Crux of Indian Economy for IAS Prelims 2020 Book

Economy Current Affairs October 2019

India ranks 63 in World Bank's Doing Business Report, 2020 (24-10-2019)

The World Bank released its latest Doing Business Report (DBR, 2020). India has recorded a jump of 14 positions against its rank of 77 in 2019 to be placed now at 63rd rank among 190 countries assessed by the World Bank.

As a result of continued efforts by the Government, India has improved its rank by 79 positions in last five years [2014-19].

Doing Business covers **12 areas of business regulation**.

Ten of these areas—starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts, and resolving insolvency—are included in the ease of doing business score and ease of doing business ranking.

Doing Business also measures regulation on employing workers and contracting with the government, which are not included in the ease of doing business score and ranking.

The Doing Business assessment provides objective measures of business regulations and their enforcement across 190 economies on ten parameters affecting a business through its life cycle. The DBR ranks countries on the basis of Distance to Frontier (DTF), a score that shows the gap of an economy to the global best practice. This year, India's DTF score improved to 71.0 from 67.23 in the previous year.

India has improved its rank in 7 out of 10 indicators and has moved closer to international best practices (Distance to Frontier score).

The changes in seven indicators where India improved its rank are as follows:

S. No.	Indicator	2018	2019	Change
1	Resolving Insolvency	108	52	+56
2	Construction Permits	52	27	+25
3	Trading Across Borders	80	68	+12
4	Registering Property	166	154	+12
5	Paying Taxes	121	115	+6
6	Getting Electricity	24	22	+2
7	Starting a Business	137	136	+1
Overall rank		77	63	+14

The important features of India's performance this year are:

- The World Bank has recognized India as one of the top 10 improvers for the third consecutive year.
- Recovery rate under resolving insolvency has improved significantly from 26.5% to 71.6%.
- The time taken for resolving insolvency has also come down significantly from 4.3 years to 1.6 years.
- India continues to maintain its first position among South Asian countries. It was 6th in 2014.

US Federal Reserve cuts interest rate for third time this year and Impact on India (31-10-2019)

The Federal Reserve (US Central bank) reduced the benchmark U.S. interest rate for the third time this year in an effort to boost the economy as the trade war and a global slowdown threaten to drag the U.S. economy down.

US Fed raises interest rates if inflation is too high, or it thinks it is heading that way. It cuts rates if it thinks there is a danger of economic growth slowing too much or inflation being too low.

Impact on India

When US Fed decreases the interest rates:
Cost of borrowing in US will be cheaper. Investors in US will be attracted to invest in India to earn high rate of interest. They will convert dollar into INR. This will push up the demand for the INR and INR will appreciate. Hence Cuts in interest rates in any country tend to make its currency lose value against others.

When US Fed increases the interest rates:
The hikes will lead to a rise in yields on US bond and a stronger dollar and a weaker rupee, which will lower investment returns for foreign investors and prompt them to sell assets in India.

For attracting the investors, RBI will be forced to increase the policy interest rates. RBI has built adequate foreign exchange reserves to take care of sudden FPI outflows. To save the INR from depreciation, RBI may sell foreign exchange reserve.

India loses Export Subsidies Case filed by US at WTO (31-10-2019)

A World Trade Organization (WTO) dispute panel agreed with the United States that India provides prohibited export subsidies to Indian exporters.

The Indian programs found in violation of WTO rules are: the Merchandise Exports from India Scheme (MEIS); Export Oriented Units (EOUs); Electronics Hardware Technology Parks (EHTPs); Bio-Technology Parks (BTPs); Special Economic Zones (SEZ); Export Promotion Capital Goods Scheme (EPCG); and a Duty free imports for exporters program (DFIS).

The panel gave India six months to withdraw these prohibited subsidies.

India is likely to appeal the ruling in the WTO Appellate Body.

