficult times. Secondly, it achieves the broader macro-prudential goal of restricting the banking sector from indiscriminate lending in the periods of excess credit growth that have often been associated with the building up of system-wide risk.

The CCCB may be maintained in the form of Common Equity Tier 1 (CET 1) capital or other fully loss absorbing capital only, and the amount of the CCCB may vary from 0 to 2.5% of total risk weighted assets (RWA) of the banks.

The CCCB decision would normally be pre-announced with a lead time of 4 quarters. However, depending on the CCCB indicators, the banks may be advised to build up requisite buffer in a shorter span of time.

The credit-to-GDP gap shall be the main indicator in the CCCB framework in India. However, it shall not be the only reference point and shall be used in conjunction with gross non-performing assets (GNPA) growth.

Credit-to-GDP gap is the difference between credit-to-GDP ratio and the long term trend value of credit-to-GDP ratio at any point in time.

However, Based on the review and empirical testing of CCCB indicators, RBI decided that it is not necessary to activate CCCB at this point in time.

Net Stable Funding Ratio (NSFR) and Liquidity Coverage Ratio (LCR) (Basel III Framework on Liquidity Standards)

The LCR standard aims to ensure that a bank maintains an adequate level of unencumbered high quality liquid assets (HQLAs) that can be converted into cash to meet its liquidity needs for a **30 calendar day** time horizon under a significantly severe liquidity stress scenario specified by supervisors.

At a minimum, the stock of liquid assets should enable the bank to survive until day 30 of the stress scenario, by which time it is assumed that appropriate corrective actions can be taken.

Liquid assets comprise of high quality assets that can be readily sold or used as collateral to obtain funds in a range of stress scenarios. They should be unencumbered i.e. without legal, regulatory or operational impediments. Assets are considered to be high quality liquid assets if they can be easily and immediately converted into cash at little or no loss of value.

The NSFR promotes resilience over a longer-term time horizon by requiring banks to fund their activities with more stable sources of funding on an ongoing basis.

The objective of NSFR is to ensure that banks maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities. A sustainable funding structure is intended to reduce the probability of erosion of a bank's liquidity position due to disruptions in a bank's regular sources of funding that would increase the risk of its failure and potentially lead to broader systemic stress.

The NSFR limits overreliance on short-term wholesale funding, encourages better assessment of funding risk across all on- and off-balance sheet items, and promotes funding stability.

Off-balance sheet (OBS) items include commitments (including liquidity facilities), whether or not unconditionally cancellable, direct credit substitutes (e.g. Guarantees), acceptances, standby letters of credit, trade letters of credit, etc.

A **credit conversion factor** is the factor which coverts an off-balance sheet exposure to an on-balance sheet credit risk exposure.

Leverage ratio (Basel III Capital Regulations)

An underlying cause of the global financial crisis in 2007 was the build-up of excessive on and off-balance sheet leverage in the banking system. In many cases, banks built up excessive leverage while apparently maintaining strong risk-based capital ratios. Therefore, under Basel III, a simple, transparent, non-risk based leverage ratio has been introduced.

The leverage ratio acts as a credible supplementary measure to the risk based capital requirement. The Bank is required to maintain a minimum leverage ratio of 4.5% (3% under Basel III).

The Basel III leverage ratio is defined as the capital measure (Tier-1 capital) divided by the exposure measure, with this ratio expressed as a percentage.

Leverage ratio is a calculation of the common equity needed to cover all assets on and off-balance sheet.

Increasing the leverage ratio means banks have more capital reserves and can more easily survive a financial crisis.

Higher leverage ratio can decrease the profitability of banks because it means banks can do less profitable lending.

Basel Committee on Banking Supervision

The BCBS is the primary global standard setter for the prudential regulation of banks and provides a forum for cooperation on banking supervisory matters. Its mandate is to strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability.

The Secretariat is provided by the Bank for International Settlements (BIS) Basel, Switzerland

The Basel Committee comprises 45 members from 28 jurisdictions, consisting of central banks and authorities with formal responsibility for the supervision of banking business.

Committee has established a series of international standards for bank regulation, most notably its landmark publications of the accords on capital adequacy which are commonly known as Basel I, Basel II and, most recently, Basel III.

Provisioning Coverage Ratio

Provisioning Coverage Ratio (PCR) is essentially the ratio of provisioning to gross non-performing assets and indicates the extent of funds a bank has kept aside to cover loan losses.

Standing Deposit Facility

The Union Budget 2018-19 has proposed an amendment to Section 17 of the RBI Act, 1934 which would allow the Reserve Bank of India to accept “money as deposits, repayable with interest, from banks or any other person under the Standing Deposit Facility Scheme, as approved by the Central Board, from time to time, for the purposes of liquidity management.”

