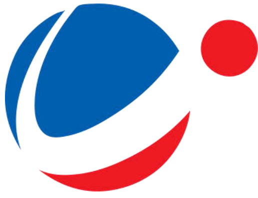

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APPROACH – ANSWER: G. S. MAINS MOCK TEST - 2066 (2023)

Answer all the questions in NOT MORE THAN 200 WORDS each. Content of the answers is more important than its length. All questions carry equal marks. ***12.5X20=250***

1. Bringing out the various functions of money, mention its advantages over other types of assets.

Approach:

- Give a brief definition of money.
- Mention various functions of money.
- List down the advantages of money over other types of assets.
- Conclude accordingly.

Answer:

Money is an economic unit that functions as a generally recognized medium of exchange for transactional purposes in an economy. Economically, each government has its own money system.

Following are the various functions of money:

- **Medium of exchange:** It means the money acts as an intermediary between the buyer and the seller.
- **A convenient unit of account:** The value of almost all goods and services can be expressed in monetary units.
- **Acts as a store of value for individuals:** Wealth can be stored in the form of money for future use. However, to perform this function well, the value of money must be sufficiently stable. A rising price level may erode the purchasing power of money.
- **Standard of deferred payment**: This means that if money is usable today to make purchases, it must also be acceptable to make purchases today that will be paid in the future.

Advantages of money over other types of assets:

- **Liquidity:** Money is considered the most liquid form of asset which can be readily exchanged for other types of assets.
  - Other assets like gold, landed property, houses or even bonds may not be easily convertible to other commodities and do not have universal acceptability.
- **Acceptability**: Money is acceptable to anyone at any point of time because of being a legal tender.
  - For instance, in the barter system, there used to be issues of **the double coincidence of wants.**
- **Durability**: Unlike the perishable items (food grains, fruits, etc.) in the case of barter, money is relatively more durable. However, there are soil rates in the case of the currency notes too.
- **Portability**: It means that the money can be conveniently carried from one place to another. This was not in the case of other assets in the barter system.
  - For instance, to carry out a transaction in the barter system, one has to take a bullock cart (to carry the food grains) along with him/her.
- **Stability**: Money is relatively stable when compared with, say, cryptocurrencies. For example, the volatility associated with cryptocurrencies brings additional risks for the end-users.
- **Uniformity**: In barter exchange, the assets for exchange are not uniform. However, the currency of a particular denomination (for e.g. Rs. 10) is all of the same size, shape, and value.

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- **Fungibility**: A 20-rupee note can be easily exchanged for other denominations, say - 10, 5 etc. However, an animal for exchange in the case of a barter system, on the other hand, cannot be considered fungible.

The presence of money in the market is a determinant of the economic condition of a country and it is regulated by the concerned Central Bank.

2. *Highlighting the instruments of monetary policy available with RBI, discuss how it not only acts as a banker to the commercial banks but also to the government.*

Approach:

- Briefly define monetary policy.
- Mention the instruments of monetary policy available with the RBI.
- Discuss how the RBI not only acts as a banker to the commercial banks but also to the government.
- Conclude accordingly.

Answer:

Monetary policy refers to the policy of the central bank with regard to the use of monetary instruments under its control. As the Central Bank, the RBI implements monetary policy through following tools:

A. Qualitative tools:

- **Legal reserve ratio**: Commercial banks are required to keep a certain amount of cash reserves known as **SLR (Statutory Liquidity Ratio)** and **CRR (Cash Reserve Ratio)** with the RBI**.**
- **Repo and reverse repo rate:** Repo and the reverse repo are the rates at which commercial banks borrow (or sell) money by selling (or borrowing) their securities to the RBI to maintain day-to-day liquidity, respectively.
- **Open Market Operations (OMOs):** These include both, outright purchase and sale of government securities, for injection and absorption of durable liquidity, respectively.
- **Market Stabilisation Scheme (MSS):** Surplus liquidity of a more enduring nature arising from large capital inflows is absorbed through the sale of short-dated government securities and treasury bills.

B. Qualitative tools: These are also known as selective instruments of the RBI's monetary policy.

- **Rationing of credit:** RBI limits the credit amount to be granted for particular sectors and commercial banks.
- **Change in Marginal Requirement:** Changing the margin requirement leads to a change in the loan size. This instrument is used to encourage the credit supply for the necessary sectors and avoid it for the unnecessary sectors.
- **Moral suasion**: Moral suasion refers to the suggestions to commercial banks from the RBI that helps in restraining credits in the inflationary period. RBI applies pressure on the Indian banking system without taking any strict action.

Other than maintaining the money supply in the market through the above tools, RBI acts as a banker to the government as well as other commercial banks.

- **Banker to commercial banks:** Reserve Bank is the only institution that can issue currency. When commercial banks need more funds in order to be able to create more credit, they may go to market for such funds or go to the Central Bank. The Central Bank provides the funds through various instruments such as Liquidity Adjustment Facility and Marginal Standing Facility.
- **Banker to the government**:
    - Under the RBI Act, 1934, RBI acts as the banker and debt manager to the Central Government as well as all state governments except Sikkim.
    - It is entrusted with the management of remittance, exchange, and banking transactions in India including floating of loans and managing them, and providing Ways and Means Advances to the Governments.

Thus, RBI plays a key role in managing and monitoring the monetary policies affecting commercial and personal finance, as well as the banking system.

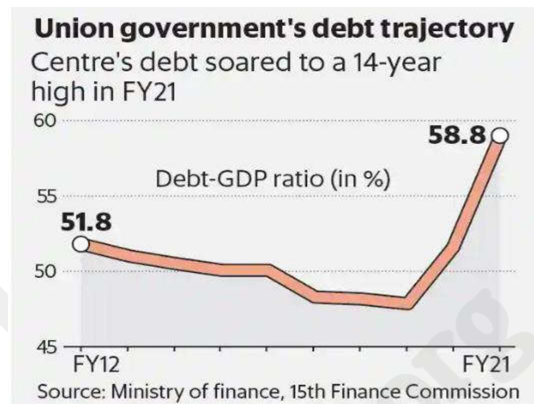
3. *What do you understand by public debt? Why is high public debt considered a matter of concern? Discuss in the context of India.*

Approach:

- Start by explaining public debt.
- Highlight recent trends and discuss issues associated with high public debt.
- Conclude accordingly.

Answer:

In the Indian context, **public debt** includes the total liabilities of the Union government that have to be paid from the Consolidated Fund of India. Sometimes, the term is also used to refer to the overall liabilities of the central and state governments. The sources of public debt are dated government securities (G-Secs), treasury bills, external assistance, and short-term borrowings.



