

# ANALYTIQUE



Vol. VII · No. 2 · Apr - June 2011

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## From the Editor's Desk

As expected, the Reserve Bank of India has raised its benchmark repo rate (under its Liquidity Adjustment Facility or LAF) by 25 basis points to 7.50 per cent on June 16, 2011. Since the beginning of 2010, RBI has been increasing interest rates continuously. It is not apparent that the RBI's actions in the last 15 to 18 months have been able to contain inflationary trends. It is however true that in the same period, the GDP growth rate has come down from 9.4 per cent in January-March 2010 to 7.8 per cent in the January-March 2011 quarter. Simultaneously, there is a visible slowdown in manufacturing as indicated in the Industrial Index of Production (IIP). It appears that RBI's policy on interest rates is guided by lower growth expectations in advanced economies as well as due to inflationary pressures primarily on commodities. Also, the capacity for conventional policy responses appears limited, with many countries having already committed to fiscal consolidation amidst growing sovereign debt risks. Domestically, the headline inflation numbers understate the pressures because fuel prices have yet to reflect global crude oil prices.

An interconnected world is nothing new and we have been living in it for some time. Integration with the world contributed to growth, lifting hundreds of millions of people out of poverty. But in the past few years, we have seen that these linkages can also have tremendous costs. A prominent example is the second round of US quantitative easing, QE2. From the perspective of Emerging Market Economies (EMEs), QE2 may have had significant negative externalities. After QE2 was announced in August 2010, the prospect of easy liquidity in the US seemed to prompt a large increase in capital flows to EMEs, threatening domestic price and financial stability. It also seemed to contribute to rising global commodity prices, intensifying inflationary pressures.

It is in this backdrop, we can think of the need to come up with enforcement mechanisms on countries that create negative externalities for the global economy despite multilateral or peer assessment cautioning them about the spillover costs their policies on others. There is a need to develop a proper framework for analysing these linkages to guide policy as well as a need for a deeper, truer understanding of the channels and mechanisms that link economies. Finally, we need to establish norms of behaviour as well as a code to discipline all players such that they are rewarded for good behaviour while being sanctioned for bad. It is a long road ahead. But the journey is not only worthwhile; in our interdependent world, it is necessary.

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# On the Last Issue of Analytique

With growing financial openness of the Indian economy, the Indian mutual fund industry has expanded significantly in the last few years. At the same time, the industry growth was affected by market upheavals from time to time. In this context, **Sachchidanand Shukla** examined the impact of macroeconomic variables such as yield on government securities, industrial production, inflation, money supply, and foreign exchange reserves, on Asset Under Management (AUM) of the Mutual Fund schemes under study using regression equations. The equations were estimated in linear and double log methods. While estimating the model, a time trend variable was also included in all equations to capture the autonomous time related changes in the endogenous variables.

The study encompassed five types of schemes: Income, Growth, Balanced, Gilt, Liquid and Money Market Schemes. Overall, the macroeconomic variables are found to have significant impact on AUM. Further, the time trend variable also had a statistically significant coefficient implying that time is having a significant impact on the movement of the endogenous variables, though the period of study has not been indicated. The study was based on 39 observations relating to the Mutual Fund schemes. Perhaps the study could include the return on investment as another important dependent variable.

In another important article, **Debojyoti Dey** and **Niteen Jain** emphasized on the need to deregulate petroleum prices in India. They pointed out that in view of the hardening of petroleum prices in the global prices the current subsidy mechanism is not sustainable. Further it leads to significant price distortions leading to inefficient use of scarce resources. Deregulation of petroleum prices will also release resources for the government which can be used for producing socially productive goods and also for the commercial use of alternative forms of energy. In this context it may be mentioned that India has initiated a process of deregulation of petroleum prices by decontrolling the price of petrol by accepting the recommendation of the Kirit Parikh Committee. But here also the reform initiative is half-hearted as the government did not implement the recommendation of taxing the diesel cars to eliminate the fuel price advantage.

The authors rightly pointed out the contentious issues relating to price decontrol. To begin with the tax rate on petroleum products in India is unusually high which needs to be rationalized in a deregulated regime. Further, there is absolute need to hedge oil price risk because oil prices are highly susceptible to international political disturbances. However, perhaps the biggest requirement on the part of the government is to educate the common people about the problems of continuing the present regime. In this context, the authors cited the example of Ghana which faced the problem of popular unrest when it tried to increase prices of oil in 2005.

