







- Review of recruitment procedures, training and remuneration policies in public Sector Banks.
- Threat of action by vigilance and other investigative authorities, mishandling the case of commercial decision create low morale. The committee wants this issue to be addressed.
- Need for professionalising and depoliticising the bank boards.

### ***Proxy Banking In India***

Indian villages were miles away from mutual funds, insurance and even equity trading. Thanks to Internet Kiosk and the ATM duo which has made it possible for rural India. This kiosk has been set up by ICICI Bank in partnership with network n-Logue Communications in remote villages of Southern part of the country. This is known as Proxy Banking. With the help of fibre optic cables, this kiosk works on wireless in local loop technology.

### **Reasons for setting-up of Proxy Banking**

- 58% of rural households still do not have bank accounts.
- Only 21% of rural households have access to credit from a formal source.
- 70% of marginal farmers do not have deposit account.
- 87% households have no formal credit. Only 1 % rural households rely on a loan from a financial intermediary. The loans take between 24 to 33 weeks to get sanctioned.
- Consumers bribe officials to get loans approved which varies between 10 and 20% of the loan amount.
- Branch banking in rurals is a loss-making.

### **Benefits to rurals**

- Small loans given for buying buffaloes.
- Loans for setting up a tea shop.
- Life and non-life insurance provided.
- Weather insurance given to farmers.
- Insurance policies sold to farmers like groundnut, castor, soya, paddy crop, etc.
- The Proxy Banking is an innovative approach to rural lending and will add to the government's expanding base of kisan credit cards and the good old guidelines for agricultural lending.

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### ***Foreign Banks in India***

The foreign banks in the private sector are branches of banks incorporated in foreign countries. There are 24 such banks with 139 branches. These branches are in the main location at port towns. Most foreign banks perform essentially the same range of services as local banks, except that their focus in terms of products and customers may be different due to their limited branch network. In addition, some banks have been introducers or providers of de novo financial engineering products such as swaps, electronic fund transfers, etc.

## CAPITAL AND COMMODITY MARKET

BSE Sensex crossed the mark of 14000 in January 2007 and 15000 in July 2007. Similarly Nifty crossed the mark of 4000 in January 2007 and is still roaring. The pick up in the stock indices could be attributable to (1) impressive growth in the profitability of Indian corporates, (2) Overall higher growth in the economy, (3) Global factors such as continuation of relatively soft interest rates and (4) Fall in crude oil prices in international market NSE and BSE retained the 3<sup>th</sup> and 6<sup>th</sup> position in terms of transactions at the stock markets globally.

- Capital market is the market for long-term funds, just as the money market is the market for short-term funds.
- It refers to all the facilities and the institutional arrangements for borrowing and lending term funds (medium-term and long-term funds).
- The supply of funds for the capital market comes largely from individual savers, corporate savings, banks, insurance companies, specialized financing agencies and the government.
- The capital market in India can be classified into:
  - Gilt-edged Market on Government and semi-government securities;
  - Industrial Securities Market;
  - Development Financial Institutions (DFI); and
  - Non-banking Financial Companies (NBFC)
- The Gilt-edged Market is the market for Government and semi-government securities, which carry fixed interest rates and backed by RBI.
- The securities traded in this market are stable in value and are much sought after by banks and other institutions.
- The Industrial Securities Market is the market for equities and debentures of companies of the corporate sector.
- This market is further classified into (a) New Issues Markets: for raising fresh capital in the form of shares and debentures, and (b) Old Issues Market: for buying and selling shares and debentures of existing companies—this market is commonly known as the stock market or stock exchange.
- The capital market is also classified into Primary Capital Market and Secondary Capital Market.
- The Primary Capital Market refers to the new issues market, which relates to the issue of shares, preference shares and debentures of non-government public limited companies, and also to the raising of fresh capital by Government companies and the issue of public sector bonds.
- The Secondary Capital Market, on the other hand, is the market for old or already issued securities. It is composed of Industrial Security Market or the stock exchange in which industrial securities are bought and sold, and the Gilt-edged Market in which the government and semi-government securities are traded.

### **Methods of raising capital**

There are three ways in which a company may raise capital in the primary market.

#### **Public issue**

- By far the most important mode of issuing securities, a public issue involves sale of securities to the public at large.

- A company making a public issue informs the public about it through statutory announcements in the newspapers, makes application forms available through stock brokers and others, and keeps the subscription open for a period of three to seven days.

### **Right issue**

- A right issue involves selling securities in the primary market by issuing rights to the existing shareholders.
- When a company issues additional equity capital, it has to be offered in the first instance to the existing shareholders on a pro rata (proportional) basis.