The Standing Deposit Facility (SDF) as and when introduced will provide an additional mechanism for draining liquidity, particularly during periods of exceptional liquidity glut

This will considerably strengthen the conduct of monetary policy as it will provide the RBI the wherewithal to absorb exceptionally large expansion of liquidity **without having to provide collateral** to market participants.

This additional instrument in the toolkit of the RBI will address episodes such as demonetisation and surges of capital inflows, and may even obviate the need for issuances under the Market Stabilisation Scheme which carry fiscal costs.

Real estate investment trusts (REITs) and Infrastructure investment trusts (InvITs)

The Securities and Exchange Board of India (SEBI) notified regulations for investment trusts – specifically, real estate investment trusts (REITs) and infrastructure investment trusts (InvITs) – in September 2014.

REITs and InvITs are Collective Investment Scheme similar to a mutual fund, which enables direct investment of money from individual and institutional investors in infrastructure /real estate projects either directly or via special purpose vehicles (SPVs) to earn a small portion of the income as return.

An investment trust is a vehicle created to primarily invest in revenue-generating real estate or infrastructure assets. These entities are ‘trusts’ by definition, and their ‘units’ (shares) are to be mandatorily listed on exchanges and regulated by SEBI. The units are traded based on their net asset value.

These entities have a pass-through structure and are therefore required to distribute majority of their earnings to unit holders. Globally, these are positioned as high-dividend-paying investments suitable for investors looking for **long-term**, stable cash flow with moderate capital appreciation.

Solar Charkha Mission of the Ministry of Micro Small & Medium Enterprises (27-06-2018)

The President of India,Ram Nath Kovind launched the Solar Charkha Mission on 27th June,2018 at a function in New Delhi on the occasion of UN SME Day. This Mission cover 50 clusters across the country with a budget of Rs.550 crore for the year 2018-19 and 2019-20.

The scheme will generate direct employment to nearly one lakh persons in rural areas and will also contribute to the green economy. Solar Charkha Units have been classified as village industries.

The scheme of Solar Charkha Mission was proposed in the Union Budget 2018-19 to harness non-conventional solar energy to further employment generation.

Flue Gas Desulphurisation

Flue Gas Desulfurization is a process of removing Sulphur from flue gas of Thermal power plant before it is released into the atmosphere.

Indian coal is high in ash, but is low in sulphur. However, coal is also imported from Indonesia, Australia and South Africa for fuelling thermal power plants. This imported coal is high in sulphur content while being low in ash.

Ministry of Environment, Forest and Climate Change has made it compulsory to install Flue Gas Desulphurisation (FGD) system in the existing and upcoming thermal power plants to curb SOx emissions.

Guidelines on Concessional Financing Scheme (CFS) to support Indian Entities bidding for strategically important infrastructure projects abroad. (01-08-2018)

The scheme envisages Government of India to provide counter guarantee and interest equalization of 2% to the EXIM Bank to offer concessional finance to any foreign Govt. or foreign Govt. owned or controlled entity; If any Indian Entity succeeds in getting contract for the execution of a project tendered by such foreign entity and the project is considered strategically important.

Major Impact: Prior to the introduction of CFS, Indian entities were not able to bid for large projects abroad since the cost of financing was very high for them and bidders from other countries such as China, Japan, Europe and US were able to provide credit at superior terms, i.e., lower interest rate and longer tenures which works to the advantage of bidders from those countries.

Also, by having projects of strategic interest to India executed by Indian entities, the CFS enables India to generate substantial backward linkage induced jobs, demand for material and machinery in India and also a lot of goodwill for India.

Implementation Strategy:

Under the Scheme, MEA selects the specific projects keeping in view strategic interest of India and sends the same to Department of Economic Affairs (DEA).

The strategic importance of a project to deserve financing under this Scheme, is decided, on a case to case basis, by a Committee chaired by Secretary, DEA and with members from Department of Expenditure, Ministry of External Affairs, Department of Industrial Promotion and Policy (DIPP), Department of Commerce, Department of Financial Services and Ministry of Home Affairs.

The Deputy National Security Adviser is also a member of this Committee. Once approved by the Committee, DEA issues a formal letter to EXIM Bank conveying approval for financing of the project under CFS.

The Scheme is presently being operated through the Export-Import Bank of India, which raises resources from the market to provide concessional finance. Government of India (GoI) provides counter guarantee and interest equalization support of 2% to the EXIM Bank.

EXIM Bank shall extend credit at a rate not exceeding LIBOR (avg. of six months) + 100 bps.

The repayment of the loan would be guaranteed by the foreign govt, in case the borrower is the foreign govt. owned or controlled entity.