When Ghana increased the petroleum prices by 50%, the government tried to compensate the poor by a slew of anti-poverty measures.

In the Indian context the impact of price deregulation on the weaker section of the society can be significant. Therefore, the government needs to take some concrete measures in this regard. The authors could have shed more light on this.

In the last article **Mehrab Irani** pointed out that the current volatility in all the asset classes including equities, bonds, oil gold, base metals and real estate has promoted confusion among the common investors. The fund managers are also not sure whether the present turbulence represent a bull or bear market correction. Given this backdrop Mr. Irani analysed the asset market developments by studying the US and Indian stock market history, price movements, valuations, interest rates etc. He pointed out that the current secondary equity market correction in emerging markets like India or China is similar to that prevalent in the U.S. scenario in 1982 characterised by high inflation-high growth path.

Overall, all the papers are well researched and provides useful insight to the readers.

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# Commodity Derivative Market in India: The Past, Present and Future

Rajnarayan Gupta\*

## Abstract

*The history of commodity derivative market in India dates back to the ancient times, but the first organized market was established in 1875. However, by mid 1960s government took a drastic step by banning derivatives trade altogether. The commodity derivative market remained virtually absent in next four decades and it made the restart only in early 2000s. Since its reintroduction it is thriving and the current trend shows strong growth potential of the market, although, the actual growth trajectory will depend upon the attitude of the policy makers and the efficiency of the regulatory mechanism.*

## Introduction

Commodity derivatives made their appearance before financial derivatives in the world and also in India. Informal trading in commodity derivatives was there even in ancient India, but the formal market took shape in the late nineteenth century. However, the growth path of the Indian derivative market was not smooth. Trading remained banned for a long period of time since 1966 and it was reintroduced in the early 2000s.

The present study makes an overview of the Indian commodity derivatives market and examines its sustainability. The study discusses the evolution of the market, its present status and the future prospect.

## Evolution of the Commodity Derivative Market in India

The beginning of the modern worldwide commodity derivative market can be traced to Chicago, which had emerged as an important agricultural commodity trading center in the early 1800s. In 1848, the Chicago Board of Trade (CBOT) was founded as a commodity exchange. Commodity derivatives are not new in India too. In fact, forward trading in commodities existed in India from ancient times (it was mentioned in Kautilya's Arthashastra), but the first modern futures market was established in 1875 for cotton contracts by the Bombay Cotton Trade Association. Oilseed and food grain futures followed and before the World War II, futures were being traded on commodities such as wheat, rice, sugar, groundnut, groundnut oil, raw jute, jute products and castor seed as well as precious metals. During World War II futures trading was prohibited to contain

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runaway speculation and illegal hoarding.

After independence, the Forward Contracts (Regulation) Act was enacted in 1952 to regulate the trading in forward and futures. The Forward Markets Commission (FMC) which oversees forward trading was instituted as a regulatory body the following year. The Act applied to all contracts whereby the delivery of goods occurs after a period longer than 11 days. The task of the commission was to monitor and regulate the trading of forward contracts since manipulation in these markets are likely to create severe imbalances with adverse welfare effects.

Nevertheless, Indian markets did not really blossom over the following four decades. Regulators viewed markets in general with suspicion and derivative markets particularly as the terrain of unscrupulous speculation. Price control was a central feature of economic policy during much of this period. This overly regulated nature of the economy did not bode well for the development of these markets. In 1966, futures trade was altogether banned to give effective powers to government price control.

A few select commodities saw a reintroduction of futures in 1980 following the Khusro Committee report. But the real breakthrough came with the liberalization of the Indian economy in the early 1990s. In 1993, the Kabra Committee was appointed to look into forward markets. The committee recommended in 1994 that all futures banned in 1966 be reintroduced as well as many others

added. Six years later, the National Agricultural Policy 2000 envisioned the removal of price controls in agricultural markets and widespread use of futures contracts. However, the commodity futures market made the true restart in early 2000s with establishment of a number of nationwide multi commodity exchanges.