The Union government's debt soared from 51.8% in 2011- 2012 to 58.8% of the GDP in 2020-21, a 14-year high. **This increasing burden of public debt is a matter of concern as discussed below**:

- **Mounting interest payments:** Borrowings built on the government's outstanding debt would add another indispensable expense in the form of interest payments.
- **Sovereign debt crisis:** As interest rates rise, it becomes more expensive for a country to refinance its existing debt. In time, income has to go toward debt repayment, and less toward government services. Much like what occurred in Europe, a scenario like this could lead to a sovereign debt crisis.
- **Inflationary pressure:** Increase in government spending or a cut in taxes would increase aggregate demand leading to demand-pull inflation.
- **Crowding out effect:** Excessive public debt leads to a higher risk premium in interest rates, which results in a reduction of private investment as well as a contraction in GDP in the long run.
- **The burden on future generations:** By borrowing, the government transfers the burden of reduced consumption to future generations. This is because it borrows by issuing bonds to the people living at present but may decide to pay off the bonds later, say after twenty years, by raising taxes.
- **Debt sustainability:** Rise in primary deficit and deterioration in interest rate growth differential would fuel skepticism on the debt sustainability of India.
- **Fiscal space:** The wide fiscal deficit leaves little room to absorb further adverse shocks without compromising credit ratings.
- **Credit ratings:** When debt approaches a critical level, investors usually start demanding a higher interest rate. If the country keeps spending, then its bonds may receive a lower credit rating which indicates how likely the country will default on its debt.

In emerging high-growth economies such as India, the government is required to propel growth through sufficient fund allocation in infrastructure and other essential resources. Therefore, governments need to carefully find that sweet spot of public debt that is large enough to drive economic growth but small enough to keep interest rates low.

4. *What is the significance of National Income Accounting? Discuss the various factors affecting GDP of a country.*

Approach:

- Start with a brief introduction about National Income Accounting.
- Mention its significance.
- Discuss various factors affecting the GDP of a country.
- Conclude accordingly.

Answer:

National Income Accounting (NIA) refers to methods or techniques used to measure the economic activity in a national economy as a whole. National income of a nation can be calculated in terms of GDP, GNP, NDP and NNP. However, the Gross Domestic Product (GDP) is the most acceptable indicator worldwide. GDP refers to the total market value of all the final goods and services produced in an economy in a given period of time. In India, GDP is estimated by the Central Statistical Office (CSO). Three methods used in its calculation are **Value Added Method (or the Product Method), Income Method and Expenditure Method.**

Significance of national accounting:

- **International comparison:** National Income Accounting measures growth rate and development of nations, which can be used to compare the standard of living of different countries.
- **Business decisions:** It reflects the relative contribution and potential of various sectors of the economy, which guide the business class to plan for future production.
- **Policy formulation:** It throws light on the distribution of income and resources in the economy, which helps the government in proper allocation of resources to bring in equality and ensure development of the nation.
- **Policy evaluation:** Income accounting identifies specific economic achievements and failures, which help the people of the nation in evaluating the policies of the government.
- **Annual budget:** It shapes the budgetary policy of the government, including borrowing and tax policy in order to neutralize the fluctuations of income and employment. The government adopts a deficit or surplus budget to arrest depression or inflation in an economy.

The factors affecting GDP of a country include:

- **Natural resources:** The geographical location and availability of natural resources like coal, iron and timber etc. affects the level of GDP.
- **Capital:** Capital is generally determined by investment that, in turn, depends on other factors like profitability, political stability etc.
- **Labour and entrepreneurship:** The quality or productivity of human resources is more important than their number. Manpower planning and education affect the productivity and production capacity of an economy.
- **Technology:** This factor is relatively more important for nations with lesser natural resources. The development in technology is determined by the level of invention and innovation in production.
- **Government:** Through its policy intervention, the government can provide a favorable business environment for investment in addition to maintaining law and order.
- **Political stability:** A stable economy and political system helps in appropriate allocation of resources. Wars, strikes and social unrest will discourage investment and business activities.

The GDP as a parameter to judge economic growth is criticized on the fact that parameters like gender inequality, income inequality, conditions of the poor are not reflected in it. Other indices like the Human Development Index (HDI), Gender Inequality Index (GII) etc. are used to take these parameters into account.

5. *What is gender budgeting? Discuss the challenges associated with it in the Indian context.*

Approach:

- Write a short note on the concept of gender budgeting.
- Highlight the challenges related to it.
- Briefly mention the steps that need to be taken to address these challenges.
- Conclude accordingly.

Answer:

Gender budgeting means incorporating a gender perspective at all levels of the budgetary process and restructuring revenues and expenditures in order to promote gender equality through gender-specific allocations. The purpose of gender budgeting is threefold:

- To promote **accountability and transparency** in fiscal planning.
- To **increase gender responsive participation** in the budget process, for example, by undertaking steps to involve women and men equally in the budget preparation.
- To **advance gender equality and women's rights**.

In an effort to integrate gender responsive budgeting in India's budgeting process, the Government of India introduced the **Gender Budget Statement (GBS)** in the Union Budget in 2005-06. However, various **challenges** still remain in implementing gender budgeting in India, including:

- **Insufficient resources:** The overall quantum of the gender budget is still less than 1% of the GDP. For instance, the gender budget was, on average, about 0.7% of the GDP, over the 2008-09 to 2019-20 period.
- **Concentration of funds in a few sectors:** Over the last decades, four ministries – Rural Development, Education, Health and MWCD have received between 85-90% of the Gender Budget expenditure. This pattern of allocation suggests a concentration of funds in a few sectors, as opposed to a widespread gender balanced budget.
- **Methodological inaccuracies:** There are methodological inaccuracies noted in the Gender Budget Statement (GBS). Although, sex-disaggregated data is available, there is a need to generate more information particularly regarding access to resources and opportunities, without which it is not possible to integrate a gender perspective in the budget process.
- **Accountability mechanisms:** Though it is mandatory to release the GBS, there are no effective accountability mechanisms mandating the impact assessment of allocations for female beneficiaries. Also, there are limitations of Parliamentary interventions as the role of the Legislatures in the budget process is often confined to budgetary approval and oversight and not in formulation and execution.
- **Lack of political will to institutionalise gender budgeting:** Gender budgeting requires political will to support a process of transforming the traditional budget-making and policy processes by removing long-standing, in-built biases.

The government has taken certain steps like constitution of **Gender Budgeting Cell (GBCs) , creation of Gender Data Bank etc.,** but more effort is required in this regard to achieve the objectives of gender budgeting. **These include:**

- Create a **ranking for state level gender budgeting** to incentivise the states in taking further steps to improve the efficacy of these measures.
- **Capacity building and technical support** should be provided to the state-level Gender Budgeting Cells.
- **Gender audits of centrally sponsored schemes and flagship programmes** should be undertaken to measure impacts.
- **Deviation between budgetary allocation and actual spending** needs to be addressed through proper monitoring of outcomes.

Despite the challenges, gender budgeting is an institutionalized tool that has allowed policymakers to assess how much the government spends on women's empowerment, and is a reflection of India's sincere efforts towards achieving its gender equality goals. In this context, India needs to revisit its approach from time to time, and tailor budgeting practices to suit the emergent needs and trends.

6. ***Elaborate on the demand-pull and cost-push factors of inflation in India.***

Approach:

- Define inflation in the introduction.
- Discuss the demand-pull and cost-push factors of inflation in India.
- Conclude accordingly with a way forward.