### **Private placement**

- In a private placement, funds are raised in the primary market by issuing securities privately to some investors without resorting to underwriting (insurance against risk by a guarantor).
- The investors in this case may be financial institutions, commercial banks, and other companies, shareholders of promoting companies, and friends and associates of the promoters.

### **Group A and Group B shares**

- The listed shares are divided into two categories: Group A shares (also referred to as cleared securities or specified shares) and Group B shares (also referred to as non-cleared securities or non-specified shares).
- For Group A shares, the facility for carrying forward a transaction from one account period to another is available; for Group B shares, it is not.

### ***Recommendations of Committee on Fuller Capital***

#### ***Account Convertibility (Tarapore Committee II) — Development of Indian debt market***

### **Government Securities Market**

- i) Over time, it would be preferable to progressively increase the share of mark-to-market category.
- ii) Promoting a two-way market  
Movement would require permitting participants to freely undertake short selling. Currently, only intra-day short-selling is permitted. This would need to be extended to short selling across settlement cycles; this would, however, require adequate regulatory/ supervisory safeguards.
- ii) To stimulate retail investments in gilts, either directly or through gilt mutual funds, the gilt Funds should be exempted from the dividend distribution tax, and income up to a limit from direct investment in gilts could be exempted from tax.
- iv) In line with advanced financial markets, the introduction of Separate Trading of Registered Interest and Principal of Securities (STRIPS) in G-secs should be expedited.
- v) Expanding investor base would be strengthened by allowing, inter alia, entry to non-resident investors, especially longer term investors like foreign central banks, endowment funds, retirement funds, etc.
- vi) To impart liquidity to government stocks, the 'As of holders of G-secs needs to be widened and repo facility allowed to all market players without any restrictions on the minimum duration of the repo; this would, however, necessitate adequate regulatory/supervisory safeguards. This will improve the incentive for a wide range of economic agents to hold G-

- secs for managing their liquidity needs through repose.
- vii) A rapid debt consolidation process that is tax neutral, by exempting the gains arising from exchange of securities from all taxes, may be taken up. If necessary, a condition may be stipulated that gains arising from such an operation cannot be distributed to the shareholders.
  - viii) The limit for FII investment in G-secs could be fixed at 6 per cent of total gross issuances by the Centre and States during 2006-07 and gradually raised to 8 per cent of gross issuance between 2007-08 and 2008-09, and to 10 per cent between 2009-10 and 2010-11. The limits could be linked to the gross issuance in the previous year to which the limit relates. The allocation by SEBI of the limits between 100 per cent debt funds and other FIIs should be discontinued.

### **Corporate Bond and Securitised Debt Market**

- i) GOI, RBI and SEBI should be able to evolve a concerted approach to deal with the complex issues identified by the High Level Committee on Corporate Bond Market.
- ii) Institutional trading and settlement arrangements need to be put in place and investors should have the freedom to join any of the trading and settlement platforms they find to be convenient.
- iii) The issuance guidelines have to be changed so as to recognize the institutional character of the market. Since issuers may like to tap the bond market more frequently than the equity market and since subscribers are mainly institutional investors, issuance and listing mechanisms in respect of instruments being placed with institutional investors should be simplified by relying more on the assessment of a recognised rating agency rather than on voluminous and tedious disclosures as required by the public issues of equities.
- iii) Until transparent trading platforms become more popular, reliable trade reporting systems should be made mandatory. Clearing and settlement arrangements like those offered by CCIL in the case of Gsecs should be in place to ensure guaranteed settlement.
- v) Stamp duty at the time of bond issues as also on securitised debt should be abolished by all the state governments.
- vi) The FII ceiling for investments in corporate bonds of US\$1.50 billion should in future be linked to fresh issuances and the present absolute limit should be retained for the year 2006-07 and be fixed at 15 per cent of fresh issuances between 2007-08 and 2008-09 and at 25 per cent between 2009-10 and 2010-11. The allocation by SEBI of the limits between 100 per cent debt funds and other FIIs should be discontinued.
- vii) Corporate bonds may be permitted as eligible securities for repo transactions subject to strengthening of regulatory and supervisory policies.
- viii) In the case of the securitised debt market, the tax treatment of special vehicles that float the securitised debt has to be materially different. Government should provide an explicit tax pass-through treatment to securitisation Special Purpose Vehicles (SPVs) on par with tax pass-through treatment granted to SEBI registered venture capital funds.
- ix) Securitised debt should be recognised under the Securities Contract and Regulation Act (SCRA), 1956 as tradable debt. The limitations on FIIs to invest in securities issued by Asset Reconstruction Companies should be on par with their investments in listed debt securities.