## Commodity Futures Market in the Last Decade

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Throughout the last decade the commodity futures market has developed significantly in terms of both network and volume. At present, there is a two-tier structure for Commodity Exchanges in India: Regional and Country-Wide. Regional exchanges are permitted to have only a limited number of contracts whose membership is local. Countywide national exchanges are multi-commodity electronic exchanges with a demutualized ownership pattern. Currently, there are three such exchanges, viz., MCX (Multi Commodity Exchange), NMCE (National Multi Commodity Exchange) and NCDEX (National Commodities and Derivatives Exchange).

MCX has evolved as the largest exchange in the country. MCX started its operations on November 10, 2003 and today it holds a market share of over 80 per cent of the Indian commodity futures market and has more than 2000 registered members operating through over 100,000 trader work stations across India. The exchange has also emerged as the sixth largest and amongst the fastest

growing commodity futures exchange in the world, in terms of the number of contracts traded in 2009. MCX offers more than 40 commodities across various segments such as bullion, ferrous and non-ferrous metals, and a number of agri-commodities on its platform. The Exchange is the world's largest exchange in silver, the second largest in gold, copper and natural gas and the third largest in crude oil futures, with respect to the number of futures contracts traded. MCX maintains an Insured Settlement Guarantee Fund of about Rs. 100 crores.

Even as reform initiatives are slowly taking shape, turnover in the Indian commodity futures market has increased many times over. The total value of trade in the Commodity Futures Market has risen substantially in the last few years (Table 1). MCX recorded the highest turnover in terms of value of trade from 2006 to 2010 followed by NCDEX and NMCE.

Total value of trading in the commodity futures market rose from Rs. 34,84,485 crore in 2006 to Rs. 36,54,487 crore during 2007 and similarly it has continuously increased to Rs. 94,94,725 crore in 2010. The average daily value of trades in the commodity exchanges improved from Rs. 15,000 crore during 2007 to Rs. 18,500 crore in 2008 and to Rs 23,200 crore in 2009. The growth could be attributed to larger participation in the market, increase in global commodity prices, the advent of new commodity exchanges and the restoration of trade in some of the suspended agricultural commodities.

At present, futures contracts are available for over 100 commodities across the country. The total number of commodities traded on Futures Exchanges are categorized into two major groups, viz., Agricultural Commodities and Non-Agricultural Commodities. Non-agricultural commodities are further categorized into bullion/ precious metals, base

**Table 1: Turnover in Commodity Futures Markets (Rs. crore)**

Exchange	Year				
	2006	2007	2008	2009	2010
Multi Commodity Exchange of India (MCX)	20,25,663	27,30,415	42,84,653	59,56,656	78,95,404
National Commodity and Derivatives Exchange Limited (NCDEX)	12,43,327	7,74,965	6,28,074	8,05,720	9,73,217
National Multi Commodity Exchange of India Ltd. (NMCE)	1,11,462	25,056	37,272	1,95,907	1,80,738
Others	1,04,033	1,24,051	83,885	1,32,173	4,45,366
<b>Total</b>	<b>34,84,485</b>	<b>36,54,487</b>	<b>50,33,884</b>	<b>70,90,456</b>	<b>94,94,725</b>

Source: Economic Survey 2010-11



metals, energy and polymer products. Agricultural commodities are further categorized into cereals, oil and oilseeds, pulses, fibres, plantations, spices and others that include guar seed, mentha oil, potato, sugar, etc. Nevertheless, of all the contracts available, only a few have been traded actively and gained major volumes including gold, silver, copper, crude oil, guar seed, chana, urad, mentha oil, soy oil and jeera.

There has been a change in the composition of trade. Initially, agricultural commodities dominated the market, bullions occupying the second place. In 2004-05, for instance, 69% of the total volume of trade was in agricultural commodities and the rest was in bullions and metals. However, the importance of agricultural commodities has decreased sharply in recent years while that of bullions has increased. In 2010-11, bullions occupied the first position with 45% share followed by metals with 24% and energy with 19%. The share of agricultural commodities in futures