India recently announced The proposed Remission of Duties or Taxes on Export Product (RoDTEP) scheme which will come into force from January 1, 2020. It will incentivise exporters at an estimated cost of Rs 50,000 crore and replace the Merchandise Exports from India Scheme (MEIS).

Background
On 14 March 2018, the United States requested consultations with India at the World Trade Organization (WTO) challenging Indian export subsidy programs.

US said these apparent export subsidies provide financial benefits to Indian exporters that allow them to sell their goods more cheaply to the detriment of American workers and manufacturers.

US said that Export subsidies provide an unfair competitive advantage to recipients, and WTO rules expressly prohibit them. According to the special and differential provisions in the WTO’s Agreement on Subsidies and Countervailing Measures, when a member’s per capita gross national income (GNI) exceeds $1,000 per annum (at the 1990 exchange rate) for a third straight year, it has to withdraw its export subsidies. According to a WTO notification in 2017, India crossed the per-capita GNI threshold for three straight years through 2015 — to $1,178 in 2015 from $1,051 in 2013. India’s exemption has expired, but India has not withdrawn its export subsidies.

Consultations are the first step in the WTO dispute settlement process. If the United States and India are not able to reach a mutually agreed solution through consultations, the United States may request the establishment of a WTO dispute settlement panel to review the matter.

Consultations were held on 11 April 2018 but failed to resolve the dispute. On 17 May 2018, the United States requested the establishment of a panel.

At its meeting on 28 May 2018, the Dispute Settlement Body (DSB) established a panel pursuant to the request of the United States.

IMF Quotas

The IMF is a quota-based institution. Quotas are the building blocks of the IMF's financial and governance structure. An individual member country's quota broadly reflects its relative position in the world economy. Quotas are denominated in Special Drawing Rights (SDRs), the IMF's unit of account.

Multiple roles of quotas

Resource Contributions- Quotas determine the maximum amount of financial resources a member is obliged to provide to the IMF.

Voting Power- Quotas are a key determinant of the voting power in IMF decisions. Votes comprise one vote per SDR100,000 of quota plus basic votes (same for all members)

Access to Financing-The maximum amount of financing a member can obtain from the IMF under normal access is based on its quota.

SDR Allocations-Quotas determine a member's share in a general allocation of SDRs.

Quota reviews

The IMF's Board of Governors conducts general quota reviews at regular intervals (no more than five years). Any changes in quotas must be approved by an **85 percent majority of the total voting power**, and a member's own quota cannot be changed without its consent.

US quota is 17.46 per cent, which translates to a vote share of 16.52 per cent, giving it a unique veto power over crucial decisions at the IMF.

Two main issues addressed in a general quota review are the size of an overall quota increase and the distribution of the increase among the members.

Size Of Overall Quota Increase
A general review allows the IMF to assess the adequacy of quotas in relation to both the members' balance of payments financing needs and the Fund's ability to help meet those needs.

Distribution of the quota increase among members
A general review allows for realignments in members' quota shares to reflect changes in their relative positions in the world economy.

Quota formula
A quota formula is used to help assess members' relative position in the world economy and it can play a role in guiding the distribution of quota increases. The current formula was agreed in 2008 and a new quota formula is being discussed in the context of the 15th General Review of quotas.

(0.50 * GDP + 0.30 * Openness + 0.15 * Variability + 0.05 * Reserves) compression factor

15th General Review of quotas

The 15th Review provides an opportunity to assess the appropriate size and composition of the IMF's resources and to continue the process of governance reforms to realign quota shares with members' relative positions in the world economy, while protecting the poorest members.

On December 5, 2016, the Board of Governors adopted a Resolution calling on the Executive Board to work expeditiously on the 15th Review in line with existing Executive Board understandings and the guidance provided by the IMFC, with the aim of completing the 15th Review by the 2019 Spring Meetings and no later than the 2019 Annual Meetings.

In 2019 Annual Meeting quota reform could not be completed due to blockage by US. India is calling for quota reforms so that share of emerging nations increases in line with their growing economic position.