GoI shall provide guarantee in case the borrower is the foreign govt. and counter guarantee in case the borrower is a foreign govt. owned or controlled entity.

Delhi Mumbai Industrial Corridor

The DMIC project was launched in pursuance of an MOU signed between the Government of India and the Government of Japan in December 2006.

DMIC Development Corporation (DMICDC) incorporated in 2008, is the implementing agency for the project. DMICDC has been registered as a company with 49% equity of Government of India, 26% equity of the Japan Bank for International cooperation (JBIC) and the remaining held by government financial institutions.
The Japanese Government had also announced financial support for DMIC project to an extent of US$ 4.5 billion in the first phase for the projects with Japanese participation involving cutting edge technology.

As part of Phase-1 of the DMIC project, following eight investment regions are being taken up for development:

1. Dadri-Noida-Ghaziabad Investment Region in Uttar Pradesh (200 sqkms)
2. Manesar-Bawal Investment Region in Haryana (402 sqkms)
3. Jodhpur Pali Marwar Industrial Area in Rajasthan (154 sqkms)
4. Khushkhera-Bhiwadi-Neemrana Investment Region in Rajasthan (165 sqkms)
5. Dholera Special Investment Region in Gujarat (920 sqkms)
6. Pithampur-Dhar-Mhow Investment Region in Madhya Pradesh (372 sqkms)
7. Shendra-Bidkin Industrial Area in Maharashtra (84 sqkms)
8. Dighi Port Industrial Area in Maharashtra (253 sqkms)

The project spans the States of Uttar Pradesh, Haryana, Rajasthan, Madhya Pradesh, Gujarat and Maharashtra along the Western Dedicated Freight Corridor (DFC) of the railways.

Dedicated Freight Corridors in Railways

Eastern Dedicated Freight Corridor (EDFC) with a length of 1856 route kms, starting from Dankuni in West Bengal will pass through the States of Jharkhand, Bihar, Uttar Pradesh and Haryana to terminate at Ludhiana in Punjab.

Western Dedicated Freight Corridor (WDFC) with a length of 1504 route kms connecting Dadri in Uttar Pradesh to Mumbai-Jawaharlal Nehru Port (JNPT), will traverse through the National Capital Region and the States of Haryana, Rajasthan, Gujarat and Maharashtra.

The WDFC will join the EDFC at Dadri. Both EDFC and WDFCs are targeted for commissioning in phases by year 2020.

Being executed by the Dedicated Freight Corridor Corporation of India Limited (DFCCIL), a Special Purpose Vehicle set up under the Ministry of Railways in 2006, the two dedicated freight corridors will provide relief to the railways' heavily congested Golden Quadrilateral along the western and eastern rail routes, and facilitate fresh industrial activity and multi-modal value-addition services hubs along the corridors.

Miscellaneous

1. The **4th Annual Meeting** of the New Development Bank (NDB) Board of Governors (BoG) and the 18th Meeting of the NDB Board of Directors (BoD) were held in Cape Town, South Africa on 31 March and 1 April 2019 respectively.
2. The **2019 Human Development Report** will focus on understanding the dimensions of **inequality** most important to people's well-being, and what is behind them. The report, to be released in the last quarter of the year, will provide a comprehensive picture of the many forms of inequality that are shaping the 21st Century.
3. Department of Financial Services (DFS), Ministry of Finance and National Informatics Centre (NIC) has jointly developed a mobile app called **Jan Dhan Darshak** as a part of financial inclusion (FI) initiative . This app will act as a guide for the common people in locating a financial service touch point (Bank branches, ATMs, Post Offices, CSC etc) at a given location in the country. (26-09-2018)
4. The Union Cabinet chaired by Prime Minister Shri Narendra Modi has approved the Signing of Terms of Reference (TOR) governing the engagement of the designated Indian Expert to provide tax assistance to Swaziland (now known as Eswatini) under the **Tax Inspectors Without Borders Programme** (TIWB) between India and Eswatini. TIWB Programme which is jointly launched by UNDP and OECD is intended to support developing countries to strengthen national tax administrations through building tax audit capacity. (10-01-2019)
5. Union Minister of Heavy Industries & Public Enterprises, Anant Geete said that The biggest success of Make in India programme is in the **auto sector**. The auto mobile sector of India is one of the largest in the world and accounts for over 7.1 % of India's GDP and contributes nearly 22 % of India's manufacturing GDP. The minister added that the sector has become a manufacturing base for global car makers. (12-06-2018)
6. NITI Aayog has identified **five sectors** that includes healthcare, agriculture, education, infrastructure and transportation that can benefit from adoption of artificial intelligence to serve the societal needs. (04-06-2018).
7. Prime Minister, Shri Narendra Modi inaugurated Samsung Electronics' new mobile phone manufacturing facility – The **World's Largest Mobile Factory** – in Noida, Uttar Pradesh, India. (09-07-2018)
8. **Nuclear Power Park** refers to a site with a number of large capacity reactors with a total capacity of 6000 MW or more. The Kudankulam site (Tamilnadu), presently has two reactors – KKNPP 1&2 (2X1000 MW) in operation and two reactors, KKNPP 3&4 (2X1000 MW) under construction. In addition, work for setting up two more units - KKNPP 5&6 (2X1000 MW) at this site has commenced. On progressive completion of Units 3 to 6, the Kudankulam site having a total capacity of 6000 MW will be a nuclear power park.
9. The Prime Minister, Shri Narendra Modi, laid the Foundation Stone of the 340 kilometer long **Poorvanchal Expressway** in Azamgarh in Uttar Pradesh. This road will connect several important and historical towns of eastern Uttar Pradesh, including Barabanki, Amethi, Sultanpur, Faizabad, Ambedkar Nagar, Azamgarh, Mau and Ghazipur – with the State Capital – Lucknow. Once this Expressway is complete, Delhi will be connected via Expressways