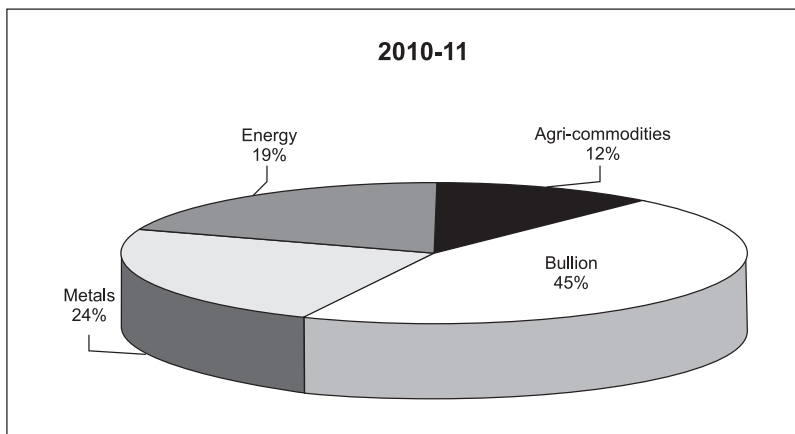
trading has come down to the level of 12% (Figure 1).

### Future of the Futures Market and Regulatory Issues

Derivative market serves two basic purposes in an economy. It provides hedging opportunities to those who suffer from uncertainties in market prices. It applies particularly to agricultural and primary articles for which supply depends highly on natural conditions such as weather. The producer, in this market, can fix his product price beforehand by agreeing on a forward contract. Buyers can also do the same to confirm the purchase price. In fact, commodity futures evolved as a means of hedging, although latter on it was used more for speculation purposes. In India, for instance, over 95 per cent of the trading volume in futures today comprises speculative trades.

Derivative market performs another economic function, viz., Price Discovery. Price discovery has been

**Figure 1: Share of Commodity Groups in Trade Volume**



defined as revealing information about future cash market prices through the futures market. Producers and consumers take their decisions partly on the basis of current market prices (spot prices) of the products and partly on the prices to prevail in future. While current prices are known, future prices are unknown and should be estimated. Futures market therefore can provide them with necessary guidelines as to the future prices of the commodities.

Despite its genuine usefulness in the society, however, commodity market has often been criticized on the ground that it involves unscrupulous speculation and hoarding and fuels inflation in the country. Critics raise the point that speculators dominate the futures market and determine the futures price, that is, the price at which the commodity can be traded in future. The futures price, in turn, influences the current market price, that is, the spot price of the commodity. Commodity prices may therefore be guided by futures prices. The problem is acute for most of the commodities traded in futures market are agricultural goods and other primary articles such as minerals. Based on this theoretical underpinning commodity market was banned in the early 60s. In recent times also, trading in certain commodities was suspended on this ground.

The criticism of the commodity market and the point for its suspension are countered by academicians and business experts. They argue that

speculation is not specific to futures market. Speculation is common even in the spot market. The demand-supply forces in the spot market are guided by the expectations of the market participants about the future. Thus, even if we prohibit futures market and let spot market to operate efficiently, the current price will always reflect, among other things, the participants' view about future demand and supply. This is something fundamental about all markets. Futures market links the conditions and prospects of present and future supply and demand in a transparent and efficient manner. The belief that markets would be more stable in the absence of price signals emanating from the futures market is open to question.

While there are arguments and counter arguments for promotion of commodity futures, the market regulator would perhaps be better guided by empirics. Investigation into the relationship between spot market and derivative market seems urgent for that purpose. Spot market has obvious influence over futures market. But reverse causality, i.e. the causality running from futures market to spot market, if any, is really a cause for concern. The market regulator should therefore make a thorough and commodity specific empirical analysis before putting stringent restrictions on trade of a certain commodity or banning it altogether.

## Conclusion

After a long period of suspension

commodity derivative market was reintroduced in India in early 2000s. Since its resumption, however, the market has been growing at a very high pace. The growth is evident in the spread of market network as well as in volume of trade. Earlier there were only regional exchanges in the country. Now there are national level bourses, namely, MCX, NCDEX and NMCE which dominate the market. Almost 100 commodities (agricultural and non-agricultural) are traded in different exchanges. The volume of trade has increased from Rs. 34, 84,485 crore in 2006 to Rs. 94, 94,725 crore in 2010.

It all shows that the market has strong growth potential. In liberalized regime we should welcome it and treat the commodity derivative market as an integral part of the economy. Derivatives provide hedging opportunities and also help in price discovery. The ill effect of the market, if any, arises from improper regulation and the market as such cannot be blamed for that. The prospect of the market therefore hinges on the efficacy of the regulator.