Any changes in quotas must be approved by an **85 percent majority of the total voting power**, and a member's own quota cannot be changed without its consent. US is having 16.52% voting share and 85% majority of the total voting power is not possible without US support.

2010 Quota reforms

The 14th General Review of Quotas was completed on December 15, 2010 and conditions for the effectiveness of quota increases were met on January 26, 2016.

The 14th Review delivered a package of far-reaching reforms of the IMF's quotas and governance.
- **Doubled quotas** to SDR477 billion
- **Shift of quota shares** shifted more than 6 percent of quota shares from over-represented to under-represented member countries; and more than 6 percent of quota shares to dynamic emerging market and developing countries.
- **Protection of the poorest** preserved the quota and voting shares of the poorest member countries.

IMF Members Quota and Votes

Rank	IMF Member	Quota		Votes	
		Millions of SDRs	Percent of Total	Number	Percent of Total
1	US	82,994.2	17.46	831,407	**16.52**
2	Japan	30,820.5	6.48	309,670	6.15
3	China	30,482.9	6.41	306,294	6.09
4	Germany	26,634.4	5.60	267,809	5.32
5	France	20,155.1	4.24	203,016	4.03
6	United Kingdom	20,155.1	4.24	203,016	4.03
7	Italy	15,070.0	3.17	152,165	3.02
8	India	13,114.4	2.76	132,609	2.64

Where the IMF Gets Its Money

Resources for IMF loans to its members on non-concessional terms are provided by member countries, primarily through their payment of quotas. Multilateral and bilateral borrowing serve as a second and third line of defense, respectively, by providing a temporary supplement to quota resources.

These borrowed resources played a critical role in enabling the IMF to support its member countries during the global economic crisis.

Multilateral Borrowing
Through the **New Arrangements to Borrow (NAB)** a number of member countries and institutions stand ready to lend additional resources to the IMF. The NAB constitutes a second line of defense to supplement IMF resources to forestall or cope with an impairment of the international monetary system.

40 Participants with Total size SDR 182 billion (US$ 250 billion). Activation requires support from 85% of creditors eligible to vote.

Bilateral Borrowing Agreements
Bilateral Borrowing Agreements serve as a third line of defense after quotas and the NAB. Since the onset of the global financing crisis, the IMF has entered into several rounds of bilateral borrowing agreements to ensure that it could meet the financing needs of its members.

Organisation of Islamic Cooperation (OIC)

The Organisation of Islamic Cooperation (OIC) is the **second largest inter-governmental organization** after the United Nations with a membership of 57 states spread over four continents.

The Organization is the collective voice of the Muslim world. It endeavors to safeguard and protect the interests of the Muslim world in the spirit of promoting international peace and harmony among various people of the world.

The Organization was established upon a decision of the historical summit which took place in Rabat, Kingdom of Morocco on 12th Rajab 1389 Hijra (25 September 1969) following the criminal arson of Al-Aqsa Mosque in occupied Jerusalem.

In 1970 the first ever meeting of Islamic Conference of Foreign Minister (ICFM) was held in Jeddah which decided to establish a **permanent secretariat in Jeddah (Saudi Arabia)** headed by the organization's secretary general.

The Organization has **consultative and cooperative relations with the UN** and other inter-governmental organizations to protect the vital interests of the Muslims and to work for the settlement of conflicts and disputes involving Member States.

For the first time, India's External Affairs Minister was invited as Guest of Honour in the 46th Council of the Foreign Ministers of the Organisation of Islamic Cooperation (OIC) in Abu Dhabi in March 2019.

Minimum Alternative Tax (MAT) under the Income Tax Act

Objective of levying MAT	MAT was introduced to target those companies that make huge profits and pay the dividend to their shareholders but pay no/minimal tax under the normal provisions of the Income Tax Act, by taking advantage of the various deductions, and exemptions allowed under the Act. Now Companies have to pay a fixed percentage of their profits as Minimum Alternate Tax. The spirit behind levy of MAT is that every person participating in the economy must contribute to the exchequer.
MAT calculation	MAT is calculated at 15% (plus surcharge and cess as applicable) on the book profit (i.e. profit shown in the profit and loss account)
MAT credit	If in any year the company pays tax as per MAT, then it can claim credit of MAT paid in 15 subsequent Assessment Years.

