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Social and Economic Issues - NABARD

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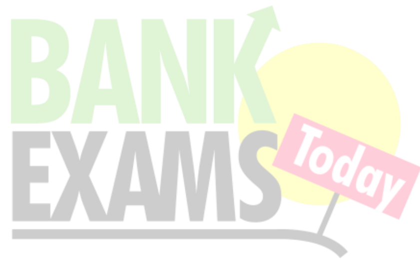

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INDIAN ECONOMY

What is Economy?

***Economy is the large set of inter-related production and consumption activities that aid in determining how scarce resources are allocated. This is also known as an economic system. Or in simple words 'careful management of available resources.'

Organizing an Economy

CAPITALISTIC ECONOMY

*Capitalism is an economic system in which capital goods are owned by private individuals or businesses.

*The production of goods and services is based on supply and demand in the general market (market economy), rather than through central planning (planned economy or command economy).

*The purest form of capitalism is free market or, in which private individuals are completely free to determine where to invest, what to produce or sell, and at which prices to exchange goods and services, without check or controls.

*Most modern countries practice a mixed capitalist system of some sort that includes government regulation of business and industry.

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STATE ECONOMY

*A State or centrally planned economy is an economic system in which the state or government makes economic decisions rather than the interaction between consumers and businesses.

*Unlike a market economy in which private citizens and business owners make production decisions, a centrally planned economy controls what is produced and the distribution and use of resources. State-owned enterprises undertake the production of goods and services.

MIXED ECONOMY

*A mixed economic system is an economic system that features characteristics of both capitalism and socialism(related to State Economy).

*A mixed economic system protects private property and allows a level of economic freedom in the use of capital, but also allows for governments to interfere in economic activities in order to achieve social aims.

*Indian Economy is an example of Mixed Economy.

OTHER CONCEPTS OF ECONOMICS

NATIONAL INCOME

Under the broad topic of national income you may hear terms like GDP, GNP, NNP etc.

GDP

*Gross Domestic Product (GDP) is the total money value of final goods and services produced in the economic territories of a country in a given year.

*Total value of goods and services produced in India for 2014-15 is projected to be around 100 lakh crore Indian rupees or around 2 trillion US dollars at current market prices. This is the value of Indian GDP when expressed at current market price.

*GDP stands for total value of goods and services produced inside the territory of India irrespective of whom produced it – whether by Indians or foreigners.

GNP

Gross National Product (GNP) is the total value of goods and services produced by the people of a country in a given year. It is not territory specific. If we consider the GNP of India, it can be seen that GNP is lesser than GDP.

FISCAL POLICY

Fiscal policy refers to the policy actions of the Government. Budget, tax, subsidies, expenditure etc. forms part of the fiscal policy. You might need to understand various deficits like Fiscal Deficit and Primary Deficit as part of Fiscal Policy.

FISCAL DEFICIT (FD)

The fiscal deficit is the difference between the government's total expenditure and its total receipts (excluding borrowing). In layman's term FD corresponds to borrowings and other liabilities.

BALANCE OF PAYMENTS

CURRENT ACCOUNT DEFICIT (CAD)

*Current Account is the sum of the balance of trade (exports minus imports of goods and services), net factor income (such as interest and dividends) and net transfer payments (such as foreign aid).

*Current account deficit in simple terms is dollars flowing in minus dollars flowing out.

CAPITAL ACCOUNT DEFICIT

*Capital account Deficit occurs when payments made by a country for purchasing foreign assets exceed payments received by that country for selling domestic assets.

*(For example, if Indians are buying a lot of properties in US, but if Americans are not buying any properties or buildings in India, India will have Capital Account Deficit.)

*A deficit in the capital account means money is flowing out the country, but it also suggests the nation is increasing its claims on foreign assets. In other words at times of Capital Account Deficit, foreign investment in domestic assets is less and investment by the domestic economy in foreign assets is more. If you need to know more about BoP, refer our notes on Balance of Payments.

INDIAN ECONOMY OVERVIEW

SECTORS OF INDIAN ECONOMY

PRIMARY SECTOR

*When the economic activity depends mainly on exploitation of natural resources then that activity comes under the primary sector. Agriculture and agriculture related activities are the primary sectors of economy.

*Contribution to GDP: 12%

*Sector share by working force: 51%
(means, the percentage of population employed by this sector)

SECONDARY SECTOR

When the main activity involves manufacturing then it is the secondary sector. All industrial production where physical goods are produced come under the secondary sector.