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# Land Resources: Breaking the Gridlock

Samiran Chakrabarty\*

## Abstract

*The burden on India's land resources is partly structural – the country covers only 2.4% of world's geographical area but is home to almost 17% of the global population. Given that almost 52% of the land is cultivable (versus the global average of 11%), land available for non-agricultural use is relatively limited. Over the next few years, Industrialisation, Urbanisation and Infrastructure Development will all lay claim to this limited resource. In anticipation of this scarcity, land acquisition has become one of the most hotly debated economic and political issues in India. In the context of land acquisition, we believe the right balance has to be struck between short-term growth needs and long-term sustainability concerns.*

## Introduction

The new Land Acquisition Bill to be tabled in the monsoon session of the parliament can be a watershed development in this regard. Probably, the passage of this Bill through the Parliamentary maze could be a pretty laborious one, but the initial reaction of political parties to the draft proposals

will be an indicator of the fate of this extremely crucial legislation.

The need for macro regulation of land acquisition (particularly for mining) has arisen because the country's mineral-rich states have relatively higher forest cover, and are home to a large proportion of India's tribal population. As the pace of economic growth has accelerated, demand for forest clearances has increased manifold. Between 1980 and 1997, 19 such clearances were allowed per year; between 1998 and 2005, the number increased to 126 per year. As a consequence, about 60,000 hectares of land were diverted to mining between 1998 and 2005. Also a large proportion of the 85 mn tribal population of India stays in these areas. Land acquisition and large-scale deforestation may have negatively affected the livelihood of tribal peoples, worsened economic inequality, and bred Maoist extremism.

More recently, land and environmental clearances have become tougher to obtain. Since 2006, the environment ministry has halted 64 projects and delayed 469 projects. Obstacles to land acquisition have become a key impediment to industrial development—a government study found that of the 190 delayed public-sector projects, 70% were delayed on account of land issues.

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In a survey by the Confederation of Indian Industry, 81% of respondents said that land acquisition is the most important hurdle to the implementation of infrastructure projects. In our view, adopting a firm timeline for awarding land and environmental clearances would significantly reduce time over-runs for industrial projects. A private study found that between 1992 and 2009, of 1,035 completed infrastructure projects, 41% experienced cost over-runs, while 82% were affected by delays. Even more worrying is that cost over-runs of government projects have increased since the global financial crisis. In fact, the Finance Secretary mentioned that India loses as much as 2ppt of GDP growth every year because of inadequate infrastructure. The surge in per-capita income, the increased share of industry in economic growth, rural-urban migration, and rising aspirations for big-ticket items like passenger cars have increased demand for infrastructure within a short time period without a commensurate supply response.

If we have to achieve our aspiration of increasing the share in GDP of manufacturing to 25%, then tackling the land end environmental issues should be treated as a priority item. The recently proposed New Manufacturing policy should particularly focus on these two issues.

At a micro level dependence on land is extremely high in India. For land owners it is often the only source of their livelihood and they do not possess

any other skills to make a living in a different profession. Even for landless labourers, agricultural land is the only means of sustaining themselves. Apart from these sets of people, there are people who hold land usage rights (for grazing cattle or gathering grass). So, there are economic, social and emotional costs attached to parting with the right to land.

Due to the inherent peculiarities of land as a resource and restrictions on the free trading of land, there are frequent instances of market failure in allocating land resources. So like in most of the other countries, the Indian government has the right to acquire land for private companies without the landholder's consent if it is for a 'public purpose'. This is done under the 115-year-old Land Acquisition Act (LAA). Post economic liberalization this trend of government acquiring land for private companies has intensified and has led to frequent social tensions. The following issues in the land acquisition process are particularly contentious at the micro level –

- “Public purpose” for which the land is acquired is not well defined in LAA.
- Land records are not maintained properly. One of the studies calculates that inefficiencies like this could be costing the country 1.3ppt of GDP growth.
- The compensation to the land owner (particularly agricultural land) is based on the value of the land in its agricultural use whereas the private party on whose behalf

government is acquiring realizes a much higher value in its non-agricultural use. Benefit sharing from the value of the land is thus unequal.

- Rehabilitation and Resettlement is not a legally guaranteed right. Although some steps have been taken to streamline the process, often the acquisition is stalled because of inordinate delays in compensating the displaced people.