Updates- RBI's revised Prompt Corrective Action framework for banks* (13-04-2017)

RBI has issued a Prompt Corrective Action (PCA) framework to maintain sound financial health of banks.

Capital, asset quality and profitability continue to be the key areas for monitoring in the revised framework.

Leverage would be monitored additionally as part of the PCA framework.

It facilitates banks in breach of risk thresholds for identified areas of monitoring, *viz.,*

Capital (Indicator to be tracked- CRAR or Common Equity Tier I ratio),

Asset Quality (Indicator to be tracked - Net Non-Performing Advances ratio) **and**

Profitability (Indicator to be tracked- Return on assets ROA), to take corrective measures in a timely manner, in order to restore their financial health.

Thus, it is intended to encourage banks to eschew certain riskier activities, improve operational efficiency and focus on conserving capital to strengthen them.

The framework is not intended to constrain the performance of normal operations of the banks for the general public.

PCA matrix - Areas, indicators and risk thresholds

Areas	**Indicators**	**Risk Threshold 1**	**Risk Threshold 2**	**Risk Threshold 3**
Capital (Breach of either CRAR or CET 1 ratio to trigger PCA)	CRAR (9%) + Capital conservation buffer (CCB) (2.5%) **OR**	upto 250 bps below Indicator i.e. <11.5% but >=9%	more than 250 bps but not exceeding 400 bps below Indicator i.e. <9% but >= 7.5%	Not applicable
	Common Equity Tier 1 (5.5%) + Capital conservation buffer (CCB) (2.5%)	upto 162.50 bps below Indicator i.e. <8% but >=6.375%	more than 162.50 bps below but not exceeding 312.50 bps below Indicator i.e. <6.375% but >=4.875%	In excess of 312.50 bps below Indicator i.e. <4.875%
Asset Quality	Net Non-performing advances (NNPA) ratio	>=6% but <9%	>=9% but < 12%	>=12%
Profitability	Return on assets (ROA)	Negative ROA for two consecutive years	Negative ROA for three consecutive years	Negative ROA for four consecutive years
Leverage (also refer Note-3)	Tier 1 Leverage ratio	<=4% but >= 3.5%	< 3.5%	Not applicable

Note

1. Breach of 'Risk Threshold 3' of CET1 by a bank would identify a bank as a likely candidate for resolution through tools like amalgamation, reconstruction, winding up, etc.

2. In the case of a default on the part of a bank in meeting the obligations to its depositors, possible resolution processes may be resorted to without reference to the PCA matrix.

3. As per RBI, minimum Leverage Ratio shall be 4% for Domestic Systemically Important Banks (DSIBs) and **3.5% for other banks** effective from the quarter commencing October 1, 2019

Risk threshold

Breach of any risk threshold would result in invocation of PCA by RBI

In case of Breach of Risk Threshold 1, RBI can place Restriction on dividend distribution/remittance of profits. Promoters/owners/parent in the case of foreign banks to bring in capital.

In case of Breach of Risk Threshold 2, RBI can place, In addition to mandatory actions of Threshold 1, Restriction on branch expansion; domestic and/or overseas. Higher provisions as part of the coverage regime.

In case of Breach of Risk Threshold 3, RBI can place, In addition to mandatory actions of Threshold 1, Restriction on branch expansion; domestic and/or overseas. Restriction on management compensation and directors' fees, as applicable.

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

Liquidity Coverage Ratio

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** to survive an acute liquidity 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.

Net Stable Funding Ratio (NSFR)

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.

The NSFR is expressed as a ratio that **must equal or exceed 100%.** The ratio relates the bank's available stable funding to its required stable funding.