## PUBLIC FINANCE

### ***Fiscal Policy***

- Fiscal policy refers to the use by the government of the various instruments such as

taxation, expenditure and borrowing to achieve the objectives of balanced economic development, full employment etc.

- The Budget or the annual financial statement of the government, gives expression to its fiscal policy.
- In accordance with Article 112 of the Indian Constitution, the President shall cause to be laid a financial statement before both the Houses of Parliament at the commencement of every financial year of the estimated receipts and expenditure of the Government of India for that year.
- The Central Government has (a) Revenue budget that is to say, the estimates of receipts and disbursements on Revenue Account and (b) a Capital budget, which relates to receipts and disbursements on Capital Account.
- The estimates of receipts on revenue account have been grouped under two broad heading viz. tax revenue and non-tax revenue. Tax revenue has been divided into: (a) Taxes on income, (b) Taxes on property and capital transactions, and © Taxes on commodities and services.
- Non-tax revenue has been sub- divided into: (i) Fiscal and other services, (ii) interest receipts and (iii) dividends and profits.

### ***Capital Account Convertibility (CAC)***

Basically CAC implies freedom to convert local currency into foreign currency and vice versa, for any purpose whatsoever, without needing any permission from the government.

The term “any purpose whatsoever” is important, for as of now India is convertible on the current account. This means one can import and export goods or receive or make payments for services rendered. However, investments and borrowings are restricted.

### **Tarapore II Committee Report**

- As per the roadmap, it detailed a road five-year time frame for government towards fuller convertibility in three phases: Phase (2006-07); Phase II (2007-08 to 2008- 9); and Phase III (2009-to 2010-11).
- Apart from Indians being able to acquire property and financial assets, and open bank accounts anywhere in the world, Indian companies will be able to borrow a billion dollars abroad every year without taking the RBI Permission.
- Indian companies will be allowed to invest four times their net worth abroad.
- It recommended the meeting of certain indicators/targets as a concomitant to the movement in: meeting RFBM targets; imparting greater autonomy and transparency in the conduct of monetary policy; reduction in the share of Government/RBI in the capital of Public Sector banks; keeping the current account deficit to GDP ratio under 3 percent etc.
- Mutual funds and portfolio management schemes will be able to invest upto two billion dollars in overseas stocks.

### ***Service tax - a promising source of revenue***

The gradual expansion of the service tax, introduced in 1994-95 to redress the asymmetric and distortionary treatment of goods and services in the tax regime, has been a buoyant source of revenue in recent years. The number of services liable for taxation was raised from 3 in 1994-95 to 6 in 1996-97, and then gradually to 99 in 2006-07. Simultaneously, the rate of tax was raised from 8 per cent to 10 per cent in 2004-05, and further to 12.0 per cent in 2006-

07. Revenue from service tax, as the combined outcome of expanding tax net, creeping rate, and buoyant service sector growth, increased rapidly from a paltry Rs. 407 crore in 1994-95 to Rs. 14,200 crore in 2004--05.

## **Pension reforms in India**

A modern pension system will lay sound foundations of financial portfolios through which individuals will be able to obtain income support in old age. Pension funds are natural vehicles for long-term investment. Including in equity. A modern, well-regulated pension sector, populated with professional pension fund managers, will also be a highly beneficial force in India's financial system, and improve resource flows in the form of long-term debt and equity to sound projects, particularly in infrastructure. The pension sector can also be a major customer of insurance companies for the purpose of converting a stock of pension wealth at retirement date into a flow of monthly pensions in the form of "annuities".

### **Objectives of pension reform in India**

Global pension reform experience over the past 10 years has shown that "no one size fits all". However, the two main aims of pension systems everywhere remain the same, namely; (i) reducing poverty and eliminating the risk of rapidly falling living standards post-retirement, and (ii) the broader goal of protecting the elderly from economic and social crisis.

India needs a pension system which is: self-sustainable; universally accessible, especially to the uncovered unorganised sector workers on a voluntary basis; lowcost. Efficient and available throughout the country; equitable and pro-labour and does not inhibit labour mobility; and well-regulated in order to protect the interests of subscribers. On August 23, 2003, Government decided to introduce a new restructured defined contribution pension system for new entrants to Central Government service, except to Armed Forces, in the first stage, replacing the existing defined benefit system. Subsequently, the New Pension System (NPS) was operationalised from January I, 2004 through a notification dated December 22.2003.