In order to develop market-based solutions for optimal land allocation, detailed land records need to be computerised; all restrictions on buying and selling of land should be removed in order to reduce rent-seeking behaviour on the part of industry (in some states, only farmers can currently buy agricultural land); and the price determination process should be perceived as fair.

Some of the suggestions of the National Advisory Committee (NAC) regarding land acquisition, resettlement and rehabilitation include –

- Compensation amount should be six times the value of land.
- People working on the land would also be eligible for compensation.
- Farmers will have right to annuity for a certain number of years over and above the compensation for the land.
- 75% of the farmers and gram-sabhas should give written consent to acquisition of land.
- However, the committee was

divided over how much land should be acquired by private players and how much by the government.

- If land is acquired and not utilized for 5 years then it should be returned to its original owners.

Particularly the issue of whether government should be acquiring land at all seems to be a contentious one. While the initial suggestion was that the government can help in acquiring 30% of the land after the private party has acquired 70%, some people are now suggesting that government should completely withdraw itself from this process. Also since land is a state subject, it is important for states to have a broad agreement on this issue. Otherwise, different regulations can alter the pattern of industrial and infrastructure development among states substantially. In the long term convergence of policies regarding land can be expected but in the short term divergent policies could accentuate inter-state inequalities.

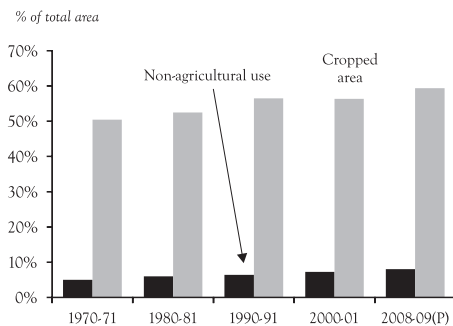
Also, at the ground level benefit-sharing is likely to be contentious given information asymmetry – the farmer often does not know the true value of his land. It is therefore important to involve local communities in the process before a private party buys land. If this process is kept relatively free from political interference, the solution is often long-lasting. Also, over a longer time period, the capacity to generate alternative employment for farmers who sell their land needs to be developed.

**Table 1: Diversion of Forest Land to Mining Increased in Recent Years**

	1980-1997	1998-2005	Total (1980-2005)
No. of mine leases granted in forest areas	317	881	1,198
Avg. no. of mine leases granted every year	19	126	80
Forest land diverted to mining (ha)	34,526	60,476	95,003
Avg. amount of forest land diverted to mining every year (ha)	2,031	8,638	6,334

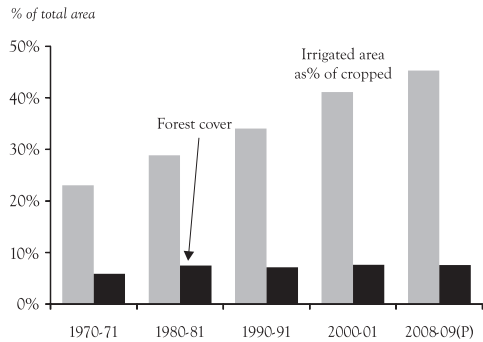
Sources: *Infrastructure Statistics 2010, Standard Chartered Research*

**Chart 1: Land for Non-Agricultural Use Remains Stagnant**



Sources: *Infrastructure Statistics 2010, Standard Chartered Research*

**Chart 2: Irrigation Improves, but Forest Cover is an Issue**



Sources: *Infrastructure Statistics 2010, Standard Chartered Research*

### Conclusion:

The macro question of how much forest or agricultural land the country needs should be kept separate from the issue of rehabilitation and resettlement. The government should decide on this based on an assessment of the sustainability of the growth process. Legislation on land acquisition is in the pipeline, and we think that once the impediments to acquiring land in a fair and transparent fashion are removed, the pace of infrastructure development will quicken significantly. Success stories of land transfers benefiting all parties will encourage others to replicate the model. This will be a key achievement not only from the perspective of infrastructure development, but also in addressing issues like economic and social inequality, employment generation, rural-urban migration, and urbanisation.