(Noida-Agra and Agra-Lucknow), to several major towns and cities of the State of Uttar Pradesh, from Noida in the west, to Ghazipur in the east. (14-07-2018)

10. Rajasthan has become the **first Indian state** to implement National Policy on Biofuels - 2018 announced by the Government during May, 2018 (01-08-2018)
11. Ministry of Food Processing Industries (MoFPI) has approved the operationalisation strategy for **Operation Greens**. Operation Greens was announced in the Budget speech of 2018-19 with an outlay of Rs 500 crores to stabilize the supply of Tomato, Onion and Potato (TOP) crops and to ensure availability of TOP crops throughout the country round the year without price volatility. NAFED will be the Nodal Agency to implement price stabilisation measures. MoFPI will provide 50% of the subsidy on the following two components: (i) Transportation of Tomato Onion Potato (TOP) Crops from production to storage; (ii) Hiring of appropriate storage facilities for TOP Crops. (05-11-2018)
12. **Neo-banking** means offering digital banking services through Mobile App. This new age branchless banking solution will allow customer the advantage of managing all their payments, collections and reconciliation on a single and seamless interface.
13. **Consortium lending** refers to several lending institutions that group together to jointly finance a single borrower.
14. **Multiple Banking** is a banking arrangement where a borrowal avails of finance independently from more than one bank.
15. **Preference shares** mean the shares which carry a fixed dividend rate and which have preferencial right over the equity share with respect to- Payment of Dividend and Repayment of Capital at the time of winding up of the company. Preference shares do not carry voting rights.

Updates - NPCI launches Unified Payments Interface 2.0 (16-08-2018)

The key features of UPI 2.0 are:

5. UPI per transaction cap moved to Rs. 2 Lacs.

Updates- The Organization of the Petroleum Exporting Countries (OPEC)

The Organization of the Petroleum Exporting Countries (OPEC) was founded in Baghdad, Iraq, with the signing of an agreement in September 1960 by **five countries** namely Islamic Republic of Iran, Iraq, Kuwait, Saudi Arabia and Venezuela. They were to become the Founder Members of the Organization.

These countries were later joined by Qatar (1961), Indonesia (1962), Libya (1962), the United Arab Emirates (1967), Algeria (1969), Nigeria (1971), Ecuador (1973), Gabon (1975), Angola (2007), **Equatorial Guinea (2017) and Congo (2018).**

Indonesia suspended its membership in January 2009, reactivated it again in January 2016, but decided to suspend its membership once more at the 171st Meeting of the OPEC Conference on 30 November 2016.

Qatar terminated its membership on 1 January 2019.

This means that, currently, the Organization has a total of 14 Member Countries.

Updates- 2018 Global Hunger Index

2018 Global Hunger Index—published jointly by Concern Worldwide and Welthungerhilfe.

Updates- International Monetary Fund

- **Largest borrowers:** Argentina, Ukraine, Greece, Egypt
- **largest precautionary loans:** Mexico, Colombia, Morocco
- **Total amount the IMF is able to lend to its member countries is**: $1 Trillion
- **Interest rate on loans to low-income countries**: 0%
- Finance & Development Magazine is published quarterly by IMF

IAS Prelims 1996 (Updates)
A redistribution of income in a country can be best brought about through
(a) progressive taxation combined with progressive expenditure
(b) **progressive taxation combined with regressive expenditure**
(c) regressive taxation combined with regressive expenditure
(d) regressive taxation combined with progressive expenditure

Progressive taxation- When tax rate gradually increases due to increase in income (like India).

Regressive expenditure- Govt spending decreases with the increase in income of people.

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