*Contribution to GDP: 28%

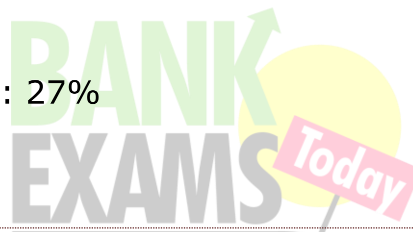
*Sector share by working force: 22%

TERTIARY SECTOR

When the activity involves providing intangible goods like services then this is part of the tertiary sector. Financial services, management consultancy, telephony and IT are good examples of service sector.

*Contribution to GDP: 60%

*Sector share by working force: 27%



INDIA AS AN INVESTMENT DESTINATION

India is the most attractive investment destination in the world, according to a survey by global consultancy firm Ernst & Young (EY). Organisation for Economic Co-operation and Development (OECD) projections on growth rate of India are 3.4 per cent for 2013-14, 5.1 percent in FY 2014–15 and 5.7 per cent in FY 2015–16. The HSBC Trade Confidence Index, the largest trade confidence survey in the world, has positioned India at the top with 142 points. The increasing demand due to its population makes the country a good market. Sectors projected to do well in the coming years include automotive, technology, life sciences and consumer products.

Indian Exports: India's exports have also been doing well, touching US$ 303 billion in FY 2012–13, almost double of what it managed (US$ 167 billion) four years ago. The US$ 1.2 trillion investment planned for the infrastructure sector in the 12th Five-Year Plan will go a long way in improving export performance of Indian companies and the Indian growth story.

Indian GDP: India is the third biggest economy in the world in terms of GDP measured at purchasing power parity (PPP), according to a World Bank report. India is also projected to become the third largest economy (Nominal GDP) in the world by 2043.

INDIAN ECONOMIC SCENARIO AND GROWTH POTENTIAL

India's industrial economy is gathering momentum on the back of improved output of eight core sector industries – coal, crude oil, refining, steel, cement, natural gas, fertilizers and electricity. Some of the important economic developments in the country are as follows:

*Indian companies have been signing many private equity (PE) deals, registering substantial increase from previous years.

*Indian corporates have also been raising significant amount through commercial papers (CPs).

*The cumulative amount of FDI equity inflows into India were worth around US$ 300 billion in the 2000–2014 period.

*The estimated value of FII holdings in India stands at US$ 279 billion.

*IT spending by the Government of India is growing 7 per cent year-on-year, according to a report by research and advisory firm Gartner.

*India's IT-business process outsourcing (BPO) industry revenue is expected to cross US$ 225 billion by 2020, according to a Confederation of Indian Industry (CII) report, titled 'The SMAC Code-Embracing New Technologies for Future Business'.

*General Electric (GE) plans to make India a manufacturing hub for its global markets due to its huge talent pool and lower manufacturing costs. The company's upcoming plant at Chakan, Maharashtra, is the first major step towards this direction.

*Public cloud services market in India is expected to grow by 37.5 per cent to touch US$ 434 million.

*Garments exports from India have increased by 31 per cent to touch US$ 1.19 billion year-on-year (y-o-y) in 2013, on back of increased demand from all major markets, including the US and the European Union (EU).

*The interest for costume jewelers is on the rise and costume jewelers estimate that they have clocked 20–30 per cent growth in the current fiscal. The industry size is expected to touch Rs 150 billion (US$ 2.40 billion) by December 2015, as per an industry body.

*The number of millionaires in India is expected to reach 300,000 by 2018 from about 182,000 currently, according to the global wealth report released by the Credit Suisse Research Institute. Wealth per adult in India has risen by 135 per cent from US$ 2,000

in 2000 to US$ 4,700 in 2013, at an average annual rate of 8 per cent.

*India added about US$ 17.6 billion worth of value domestically in 2012 by processing and fabricating gold bars and coins.

*The Life Insurance Council (LIC), the industry body of life insurers in India, has estimated the sector to record a compound annual growth rate (CAGR) of 12–15 per cent over the next five years.

*The total number of registered micro, small and medium enterprises (MSME) in India recorded a 19 per cent growth in FY 2011–12, according to the Ministry of MSME's annual report for FY 2012–13.

*Agricultural gross domestic product (GDP) in India is expected to grow by over 5 per cent.

GOVERNMENT INITIATIVES TO BOOST INDIAN ECONOMY

Frame work for Investments by RBI: In a bid to bring more investments into India's debt and equity markets, the Reserve Bank of India (RBI) has set up a framework for investments which will enable foreign portfolio investors to take part in open offers, buyback of securities and disinvestment of shares by the Central and State governments.

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Opening up Insurance sector: FIIs and non-resident Indians (NRIs) will now be able to invest in the insurance sector, within the 26 per cent cap on FDI. DIPP confirmed in a press note that the norms would also apply to insurance brokers, third-party administrators (TPAs), loss assessors and surveyors. The investments can be made through the automatic route.