# Agricultural Policy Review

Debashis Sarkar\*

## Abstract

*There are several evidences that suggest heavy subsidisation of agricultural exports by developed countries due to WTO obligations, the situation is fast changing in India. International agricultural prices have become lower than the Indian agricultural prices. The growing unrest in several states because of the distress of farmers specialising in agricultural commodities and their disadvantageous exports position needs serious attraction of our policy markets.*

*The paper focuses the policy statements in the light of National Agricultural Policy (2000) which was presented in the Parliament on July 28, 2000 due to the relatively poor growth of agriculture during the nineties.*

## Introduction

Policy can be considered as a response of the government indicating its position on an area of significant concerns to a political and administrative system. Such sectors are of course connected with the other

segments of the economy and more than that with the policy, bureaucracy and the outside pressure groups. Interrelatedness of policies and their outcomes therefore cannot be fully explored but their probable direction of impact can be visualised. Hence, the study of policy making all require understanding of the institutional dynamics and case studies in order to analyse the emergence of the situation and the resolution of possible conflicts in goals. One of the important points of discord and subsequent resolutions is the understanding between the Central and State Governments, even keeping aside the other important players for a moment. According to the Indian constitution, agriculture is in the State list but many facets of the sector are either in the Central list or under the concurrent list. Even being on the State list, the policies pertaining to agriculture are mostly initiated at the Central level sometime consulting with the state. The only way of handling such a tricky issue is to understand the policy matrix through revealed juxtaposition.

The relative rate of growth in agricultural sector of the economy

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of India in the last 20 years would appear considerable and modest but realistically not high from the efficient utilization of inputs over time. The number and area of the large upper middle farms have declined over time although the position of the lower middle farms was remained stable over the past years. Under such conditions small-scale agriculture with an ever-increasing number of holding and straps of land with constantly decreasing area of the average holding size, using more and more family labour continue to thrive and grow more especially in context of relatively high rate of population growth over the past decades. In general, the tendency for substitution of hired labour with the family labour was quite evident and real in Indian agriculture. Family labour, although it has a little capitalist basis, in the Indian situation, still sustains a way of old social life, more related with the feudal mode of production chiefly based on family labour participation in small scale agriculture, handicrafts and use of the old implements of production. Large scale agriculture with machines and more number of hire labourers in wages system for production of crops, their entire sale in the market, excepting that of the commercial crops like jute, potato, fruits and vegetables mostly produced in the small and marginal farms, is conspicuously absent in the agriculture sector of Indian economy until the present time.

In the sphere of commodity production and exchange, the proportion of market

arrivals of rice was much less. A list of crops and livestock are given in Table 1 where India has the competitive advantage and where it should become a world class producer and supplier over the other neighbouring countries as it enjoys competitive advantage in those areas.

**Table 1: Thrust Areas in the Changing Scenario in India (2001-02)**

Sl. No.	Particulars	Production in '000 tonnes
1.	<b>Food crops</b>	
	Rice	93084.5
	Wheat	71814.3
	Pulses	13190.6
	Food Grains	212033.8
2.	<b>Non-food crops</b>	
	Oilseeds	20460.8
	Sugarcane	300096.4
	Jute & Mesta*	11640.7
3.	<b>Fruits and Vegetables</b>	
	Fruits	41507.1
	Vegetables	71594.6
4.	<b>Animal Husbandry**</b>	
	Cattle	204584
	Buffaloes	84206
	Sheep	50783
	Goat	115279

Note: \*in '000 bales, \*\*number in '000

Source: Indian Infrastructure Database, 2005

Again, the redistribution of land in the name of so called land reform

has hastened the process of the proliferation in the number of holdings and growing number of the already numerous marginal and uneconomic holdings, and deterioration in the quality of top soil. The holdings utilising new technology already face and feel the brunt of the higher costs of production, less average net income and therefore less surplus fund to invest further in agriculture. With the growing market forces and liberalisation of the Indian economy, the existing vestiges of the old society or the semi-feudal conditions along with much lower form of capitalist production will continue to be the order of the days to come. New form or developed capitalist organisation of production with its new relations of production in Indian agriculture will be a mirage in the existing too much labour surplus socio-economic organisation of the country. The existing semi-feudal, petty mode of production mainly with the family labour for survival and substance, in the agricultural sector in much certainly will pre-dominate the Indian agriculture in the near future. Large scale agriculture with machines and more number of hired labourers in wages system for production of crops like jute, potato, fruits and vegetables produced in the small and marginal farms, is conspicuously absent in the agriculture sector of Indian economy until the present time. Over exploitation of groundwater in the major parts India has resulted serious depletion of groundwater potential and thereby deterioration in the supply of quality drinking water and receding

water table. A major part of canal irrigation system is highly dependent on the nature of rainfall.