Answer:

Inflation refers to a sustained rise in the general price level in the economy and a fall in purchasing power of money over a period of time. It primarily occurs due to two sets of factors, the demand-pull factors, and the cost-push factors.

Demand-pull inflation arises when aggregate demand in the economy becomes more than aggregate supply. It occurs due to the following factors:

- **Increase in government expenditure**: Increased government expenditure, for example Direct Benefit Transfers, increases the purchasing power, leading to increased demand at constant supply, resulting in price rise.
- **Increased income:** Rise in purchasing power due to higher disposable income in the hands of people; for example, implementation of 7th Pay Commission, leads to increase in demand for commodities/services, which in turn leads to inflation.
- **Changing consumption patterns**: Increase in consumption, for example, of protein-rich food like pulses, eggs, fish, etc., can increase the prices of these commodities in the economy.
- **Rapid rise in population**: In the case of India, increased demand due to the rising population results in a demand-supply mismatch, raising the prices.
- **Black money**: It increases the demand for commodities, leading to extensive hoarding and black marketing of essential goods. For example, a large part of the black money is used in buying and selling real estate in urban areas, thus fuelling demand and leading to rising real estate prices.

Cost-push inflation arises when the aggregate supply of goods and services decreases because of an increase in production costs. It occurs due to the following factors:

- **Demand and supply mismatch:** When aggregate supply does not meet the aggregate demand e.g., a rise in oil price due to situations like the Russia-Ukraine crisis leads to inflation. An increase in the cost of wages and raw materials also leads to cost-push inflation.
- **Infrastructural bottlenecks**: Infrastructural issues, for instance, the lack of proper roads increases the logistic costs, poor supply of electricity incurs additional costs due to provision of alternate measures, etc. All these, ultimately lead to a rise in the cost of production.
- **Seasonal and cyclical fluctuations**: Owing to events such as failed monsoons there is a drop in agricultural productivity, which inevitably results in inflation at times.
- **Increase in taxation**: These taxes add up to the retail prices of the commodity. For example, taxes such as customs and excise duty levied on commodities raise the cost of the commodity.
- **Increase in administered prices**: When the government increases the MSP (Minimum Support Price) for the food grains, taxes on petroleum products, etc., it leads to inflation.

To control inflation and maintain price stability in the economy, the government has formed an institutional **Monetary Policy Committee**. Further, the fiscal policy of the government works in tandem with the inflation target determined by the Monetary Policy Committee.

7. ***The economic reforms of 1991 were a comprehensive structural overhaul of the Indian economy. Discuss.***

Approach:

- Give a brief context about the 1991 economic reforms.
- Write about salient points of the economic reforms of 1991 to show their extent.
- Conclude accordingly.

Answer:

The Balance of Payments crisis in 1991 and the subsequent rise in inflation forced India to adopt wide-ranging reforms, popularly known as Liberalization, Privatization, and Globalization (LPG).

The economic reforms of 1991 were a comprehensive structural overhaul of the Indian economy:

- **Liberalization**
  - **Delicensing:** The licensing requirement was done away with for most of the industries in a gradual manner and only a **few** industries are now reserved for the public sector **(for e.g. atomic energy generation)**.
  - **Relaxation under Monopolistic and Restrictive Trade Practice (MRTP) Act:** Now, it was no longer required to seek prior government approval for the expansion and establishment of new industries. The emphasis has shifted now to restricting unfair trade practices and safeguarding the interest of consumers.
  - **Liberalisation of capital markets:** Under the regulation of SEBI, a new company could be floated with the issuance of shares and debentures without seeking the permission of the government.
  - **Foreign exchange market:** Flexible exchange rate has been introduced under which the exchange rate is determined by market forces. In 1993-94, the rupee was made fully convertible on trade accounts in terms of the foreign currency.
  - **Removal of restrictions:** Restrictions on mergers, takeovers, separation of industrial units, etc. have been largely removed.
- **Privatization:** The government started **disinvestment** by selling off the equities of the PSUs. The purpose behind such a move was to improve financial discipline and facilitate modernization. It helped the PSUs to gain from the efficient functioning of the private sector and improved decision-making at managerial levels.
- **Globalization:** This paved the way for the **integration of the Indian economy with the global economy**. In recent times, many services such as voice-based business processes (popularly known as BPO or call centres), record keeping, accountancy, banking services, music recording, film editing, book transcription, clinical advice, and even teaching are being outsourced by companies in developed countries to India.

With these reforms, the focus now has shifted from the earlier 'License-Permit-Quota' regime towards a regime under which the government plays the role of a facilitator and enables the private sector to play a proactive role in driving the economic development of India.

8. What do you understand by capital account convertibility? State the merits and demerits of full capital account convertibility for India.

Approach:

- Define Capital Account Convertibility (CAC).
- Substantiate the pros and cons for moving towards the path of fuller CAC in the context of India.
- Conclude accordingly.

Answer:

Capital account convertibility (CAC) means the freedom to conduct investment transactions without any constraints. Typically, it would mean that there would be no restrictions on the number of rupees (local currency) that can be converted into foreign currency. It implies freedom of currency conversion related to capital inflows and outflows, and therefore sometimes referred to as Capital Asset Liberalisation.

At present, India allows full convertibility in the current account but only partial convertibility in the capital account. The two **Tarapore Committee Reports—1997 and 2006**—laid out a path to move towards full CAC. However, the process of **liberalizing the capital account**, in the last three decades since liberalization began, has remained a gradual and cautious one.

Merits of full CAC:

- **Improved access to international markets:** CAC would facilitate further liberalization and attract foreign investments.
- **Bring in financial efficiency**: An open capital account could bring with it greater specialization and innovation by exposing the financial sector to global competition. It may reduce the cost of capital.
- **Increase the choices for investments**: Residents get the opportunity to base their investment and consumption decisions on global interest rates and global prices for tradeables, which could enhance their interests and welfare. For instance, Indian investors would be able to invest in foreign securities and assets.
- **Hedging investment risks:** By offering the opportunity of using the world market to diversify portfolios, an open capital account permits both savers and investors to protect the real value of their assets through risk reduction.

Arguments against full CAC:

- **Export of domestic savings:** Speculative activity can lead to an outflow of capital from the country as seen in the case of some South-East Asian economies during 1997-98.
- **Tax avoidance**: CAC could weaken the ability of the authorities to tax domestic financial activities, income, and wealth.
- **Cost-push inflation**: Mostly the market-determined exchange rates are higher than officially fixed exchange rates. Thus, CAC could raise import prices and cause cost-push inflation.
- **Disruptions in the economy:** Improper management of CAC can lead to currency depreciation and affect trade and capital flows.

Still, the preconditions for convertibility set out in the Tarapore committee (gross fiscal deficit being less than 3.5% of GDP, an inflation rate of 3-5% over three years, the effective CRR being 3%, and gross NPAs of 5% or less) remains to be achieved. Thus, efforts must be made in this regard if the benefits of CAC need to be achieved.