Promotion of SMEs: The Government of India along with the industry has been working towards fashioning a more dynamic environment for small and medium enterprises (SMEs) and startups over the last few years. Indian SMEs employ about 40 per cent of the country's workforce and contribute 45 per cent to the overall manufacturing output. A positive policy framework allied with the growth of angel funds and a vibrant entrepreneurial culture is contributing to the growth of first generation entrepreneurs in the country.

Infrastructure: The Cabinet Committee on Investments (CCI) under UPA government had approved the speedy execution of 36 infrastructure projects entailing investments of Rs.1,830 billion (US$ 29.28 billion) to boost investor confidence.

ROAD AHEAD

With the objective of taking bilateral trade relations to the next level of a comprehensive economic partnership agreement, India is readying itself to sign the free trade agreement (FTA) on services and investment with the Association of Southeast Asian Nations (ASEAN). The target for the two-way trade partnership is US $100 billion by 2015, for which an integrated transport network is necessary. Thus, the emphasis is on a massive road connectivity plan to tie the region together to enhance economic objectives.

1991: ECONOMIC REFORMS

The strategy of reforms introduced in India in July 1991 presented a mixture of macroeconomic stabilization and structural adjustment. It was guided by short-term and long-term objectives. Stabilization was necessary in the short run to restore balance of payments equilibrium and to control inflation. At the same time changing the structure of institutions themselves through reforms was equally important from long term point of view.

The new government moved urgently to implement a program of macroeconomic stabilization through fiscal correction. Besides this, structural reforms were initiated in the field of trade, industry and the public sector.

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OBJECTIVE OF REFORMS

As per the Discussion Paper on Economic Reforms brought out by the Ministry of Finance in July 1993, the objectives of the reforms were:

"…to bring about rapid and sustained improvement in the quality of the people of India. Central to this goal is the rapid growth in incomes and productive employment… The only durable solution to the curse of poverty is sustained growth of incomes and employment… Such growth requires investment: in farms, in roads, in irrigation, in industry, in power and, above all, in people. And this investment must be productive. Successful and sustained development depends on continuing increases in the productivity of our capital, our land and our labor.

Within a generation, the countries of East Asia have transformed themselves. China, Indonesia, Korea, Thailand and Malaysia today have living standards much above ours… What they have achieved, we must strive for."

MAJOR STEPS IN THE 1991 REFORMS

The major policy initiatives taken by the Government to fundamentally address the balance of payments problem and the structural rigidities were as follows:

FISCAL REFORMS: A key element in the stabilization effort was to restore fiscal discipline. The data reveals that fiscal deficit during 1990-91 was as large as 8.4 percent of GDP. The budget for 1991-92 took a bold step in the direction of correcting fiscal imbalance. It envisaged a reduction in fiscal deficit by nearly two percentage points of GDP from 8.4 percent in 1990-91 to 6.5 percent in 1991-92.

The budget aimed at containing government expenditure and augmenting revenues; reversing the downtrend in the share of direct taxes to total tax revenues and curbing conspicuous consumption. Some of the important policy initiatives introduced in the budget for the year 1991-92 for correcting the fiscal imbalance were: reduction in fertilizer subsidy, abolition of subsidy on sugar, disinvestment of a part of the government's equity holdings in select public sector undertakings, and acceptance of major recommendations of the Tax Reforms Committee headed by Raja Chelliah. These recommendations aimed to raise revenue through better compliance in case of income tax and excise and customs duties, and make the tax structure stable and transparent.

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MONETARY AND FINANCIAL SECTOR REFORMS: Monetary reforms aimed at doing away with interest rate distortions and rationalizing the structure of lending rates.

The new policy tried in many ways to make the banking system more efficient. Some of the measures undertaken were:

*Reserve Requirements: reduction in statutory liquidity ratio (SLR) and the cash reserve ratio (CRR) in line with the recommendations of the Narasimham Committee Report, 1991. In mid-1991, SLR and CRR were very high. It was proposed to cut down the SLR from 38.5 percent to 25 percent within a time span of three years. Similarly, it was proposed that the CRR br brought down to 10 percent (from the earlier 25 percent) over a period of four years

*Interest Rate Liberalization: Earlier, RBI controlled the rates payable on deposits of different maturities and also the rates which could be charged for bank loans which varied according to the sector of use and also the size of the loan. Interest rates on time deposits were decontrolled in a sequence of steps beginning with longer term deposits, and liberalization was progressively extended to deposits of shorter maturity

*Greater competition among public sector, private sector and foreign banks and

elimination of administrative constraints

*Liberalization of bank branch licensing policy in order to rationalize the existing branch network

*Banks were given freedom to relocate branches and open specialized branches

*Guidelines for opening new private sector banks

*New accounting norms regarding classification of assets and provisions of bad debt were introduced in tune with the Narasimham Committee Report

REFORMS IN CAPITAL MARKETS: Recommendations of the Narasimham Committee were initiated in order to reform capital markets, aimed at removing direct government control and replacing it with a regulatory framework based on transparency and disclosure supervised by an independent regulator. The Securities & Exchange Board of India (SEBI) which was set up in 1988 was given statutory recognition in 1992 on the basis of recommendations of the Narasimham Committee. SEBI has been mandated to create an environment which would facilitate mobilization of adequate resources through the securities market and its efficient allocation.