NSFR =

$$\frac{\text{Total Available Stable Funding (ASF)}}{\text{Total Required Stable Funding (RSF)}} \geq 100\%$$

ASF

A bank's total ASF is the portion of its capital and liabilities that will remain with the institution for more than one year.

RSF

A bank's total RSF is the amount of stable funding that **it is required to hold** given the liquidity characteristics and residual maturities of its assets and the contingent liquidity risk arising from its off-balance sheet exposures.

The NSFR is generally calibrated such that longer-term liabilities are assumed to be more stable than short-term liabilities.

The NSFR is calibrated under the assumption that short-term (maturing in less than one year) deposits provided by retail customers and funding provided by small business customers are behaviourally more stable than wholesale funding of the same maturity from other counterparties.

The NSFR assumes that unencumbered, high-quality assets that can be securitised or traded, and thus can be readily used as collateral to secure additional funding or sold in the market, do not need to be wholly financed with stable funding.

NSFR assumes that some short-dated assets (maturing in less than one year) require a smaller proportion of stable funding because banks would be able to allow some proportion of those assets to mature instead of rolling them over.

Updates- Maharatna PSU (Page no 231 of Crux) (23-10-2019)

The government accorded 'Maharatna' status to Hindustan Petroleum Corporation Limited (HPCL) and Power Grid Corporation of India Limited. (PGCIL).

Updates- International Monetary Fund (Page no 168 of Crux) (01-10-2019)

Kristalina Georgieva was selected Managing Director of the IMF on September 25, 2019. She assumed her position on October 1, 2019.

Updates- International Solar Alliance (Page no 190 of Crux)

The Ministry of New and Renewable Energy hosted the second Assembly of International Solar Alliance (ISA) on 30 and 31 October 2019 New Delhi.

The Assembly is the supreme decision making body of the ISA, and gives directions on various administrative, financial and programme related issues. Shri R.K. Singh, Minister for New and Renewable Energy and Power is President of the ISA Assembly and Ms Brune Poirson, Minister of State for the Ecological and Inclusive Transition Govt. of France, is the Co-President of the Assembly.

Miscellaneous

1. RBI gives approval to the Kerala Government for the **formation of the Kerala Bank**. With its formation, the proposed Kerala Bank will be the largest banking network in the state. Kerala Bank would be formed amalgamating the District Co-operative Banks (DCBs) with Kerala State Co-operative Bank. (10-10-2019)

2. India has received first tranche of details about financial accounts of its residents in **Swiss banks** under a new automatic exchange of information framework between India and Switzerland, marking a significant milestone in the fight against black money suspected to be stashed abroad. The next exchange would take place in September 2020. (07-10-2019)

3. The Royal Swedish Academy of Sciences has decided to award The Sveriges Riksbank Prize in Economic Sciences in Memory of **Alfred Nobel 2019** jointly to **Abhijit Banerjee**, Esther Duflo and Michael Kremer "for their experimental approach to alleviating global poverty." (14-10-2019)

4. Union Cabinet approved the proposal for revival of BSNL and MTNL by administrative allotment of spectrum for 4G services, debt restructuring by raising of bonds with sovereign guarantee, reducing employee costs through VRS, monetisation of assets and **in-principle approval of merger of BSNL & MTNL**. (23-10-2019)

5.Recognizing the role of innovation as a key driver of growth and prosperity for India, **NITI Aayog with Institute for Competitiveness** as the knowledge partner has released the India Innovation Index 2019. **Karnataka** is the most innovative **major state** in India. **Sikkim and Delhi** take the top spots among the **north- eastern & hill states**, and **union territories/city states/small states** respectively. (17-10-2019)

6. Tamil Nadu became the first State in the country to enact a law on **contract farming** (30-10-2019)

7.India signed **Strategic Partnership Council Agreement** with Saudi Arabia. India became the fourth country to sign such an agreement with Saudi Arabia. Other three are Germany, Russia and Japan.

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