9. *Planned development was one of the key economic reforms undertaken in post-independence India. In this context, discuss why the Second Five-Year Plan is regarded as a milestone.*

Approach:

- Introduce briefly on planned development as a key economic reform post-independence.
- Discuss the Nehru-Mahalanobis strategy of developmental planning adopted in the Second Five-Year Plan.
- State its contribution to the evolution of planning.
- Conclude accordingly.

Answer:

In the backdrop of partition and independence, India was mired in the stranglehold of issues like stagnating per capita national income, poorly developed industries, inadequate infrastructure, mass poverty, extreme unemployment and underemployment etc. In this context, planned development emerged as the key strategy of India's developmental efforts. It provided for a systematic utilization of the available resources at a progressive rate on a national scale to achieve substantial progress on the socio-economic front.

The era of planned development was ushered in with the launch of the **First Five-Year Plan** in April 1951 (the Harrod-Domar model), which addressed the problems arising from massive influx of refugees, acute food shortage and mounting inflation. However, it was the **Second Five-Year Plan which is regarded as the milestone in the trajectory of planning.** It was based on the **Nehru-Mahalanobis strategy of development**, which guided the planning practice for more than three decades until the end of the Seventh Five-Year Plan.

The significant contributions of the **Second Five-Year Plan can be discussed as follows:**

- **Rapid growth of the productive capacity** of the economy by directing public investment towards **development of industries**, especially capital goods industries. Industrialization with preference to capital goods industries over consumer goods industries became the core of this development strategy.
- **Creation of basic physical and human infrastructure** and progress in the sphere of **human capital** due to the setting up of institutions of higher learning, especially in the **scientific field.**
- **Raising the rate of investment** since the rate of development is dependent on the rate of investment. It involved **stepping up domestic and foreign savings** also. This resulted in economic growth and both the savings and investment rates rose substantially.
- **Growth in agricultural production** because of land reforms, Community Development Programme, large investment in irrigation and power and agricultural research. It also included simultaneous promotion of labour-intensive small and cottage industries for the production of consumer goods and expansion of employment opportunities.
- **Enhancement of the scope and importance of the public sector,** so that this sector comes to predominate capital goods industries, and controls the commanding height of the Indian economy.
- **Import substitution** for self-reliance and reduction of external dependence.
- Endeavours towards setting up of **an elaborate system of controls and industrial licensing** to allocate resources among industries as per the Plan requirements through the Industries Development and Regulation Act (IDRA) of 1951.

The Nehru-Mahalanobis strategy of development, however, faced considerable criticism owing to its greater emphasis on industrialization compared to agriculture, due to which the latter suffered. Allocation of higher priority to heavy industries compared to labour-intensive industries also resulted in heavy concentration of wealth and large-scale unemployment. Further, it was argued that the objective of removal of poverty could not be achieved by growth itself. Nevertheless, **the Second Five-Year Plan laid the bedrock for the basic physical and human infrastructure for comprehensive development in the society** going forward.

10. What is balance of payments of a country? Give an account of its various components.

Approach:

- Explain the concept of balance of payments of a country.
- Discuss its various components.
- Conclude accordingly.

Answer:

The **balance of payments (BoP**) records the transactions in goods, services and assets between residents of a country with the rest of the world for a specified time period, typically a year. A country's BoP reveals its financial and economic status and helps the government to decide on fiscal and trade policies.

There are three components of BoP viz. current account, capital account and financial account.

A) Current account: It is the record of trade in goods and services and transfer payments. Current account is in balance when receipts on the current account are equal to the expenditure/payments on the current account. Similarly, the current account could be in surplus or deficit depending upon the quantum of receipts and expenditure on the current account. It includes various components like:

- **Trade in goods,** which includes exports and imports of goods. The difference between the values of exports and values of imports of goods of a country in a given period of time is called **Balance of Trade (BoT).**
- **Trade in services,** which includes **factor income and non-factor income transactions**. Net factor income has two components i.e., net income for compensation of employees and

net investment income. Net non-factor income includes examples like shipping, banking, insurance, tourism, software services etc.
  - Difference between values of exports and values of imports of invisibles like services, transfer and flows of income etc. is called **Net Invisibles.**
- **Transfer payments** are the receipts which the residents of a country get for free without having to provide any goods or services in return. They consist of gifts, remittances and grants and could be given by the government or by private citizens living abroad.

B) Capital account: It records **all international transactions of assets**. An asset is any one of the forms in which wealth can be held, for example, money, stocks, bonds, government debt etc. Purchase of assets is a debit item on the capital account while sale of assets like sale of shares of an Indian company to a foreigner is a credit item on the capital account. Various components of capital account include:

- **Investments:** It includes direct investment and portfolio investment. Direct investments includes FDI, equity capital, reinvested earnings and other direct capital flows while portfolio investment includes FII, offshore funds etc.
- **External borrowing:** It includes External Commercial borrowings, short-term debt etc.
- **External assistance:** It includes government aid, inter-governmental, multilateral and bilateral loans etc.

C) Financial account: The flow of funds from and to foreign countries through various investments in real estates, business ventures, FDI etc. is monitored through the financial account. This account measures the changes in the foreign ownership of domestic assets and domestic ownership of foreign assets.

As per the, IMF new accounting standards financial account has also been included as a component of BoP. India has also made the changes but the RBI continues to publish data according to the old classification as well.

11. What is land pooling? State its benefits and associated challenges.

Approach:

- Explain what you understand by land pooling.
- Discuss its benefits.
- Highlight the challenges associated with it.
- Conclude accordingly.

Answer:

Land pooling is a **land acquisition strategy** wherein a single agency or government body consolidates small land parcels into a large parcel, provides it with infrastructure and returns a sizable land portion of redeveloped land to the original owners after deducting some portion as the cost of infrastructure development. Presently, this scheme is in execution in Delhi and Andhra Pradesh.

Benefits of Land Pooling:

- **For landowners:**
  - They get benefitted by the **increase in land value,** as the value of the land retained increases substantially compared to his original holding.
  - They get **access to substantially better infrastructure** such as roads, hospitals, schools, water etc.
  - It would lead to **conversion of irregular parcels into plots of regular sizes and shapes,** which would be appropriate for further development.
  - The strategy to not displace original landowners would **retain the traditional sense of belonging for the landowners.**
- **For the government:**
  - Under the approach, the government does **not have to pay any initial outlay** to acquire the land.

- The approach would **face relatively less resistance by landowners,** as it treats them as investors in the development projects.
    - It **fast-tracks the traditional land acquisition process** while addressing the associated social concerns.
    - Increased property prices lead to a higher **tax base for the government**.
- **Increase of public-private cooperation and trust:** Land pooling strategy ensures a three-way win for the private players to put their skills to use, the government to facilitate the development and ultimately the land owners who benefit from the development.
    - Since it involves participation of the landowners, diversion of land for another use is prevented.