### **The main features of the NPS:**

- It is based on defined contribution. New entrants to Central Government service contribute 10 per cent of their salary and dearness allowance (DA), which is matched by the Central Government (Tier-I).
- Once the NPS architecture is fully in place, employees will have the option of a voluntary (Tier-II) withdrawable account in the absence of the facility of General Provident Fund (GPF). Government will make no contribution to this account.
- Employees will normally exit the system at or after the age of 60 years. At the time of exit, it is mandatory for them to invest 40 per cent of the pension wealth to purchase an annuity to provide for lifetime pension of the employee and his dependent parents and spouse. Remaining 60 per cent of pension wealth will be paid to the employee in lump sum at the time of exit. Individuals would have the flexibility to leave the pension system prior to age 60. However, in this case, mandatory annuitisation would be 80 per cent of the pension wealth.
- The new system will have a central record keeping and accounting infrastructure and several fund managers to offer investment options with varying proportions of investment in fixed-income instruments and equity.
- The new system will also have a market mechanism (without any contingent liability)

through which certain investment protection guarantees would be offered for the different schemes.

### ***Public Debt***

By India's public debt we mean the internal and external debt of the Government of India. The most comprehensive definition of public debt would include the indebtedness of all the three levels of government and all public enterprises, to the domestic private sector and to the external sector. Borrowing from RBI is equivalent to printing (base) money. It enables the Government to obtain resources without incurring liability to repay loan or pay interest. Borrowing from RBI does not in effect entail any liability to repay, but interest is paid on the government debt held by it. Much of this interest is not re-routed to the Government of India, but is spent in various ways by RBI as allocation of its profits. We, therefore, reckon the liabilities of Government of India to RBI as part of public debt and including the interest on it as part of the interest on public debt.

In the case of Government of India, the internal debts are:

- i. Market loans defined as loans with a maturity of one year or longer at the time of issue.
- ii. Treasury bills are a major source of short term funds for the Government to bridge the Gap between revenue and expenditure with the increasing demand for funds for Investment under the plans, the Government of India has resorted to heavy borrowing Through the issue of T-bills, a major part of which is held by the RBI.
- iii. Special securities which comprises securities issued to International Financial Institutions And is inclusive of such items as market loans in course of repayment, special bearer bonds.
- iv. Small savings which are a source of borrowing for the Government are of special Significance particularly in growth seeking, inflation-sensitive economy like India. It is the Safest form of governmental borrowing as it taps the genuine savings of the people and Provides the government with much needed support.

Any definition of external debt should keep the commonly accepted components in view. "Gross international debt is the amount, at any given time, of disbursed and outstanding contractual liabilities of residents of a country to non-residents to repay principal with or without interest, with or without principal".

- India's external debt stock stood at US\$ 126.4 billion at end-March 2006, reflecting an increase of US\$3.2 billion over the year. The rise in external debt stock during this period was brought about essentially by a rise in ECBs, NRI Deposits and short-term debt.

### ***Value Added Tax***

Value Added Tax is a multi-point destination based system of taxation, with tax being levied on value addition at each stage of transaction in the production/distribution chain. VAT is a multistage sales tax with credit for taxes paid on business purchases.

### **Salient features of VAT**

- Uniform schedule of rates of VAT for all states. This would make the tax system simple and uniform and prevent unhealthy tax competition among states.
- The provision of input tax credit would help in preventing cascading effect of tax.
- The provision of self-assessment by dealers would reduce harassment. Small traders with turnover up to Rs 5 lakhs would be exempt from the provision of VAT.
- The zero-rating of exports would increase the competitiveness of Indian exports.

Sale tax/VAT is basically a stage subject, the control Government is playing the role of a facilitation for successful implementation of this significant reform measure. The empowered committee of state finance ministers, constituted by the ministry of Finance, Government of India has come up with a white paper on state-level value added tax on January 17.

### **White Paper on State-level VAT**

- Introduction of VAT would help avoid cascading nature of sales tax. Present multiple rates and taxes can converge into a few rates and a single VAT.  
Transparency in the system of tax administration through simple self-assessments and departmental audit.  
Rationalisation of taxes to result in lower tax burden and higher tax revenues.
- State VAT to have two basic rates of 4 per cent and 12.5 per cent and to cover 550 commodities. About 270 commodities will be under 4 per cent rate.
- 46 items, comprising of natural and unprocessed products in unorganized sector, items legally barred from location and items having social implications are exempt from VAT

Gold and silver ornaments subject to a special VAT rate of 1 per cent and other commodities to attract a general VAT rate of 12.5 percent.