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INDUSTRIAL POLICY REFORMS: In order to consolidate the gains already achieved during the 1980s, and to provide greater competitive stimulus to the domestic industry, a series of reforms were introduced in the Industrial Policy. The government announced a New Industrial Policy on 24 July 1991. The New Industrial Policy established in 1991 sought substantially to deregulate industry so as to promote growth of a more efficient and competitive industrial economy. The central elements of industrial policy reforms were as follows:

*Industrial licensing was abolished for all projects except in 18 industries. With this, 80 percent of the industry was taken out of the licensing framework.

*The Monopolies & Restrictive Trade Practices (MRTP) Act was repealed to eliminate the need for prior approval by large companies for capacity expansion or diversification.

*Areas reserved for the public sector were narrowed down and greater participation by private sector was permitted in core and basic industries. The new policy reduced the number of areas reserved from 17 to 8. These eight are mainly those involving strategic and security concerns. (Example, railways, atomic energy etc.)

*The policy encouraged disinvestment of government holdings of equity share capital of public sector enterprises.

*The public sector units were provided greater autonomy and professional management that could be helpful for generating reasonable profits, through an MOU(Memorandum of Understanding) between the enterprise and the concerned Ministry, through which targets that the enterprise had to achieve were set up

TRADE POLICY REFORMS: Under trade policy reforms, the main focus was on greater openness. Hence, the policy package was essentially an outward-oriented one. New initiatives were taken in trade policy to create an environment which would provide a stimulus to export while at the same time reducing the degree of regulation and licensing control on foreign trade.

The main feature of the new trade policy as it has evolved over the years since 1991 are as follows:

*Freer imports and exports: Prior to 1991, in India imports were regulated by means of a positive list of freely importable items. From 1992, imports were regulated by a limited negative list. For instance, the trade policy of 1 April 1992, freed imports of almost all intermediate and capital goods. Only 71 items remained restricted.

*Rationalization of tariff structure and removal of quantitative restrictions: The Chelliah Committee's Report had suggested drastic reduction in import duties. It had suggested a peak rate of 50 percent. As a first step towards a gradual reduction in the tariffs, the 1991-92 budget had reduced the peak rate of import duty from more than 300 percent to 150 percent. The process of lowering the customs tariffs was carried further in successive budgets.

Trading Houses: The 1991 policy allowed export houses and trading houses to import a wide range of items. The Government also permitted the setting up of trading houses with 51 percent foreign equity for the purpose of promoting exports. For instance, under the 1992-97 trade policy, export houses and trading houses were provided the benefit of self-certification under the advance license system, which permits duty free imports for exports.

PROMOTING FOREIGN INVESTMENT: The government took several measures to promote foreign investment in India in the post-reform period. Some of the important measures are:

*In 1991, the government announced a specified list of high technology and high-investment priority industries wherein automatic permission was granted for foreign direct investment (FDI) up to 51 percent foreign equity. The limit was raised to 74 percent and subsequently to 100 percent for many of these industries. Moreover, many

new industries have been added to the list over the years.

*Foreign Investment Promotion Board (FIPB) has been set up to negotiate with international firms and approve direct foreign investment in select areas.

*Steps were also taken from time to time to promote foreign institutional investment (FII) in India.

RATIONALIZATION OF EXCHANGE RATE POLICY: One of the important measures undertaken to improve the balance of payments situation was the devaluation of rupee. In the very first week of July 1991, the rupee was devalued by around 20 percent. The purpose was to bridge the gap between the real and the nominal exchange rates that had emerged on account of rising inflation and thereby to make the exports competitive.

The 1991 economic reforms were focused primarily on the formal sector, and as a result, we have seen significant boom in those areas that were liberalized. Sectors such as telecom and civil aviation have benefited greatly from deregulation and subsequent reforms. However, liberalisation and economic reforms still have a long way to go, especially for the informal sector—including the urban poor who hold jobs as street vendors or rickshaw pullers, the agricultural sector, Micro, Small and Medium Enterprises (MSMEs) and tribals. The slow growth and stagnation in these sectors which have not seen any reform further highlights the significant role of the 1991 reforms in helping India's economy become what it is today.

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