Associated challenges in this context are:

- **Whether proper consent for land pooling** has been given by landowners is debatable, with the speed needed for development often pressuring agencies to make land pooling compulsory.
- More needs to be done to ensure that compensation and resettlement provisions extend to tenant farmers and agricultural labourers, as **compensatory packages are often insufficient for the landless.** Also, capital value appreciation may take time.
- **Inconsistencies in land pooling** and its associated legal framework complicate the acquisition process. Moreover, it is **difficult to apply for land pooling in congested urban areas.**
- Restarting farming on the reconstituted plots **incurs high costs,** as new farm equipment must be bought.

Given the pressing need for development in India, land acquisition by the states has persistently been a key issue. A number of flagship urban development projects have been delayed owing to issues with land acquisition. Moreover, the mechanism created under the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement (RFCTLARR) Act, 2013 further adds complications such as social impact survey, higher rates of compensation, caps on acquisition of multi-crop and agricultural land, mandatory consent of landowners as well as consent of the Gram Sabhas in the Scheduled Areas. These need to be addressed to ensure the success of the land pooling scheme.

12. Discuss the need and concerns associated with privatisation of public sector banks.

Approach:

- Discuss the recent context of privatisation of public sector banks.
- Elaborate on the need for privatisation of public sector banks.
- Discuss the concerns associated with it.
- Conclude with the steps that can be taken to strengthen public sector banks.

Answer:

The government is planning to introduce key financial sector bills of the proposed law for facilitating privatisation of public sector banks. The government is seeking to reduce its holding in public sector banks as a part of its disinvestment drive.

Need for privatisation of public sector banks (PSBs):

- **Autonomous decision-making:** Control and interference by the government prevent PSBs from staying competitive in the current environment. High level of autonomy will facilitate faster decision-making.
- **Innovation and expertise**: Private players have the will and capital to innovate new products (new schemes, services, etc.) and achieve expertise in their respective fields by offering quality service and guidance.
- **For enhanced efficiency in debt coverage**: The asset quality and efficiency of debt coverage of private sector banks are better than that of the public sector banks. A comparative study for the period of 2015 to 2019 has found that in comparison to private sector banks, public sector banks registered higher non-performing assets (NPAs).

- **Loss of market share of PSBs**: Private banks are operating in creamy places, cherry picking customers and PSBs are left with the difficult markets in poorer districts. Further, urban and semi-urban consumers are rapidly shifting to private banks.
- **Better human resource management**: Privatisation will help in introducing a high degree of professional management, in contrast to present PSBs which have a huge human capital deficit.
- **Recapitalisation requirements:** Banks are in need of additional capital to maintain capital adequacy ratio for continuing their lending operations and the government may have difficulty in providing additional capital to the PSBs on account of fiscal constraint.

Concerns associated with privatisation of PSBs:

- **Financial exclusion of the weaker sections**: Driven by the profit motive, private sector banks concentrate on the more affluent sections of the population and metropolitan/urban areas. Privatisation of PSBs may lead to financial exclusion of the weaker sections of the society, particularly in the rural areas.
- **Concerns regarding safety of deposits**: A significant number of private banks and financial institutions have failed in recent times. Privatisation of PSBs will remove the sovereign guarantee behind the PSB deposits and make household savings less secure.
- **Macroeconomic effects of bank failures**: Failure of banks will have a tremendous contagion effect and will derail the economy. With low government holding, recapitalisation of private sector banks may be seen as a moral hazard in the event of bank failure.
- **Problems faced by PSBs**: The major problem faced by banks i.e. increasing NPAs are common to both private and public sector banks.

In this context, public sector banks can leverage tech-enabled and smart banking like loan management systems and centralised processing centres for reduced retail loan disbursement turnaround time. Further, adherence to risk-based pricing must be improved and banks boards need to be empowered to take autonomous decisions with minimal government interference. One-time settlement platforms and portals, eDRT (Debt Recovery Tribunals) need to be put in place for online recovery case management. Additionally, non-Executive Chairmen need to be introduced in PSBs and Board Committee Systems need to be strengthened to improve governance in the banking sector in India.

13. What is inflation targeting? How does the inflation targeting framework operate in India?

Approach:

- Define inflation targeting in the introduction.
- Discuss the framework of inflation targeting in India.
- Discuss its advantages.
- Conclude accordingly.

Answer:

Inflation targeting is a **practice whereby the central bank of the country makes a commitment to keep the inflation within some desirable/reasonable limit** as fixed by it. In the recent past, several countries have been opting for inflation targeting as a monetary policy objective due to the following reasons:

- Helps in **long-term planning** for public and private entities and in **policy formulation**.
- **Redistributes income and wealth** between different groups in the society. High inflation benefits some groups at the expense of others.
- **Provides a climate of certainty** and thus boosts lender confidence, as high inflation implicitly penalizes the lender.

Inflation targeting requires the following:

- Ability of the central bank to conduct **monetary policy** with some degree of **independence.** Fiscal policy considerations cannot dictate monetary policy alone.
- The second requirement is the willingness and ability of the monetary **authorities not to target other indicators**, such as wages, the level of employment, or the exchange rate.

The Inflation targeting framework in India was initiated through the **Inflation targeting agreement of 2015** which further culminated into the **Amendment of the RBI Act in 2016.**

- The **Act adopted year-on-year changes in the headline Consumer price Index (CPI)** as the measure of inflation target. The target was fixed at 4% with an upper and lower tolerance band of 2%.
- **The Act** has **mandated the following working methodology** for the Monetary Policy Committee (MPC):
  - The decisions by the MPC are decided by a majority of votes by the members present and voting, and in the event of an equality of votes, the Governor has a second or casting vote.
  - The resolution adopted by the Monetary Policy Committee must be published after the meeting of the MPC.
  - The RBI must publish a report on monetary policy twice a year. The report should outline **the sources of inflation and short-medium term forecasts of inflation**.
  - In the **event of failure to achieve the inflation target**, the Act lays down that the RBI will inform the Central Government the following:
    - ✓ **The reasons for failure to achieve** the inflation target.
    - ✓ **The remedial actions** it proposes to take.
    - ✓ **An estimate of the time** within which the inflation target shall be achieved after the implementation of the remedial actions.

It needs to be kept in mind that there is a built in "escape clause" in the monetary policy that permits inflation to rise above the mandated target. The RBI during the ongoing pandemic has resorted to its use to keep interest rates low.

14. What are the objectives of government budgeting? Enumerate the various components of government budget in India.

Approach:

- Explain the meaning of government budgeting.
- Discuss its objectives (allocation, redistribution and stabilisation).
- Discuss its various components (revenue and capital budget).
- Conclude accordingly.

Answer:

The Indian Constitution requires the government to present before the Parliament a statement of its estimated receipts and expenditures in respect of every financial year which runs from 1 April to 31 March **(Article 112)**. This **'Annual Financial Statement'** constitutes the main budget document of the government.

Objectives of government budgeting include:

- **Allocation of resources:** The government provides certain goods and services which cannot be provided by the market mechanism i.e. by an exchange between individual consumers and producers. Examples of such goods are national defence, roads, government administration etc. which are referred to as public goods.
- **Redistribution:** The government sector affects the personal disposable income of households by making transfers and collecting taxes. It is through the budget that the government can change the distribution of income and bring about a distribution that is considered 'fair' by society.
- **Economic stabilisation:** In any period, the level of demand may not be sufficient for full utilisation of labour and other resources of the economy. Since wages and prices do not fall below a level, employment cannot be brought back to the earlier level automatically. The government needs to intervene to raise the aggregate demand.

Components of a budget:

There are two accounts in the budget. One that relates to the current financial year only are included in the revenue account, also called the **revenue budget**. The second component is

concerned with the assets and liabilities of the government into the capital account, also called **capital budget.**

Revenue budget:

- **Revenue receipts:** Revenue receipts are those receipts that do not lead to a claim on the government. They are therefore termed non-redeemable. They are divided into tax and non-tax revenues.
- **Revenue expenditure:** Revenue expenditure is the expenditure incurred for purposes other than the creation of physical or financial assets of the central government. It relates to those expenses incurred for the normal functioning of the government departments and various services, interest payments on debt incurred by the government, and grants given to state governments and other parties.

Capital budget:

- **Capital receipts**: The government receives money by way of loans or from the sale of its assets. Loans will have to be returned to the agencies from which they have been borrowed. Thus, they create liability. Disinvestment, as a component, is a component of capital receipts.
- **Capital expenditure:** There are expenditures of the government which result in creation of physical or financial assets or reduction in financial liabilities. This includes expenditure on the acquisition of land, building, machinery, equipment, investment in shares, and loans and advances by the central government to state and union territory governments, PSUs and other parties.

The budget, it has been argued, reflects and shapes, and is, in turn, shaped by the country's economic life.

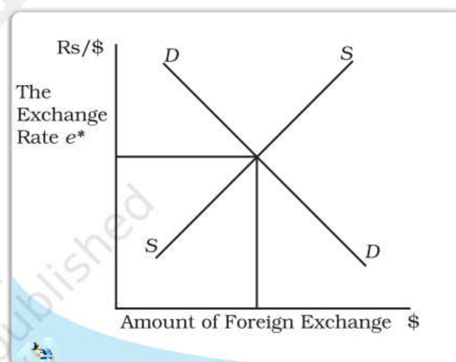
15. What is flexible exchange rate? Explain the factors which lead to appreciation and depreciation of the Indian rupee in terms of dollar.

Approach:

- Define flexible exchange rate.
- Discuss the various situations which lead to appreciation or depreciation of currency.
- Conclude accordingly.

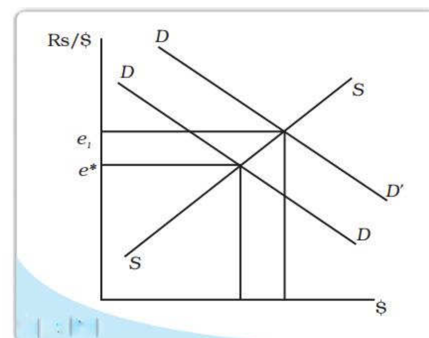
Answer:

A flexible exchange rate is a monetary regime where the price of currency of a nation relative to other currencies is determined by market forces based on supply and demand. This is in contrast to a fixed exchange rate, in which the government entirely or predominantly determines the rate.



Equilibrium under Flexible Exchange Rates

In a completely flexible system, the Central Banks do not intervene in the foreign exchange market. Therefore, when the demand for foreign goods and services increases (for example, due to increased international travel by Indians), then the demand curve **shifts upward and right to the original demand** curve. This increase in demand for foreign goods and services results in a change in the exchange rate.



Effect of an Increase in Demand for Imports in the Foreign Exchange Market

Now, the new equilibrium gets created at "e1" which is higher than the earlier equilibrium "e". It means that more rupees are to be paid for the foreign currency (dollar). In other words, with increased demand of foreign goods/services, the value of rupees in terms of foreign currency (dollar) has fallen and value of foreign currency (dollar) in terms of rupees has risen. This situation is called '**depreciation of domestic currency' in terms of foreign currency (dollar)**.

Similarly, in a flexible exchange rate regime, when the price of domestic currency in terms of foreign currency (dollar) increases, it is called '**appreciation of the domestic currency' (rupees) in terms of foreign currency (dollars**).

Factors influencing appreciation and depreciation of Indian rupee:

- **Speculation:** When money is being used as an asset and Indians speculate that the dollar is going to increase in value relative to the rupee, they will want to hold dollars to make gains. This expectation would increase the demand for dollars and cause the rupee-dollar exchange rate to increase.
- **Inflation**: Countries with low inflation (high purchasing power) typically have stronger currencies compared to those with higher inflation rates. This is because inflation decreases the buying capacity of the rupee.
- **Interest rates:** In the short run, the domestic currency of a country where differential interest rates are higher, appreciates. However, if these rates remain too high for too long, inflation can start to creep up, resulting in a devalued currency.
- **Income**: In general, other things remaining equal, a country whose aggregate demand grows faster than the rest of the world normally finds its currency depreciating because its imports grow faster than its exports. Thus, if imports grow faster than exports, the Indian rupee will depreciate and vice-versa.
- **Public debt**: If the government debt outpaces economic growth, it can drive up inflation, thus depreciating the Indian rupee.
- **Current account deficit:** Countries that have positive or low current account deficits tend to have stronger currencies than those with high deficits.

Other than these factors, political stability and economic growth are the two factors which attract more foreign investment, which in turn. help lower inflation and drive up the country's currency exchange rate.

16. Highlight the salient features of the Goods and Services Tax. Provide an account of its achievements since being implemented and the challenges it still faces.

Approach:

- Give a brief introduction of the Goods and Services Tax (GST).
- State the salient features of GST.
- Discuss the achievements as well as some concerns regarding the GST since its implementation.
- Conclude accordingly.

Answer:

Goods and Services Tax (GST) is an **indirect tax** which came into effect on **1st July 2017** by replacing many indirect taxes in India such as the excise duty, VAT, services tax, etc. Goods and Service Tax (GST) is levied on the supply of goods and services and is a **destination-based tax** that is levied on every value addition.

Salient features of the Goods and Services Tax:

- GST is applicable on '**supply' of goods or services** as against the concept of the manufacture of goods or on sale of goods or on provision of services.
- GST is based on the **principle of destination-based consumption taxation** as against the **principle of origin-based taxation**.
- India has a **dual GST** system with the Centre and the States simultaneously levying tax on a common base. The GST to be levied by the Centre is the **Central GST(CGST**) and that to be levied by the States is the **State GST (SGST**).
- An **Integrated GST (IGST)** is levied on **inter-state supply** of goods or services. This is levied and collected by the Government of India and such tax is apportioned between the Union and the States in the manner as may be provided by Parliament by law on the recommendation of the GST Council.

- Import of goods or services would be treated as **inter-state supplies** and would be subject to IGST in addition to the applicable customs duties.

Since its implementation in 2017, **the GST has achieved the following milestones:**

- **Widening of India's tax base**: The tax base almost doubled from 66.25 lakhs to 1.28 crores in the last four years (2017- 2021).
- **Ease of compliance:** It brought in efficiencies in indirect tax compliances and reduced the number of indirect tax authorities that business needed to interact with.
- **Increased logistics efficiency**: As per an estimate, it has saved over 50% of logistics effort and transit time of goods movement by eliminating the entry tax, check-posts (inter-state barriers) and introducing **nationwide e-way bills**.
- **Reduced transaction costs**: By eliminating 2% of additional cost (Central Sales Tax) on all interstate transactions, the GST has significantly reduced the overall transaction cost.
- **Increase in transparency**: It allows taxpayers to track their compliances online on the GST Portal, get the basic information about any business by entering the respective PAN or GSTIN etc, thus increasing transparency in the system.

However, there are several **challenges** that still need to be addressed, such as:

- **Overestimation of GST collection**: Actual collection is lower than initial estimations, thereby raising questions on the efficacy of the GST regime.
- **Complex tax slabs:** A complex slab structure with frequent switching of items between them leads to confusion in the compliance system and unethical profiteering due to fluctuating tax rates.
- **Complex and cumbersome filing structure**: The current GST return filing structure puts the onus of burden on the taxpayer with requirements of possessing a valid tax invoice/debit note, actual receipt of goods/service by the recipient, etc., making it a complex and cumbersome tax regime.
- **Ambiguous and conflicting AAR judgments**: Conflicting rulings from various benches of the Appellate Authority for Advance Ruling across different States has led to confusion among taxpayers.
- **Tax evasion and tax fraud**: GST tax evasion and tax fraud, including use of fraudulent invoices, fake e-way bills, etc has led to massive losses in revenue collection (approximately Rs. 40,000 crore).

While the government has worked to solve many issues, considerable intervention is still required to bring GST to its full efficiency. The proposal to have a single return will simplify compliance and do away with matching requirements. Such a step will bring out the true sense of 'One Nation, One Tax'.

17. While digitisation of land records is a positive step, there are some challenges that need to be addressed. Discuss.

Approach:

- Introduce by briefly writing about the need of digitisation of land records.
- Mention advantages as well as challenges associated with the digitisation of land records.
- Conclude accordingly.

Answer:

Access to land is a critical factor for economic growth and poverty reduction. For government, industry, and citizens to be able to use this asset effectively and to minimize land conflicts, digitisation can help by improving access to reliable land and property records.

Advantages of digitisation of land records:

- **Reduction in litigations and burden of cases:** A NITI Aayog paper suggests that land disputes on average take about 20 years to be resolved. Land disputes add to the burden of the courts and impact sectors and projects that are dependent on these disputed land titles.

- **Promoting agricultural credit**: Land is often used as collateral for obtaining loans by farmers. Digitisation of land records and online creation of equitable mortgages would help in faster disbursement of agriculture credit.
- **Development of new infrastructure**: The economy of the country is shifting from agrarian to manufacturing and services based. However, several new infrastructure projects are witnessing delays due to lack of updated land records.
- **Urbanisation and housing**: Slum dwellers do not have access to a clear land title or ownership rights. Further, since many colonies in which the poor reside are unauthorised, it is difficult for Urban local bodies to provide basic services to them. Easier online approvals of plans and occupancy certificates will provide clarity over ownership status.
- **To check benami transactions**: Unclear titles and non-updated land records enable carrying out property transactions in a non-transparent way. The Standing Committee on Finance in 2015 noted that **generation of black money** through benami transactions could be eliminated by digitisation of land records and their regular updation.

Challenges faced in Digitization of Land Records:

- **Lack of unified legal framework**: The system of land records was inherited from the zamindari system. The legal framework in India does not provide for guaranteed ownership, and the manner in which information pertaining to land records is collected and maintained further exacerbates the gaps in these records.
- **Land unavailability in development of infrastructure**: These delays occur because of non-availability of encumbrance free land, non-updation of land records, resistance to joint measurement survey of land records, demands for higher compensation by landowners, and filing of large number of arbitration cases by landowners.
- **Lack of manpower**: One of the major roadblocks in ensuring continuous updation of land records is the lack of skilled manpower in the land record departments of states.
- **Poor synergy across land record departments**: The Revenue department as the custodian of textual records; the survey and the settlement department managing the spatial records and the registration department responsible for registering land transactions, lack synergy in functioning.
- **Digital divide**: Lack of awareness and digital illiteracy are prevalent, especially in rural areas.

To address these challenges, there is a need for wider adoption of technologies such as geographical information systems, data warehouse, and webs. It would help in making land records management efficient and easier for decision making, strategy planning and productive modelling**.** Also, an online or digital record department could be established for the betterment of online land records maintenance.

18. What are Non-Performing Assets (NPAs)? Highlight the measures taken by the government to address the menace of NPAs in India in recent times.

Approach:

- Introduce by explaining the concept of Non-Performing Assets (NPAs).
- Mention the measures taken by the government to tackle the NPAs.
- Conclude accordingly.

Answer:

A **non-performing asset** (NPA) refers to a classification for loans or advances of a bank that are in default or in arrears. The period beyond the 'due date', past which the principal or interest payments are considered late or missed, has been accepted as **'90 days'** in India. For **agricultural advances**, instead of 90 days overdue, **cropping seasons** are taken into consideration.

Banks are required to classify non-performing assets further into the following three categories

- **Sub-standard Assets**: These assets have been classified as NPA for a period not exceeding 12 months.
- **Doubtful Assets**: These assets have remained NPA for a period exceeding 12 months.

- **Loss Assets**: A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly.

As per RBI data, gross non-performing assets (GNPAs) of scheduled commercial banks in 2021 have doubled since 2014, but have declined from ₹9.5 trillion in FY19 to about ₹8 trillion as on 30.9.2021. To resolve the issue of NPA, the Indian government has introduced interventions in **four major areas (4R's):**

1. **Recognition** of NPAs or hidden stress:
    - A large-scale Asset Quality Review was initiated in 2015 to identify NPAs in a transparent manner.
    - A large credit database has been created with the **Central Repository of Information on Large Credits (CRILC)** to identify early signs of distress in a borrower.
    - **A Prompt and Corrective Action (PCA**) framework has been created by the RBI to improve the performance of banks with weak financial metrics.
2. **Recapitalization of Banks**:
    - **Mission Indradhanush** was launched in 2015 to infuse more capital in state-run banks through budgetary allocations and recapitalization bonds so that they meet the capital adequacy norms. Since then, the banks have been infused with around ₹3 trillion with an additional ₹70,000 crore pledged in FY20 to meet the Basel III norms.
    - **National Asset Reconstruction Company (NARCL) or Bad Bank** has been launched in 2021, which proposes to acquire stressed assets of about Rs. 2 Lakh crore in phases through Cash (15%) and Security Receipts (85%). The Central Government guaranteed Rs.30,600 crore for 5 years to back Security Receipts issued by NARCL.
3. **Resolution of insolvency**:
    - **Insolvency and Bankruptcy Code**: The IBC was enacted in 2016 to provide a time-bound 180-day recovery process for insolvent accounts.
    - **Project Sashakt**: It aims at a resolution of assets with larger value on a high priority. Under the project, bad loans of up to ₹ 50cr will be managed at the bank level, for bad loans of Rs. 50-500cr, the bank will enter into an **inter-creditor agreement** and for loans above Rs. 500cr, it aims to create an independent **Assets Management Company**.
4. **Reform**:
    - **More robust Credit Risk Management**: Through regulatory reforms like higher provisioning for stressed assets, detailed sectoral as well as individual analysis of the profit and loss statements, and financial safeguards against external factors.
    - **Widening of powers of RBI**: Through a series of legislations and executive orders. For example, punitive measures were introduced as part of the PCA framework.
    - **Key reforms undertaken for PSBs**: Such as incorporating the usage of third-party data sources for due diligence, creation of online end-to-end One Time Settlement (OTS) platforms, and strict segregation of monitoring and sanctioning of high-value loans.

The broad-based nature of solution of the NPA problem acts as a catalyst for the overall banking reforms. Increasing levels of NPAs can act as an appropriate anchor for monitoring and progressing towards the better overall health of the financial system.

19. What do you understand by sterilization? How does RBI stabilize money supply against external shocks?

Approach:

- Briefly explain sterilization by RBI in the introduction.
- Discuss how RBI stabilizes money supply against external shocks.
- Conclude accordingly.

Answer:

Sterilization is a form of monetary action in which a central bank seeks to limit or neutralise the effect of inflows and outflows of capital on the money supply.

For instance, if it takes Rs 70 to purchase 1 USD and the RBI wishes to keep the exchange rate from rising from its current level, it must sell dollars out of its foreign exchange reserves. Since the dollars will be purchased with rupees, the supply of rupees in circulation will decrease and the supply of dollars in circulation will increase, therefore, the value of the dollar will not rise relative to the rupees. But this action reduces the amount of domestic currency in circulation, which might not be desirable. For example, it may lead to a rise in interest rates. In order to counteract or sterilize this effect, the central bank may simultaneously purchase domestic (Indian) bonds in order to put domestic currency back in circulation. Similarly, if a central bank is buying foreign currency to keep the value of domestic currency low, it can sterilize such intervention by selling bonds and removing from circulation domestic currency that was introduced by such foreign exchange market intervention.

In India, RBI has following mechanisms to stabilise money supply against external shocks:

- **Open Market Operations (OMO):** This is the main instrument of sterilisation used by RBI, where excess liquidity in the system is absorbed through the outright sale of securities.
  - **Market Stabilisation Scheme (MSS):** Under this scheme, the RBI issues Market Stabilisation Bonds (MSBs) to withdraw the excess liquidity in the economy. The value of bonds in rupees is treated as net RBI debt to the government. This is because the proceeds from MSS will not go to the government, though it is the government that provided the bonds. The proceeds from the Market Stabilization Scheme are held in a separate identifiable cash account. The fund is appropriated only for the redemption of the treasury bills or dated securities issued under the MSS. The interest payments for MSS securities represent the budgetary burden for ensuring price stability and is often referred to as the carrying cost of sterilization.
- **Balances of the Government of India with the RBI**: As the RBI Act does not permit payments of interest on Government balances, these balances are invested in government securities held in the portfolio of the Reserve Bank for earning interests. As a consequence, it is used as an instrument of sterilization.
- **Forex Swaps:** It helps in the postponement of creation of liquidity generated by capital inflows and the consequent accretion to reserves e.g., building up of Forward Purchase Obligations to meet repayment of Resurgent India Bonds (RIBs).

Other than these mechanisms, the absorption or injection of liquidity through Liquidity Adjustment Facility (LAF) and Cash Reserve Ratio (CRR) also has the ability of sterilising liquidity. However, they are to be used under extreme cases, when other options are exhausted.

Forex market intervention requires a continuous assessment of exchange market conditions, liquidity conditions, G-sec market conditions and forward market conditions. The prudent sterilised interventions by RBI have not only ensured that the reserve money growth remains consistent with the requirements of the growing economy but also that money market rates remain aligned with the operating target of the monetary policy, no matter how significant and persistent the liquidity impact of forex interventions may be.

20. What are the objectives of the Fiscal Responsibility and Budget Management Act, 2003 (FRBMA)? Enumerate its key features.

Approach:

- Give a brief introduction on Fiscal Responsibility and Budget Management Act, 2003 (FRBMA).
- Write down the objectives of FRBM Act,2003.
- Mention the key features of the Act.
- Conclude accordingly.

Answer:

The Fiscal Responsibility and Budget Management (FRBM) Act was enacted in 2003, with the aim to introduce transparency and discipline in India's fiscal management systems. It marked a **turning point in fiscal reforms**, binding the government through an institutional framework to pursue a prudent fiscal policy.

Objectives of FRBM Act, 2003:

- The central government needs to ensure **Inter-generational equity**.
- Long-term macro-economic stability by **achieving sufficient revenue surplus**.
- **Removing fiscal obstacles** to monetary policy.
- Effective debt management by **limiting deficits and borrowing**.
- To give the Reserve Bank of India (RBI) **flexibility to deal with inflation** in India.
- To introduce a more **equitable distribution of India's debt** over the years.

The FRBM Act has the following **key features**:

- The Act mandates the central government to take appropriate measures to **reduce the fiscal deficit and revenue deficits** so as to originally eliminate the revenue deficit by 2009 and thereafter build up an adequate **revenue surplus.**
- If the fiscal and revenue deficits are not achieved through tax revenues, the necessary adjustment has to come from **a reduction in expenditure**.
- The actual deficits may exceed the targets specified only on **grounds of national security or natural calamity** or such other exceptional grounds as the **central government may specify**.
- The central government **shall not borrow from the Reserve Bank of India** except by way of advances to meet temporary excess of cash disbursements over cash receipts.
- The Reserve Bank of India must not subscribe to **the primary issues of central government** securities from the year 2006-07.
- Measures to be taken to ensure greater transparency in fiscal operations.
- The central government to lay before both Houses of Parliament **three statements**
  - Medium-term Fiscal Policy Statement,
  - The Fiscal Policy Strategy Statement,
  - The Macroeconomic Framework Statement along with the Annual Financial Statement.
- **A quarterly review of the trends** in receipts and expenditure in relation to the budget be placed before both Houses of Parliament.

These targets were put off several times. The Act was reviewed in 2016 by the **NK Singh Committee,** which suggested to target the debt to GDP ratio instead and bring it down to 60% by 2023 (comprising 40% for Centre and 20% for states). It also recommended to reduce the fiscal deficit from 3.5% (2017) to 2.5% by 2023, and advocated rather for a fiscal range with an 'escape clause' to accommodate countercyclical issues and situations of emergencies.

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