In view of the WTO obligations, the likely impacts of WTO clauses on the farmers are presented in Table 2.

According to the agreement, developed countries agreed to reduce these subsidies by 20 per cent over six years and developing countries by 13 per cent over 10 years. However, developed countries under Green Box and Blue Box subsidies continue to support agriculture. Green Box subsidies include amount spent on government services such as research, disease control, and infrastructure and food security. They also include payments made directly to farmers that do not stimulate production, such as certain forms of direct income support assistance to help farmers restructure agriculture, and direct payments under environmental and regular assistance programmes. This definition is very wide and includes all types of government subsidies. Similarly, Blue Box subsidies are certain direct payments made to farmers where the farmers are to limit production, certain government assistance programmes to encourage agriculture and rural development in developing countries, and other support on a small scale when compared with the total value of products supported 15 per cent or less in the case of developed countries and 10 per cent or less for developing countries are not allowed to increase their negligible level of export subsidy while developed countries are allowed

to maintain 64 per cent of their subsidy outlays on the base level. Consequently, agricultural imports from developed

countries are available at much below the market price in the domestic economy.

**Table 2: National Agricultural Policy**

Sr. No.	Important clauses	Suggestions for improvement
1.	<p><b>Article: 8</b> Techniques like moisture management in the form of mulching, drip and sprinkler irrigation, green house technology etc. have been emphasised under the heading of “sustainable agriculture” for the better use of irrigation water.</p>	<p>Agriculture in India is primarily rain fed. As per the availability of data on irrigation, it has been observed that only 40 per cent of the net sown area is irrigated by different sources of irrigation. Similarly, over exploitation of groundwater in the major areas of the states has resulted serious depletion of groundwater potential and thereby deterioration in the supply of quality drinking water and receding water table. Therefore, re-excavation of existing ponds, efficient use of canal irrigation as well as technique like water recharging may be included in this article.</p>
2.	<p><b>Article: 19</b> It has been mentioned that government will endeavour to move towards a regime of financial sustainability of extension services through affecting in a phased manner, a more realistic cost recovery of extension services and inputs.</p>	<p>Some states were rather late to adopt the new technology including irrigation and hyv seeds and chemical fertilisers. Due to the numerous uneconomic and heterogeneous holdings and scattered land parcels, the adoption of new technology has been thwarted and become very slow and patchy. The new technology is a capital-intensive package which the poor peasants usually cannot afford and avail of, when the rural sector is largely over-supplied with ever increasing surplus labour power. Therefore, cost of recovery of extension and inputs is very much impractical at this stage.</p>
3.	<p><b>Article: 21</b> It has been suggested that adequate and timely supply of quality inputs and credit at reasonable rates to farmers will be the endeavour of the government.</p>	<p>There should be a clear cut direction and machinery in supplying quality inputs to the poor farmers. As most of the farmers are marginal and small in size, lower interest rate must be included under this clause.</p>
4.	<p><b>Article: 23</b> It has been recommended that protection to plant varieties through a sui generis (Plant Breeder Rights) legislation will be granted to encourage research and breeding of new varieties particularly in the private sector.</p>	<p>This clause is against the interest of the farmers and would act as an impediment to the development of new plant varieties. Therefore, the right of the farmers and researchers should be fully protected in India.</p>
5.	<p><b>Article: 25</b> It has mentioned that government will endeavour to</p>	<p>Another area of controversy has been the limits on the extent to which poor farmers can be provided incentive. Developed countries subsidise their</p>

**Table 2: National Agricultural Policy (contd.)**

Sr.No.	Important clauses	Suggestions for improvement
	create a favourable economic environment for increasing capital formation and farmer's own investments by removal of distortions in the incentive regime for agriculture, improving the terms of the trade with manufacturing sectors and bringing about external and domestic market reforms backed by rationalisation of domestic structure.	agriculture so that they can dump cheap grains in the markets of other countries, while in contrast, developing countries like India use incentive to help the capital-served poor farmers to increase their production. Therefore, specific provision should be made so that the poor farmers get incentives for increasing agricultural production.
6.	<p><b>Article: 26</b> It has been argued that commodity-wise strategies and arrangements for protecting the grower from adverse impact of undue price fluctuations in world markets and for promoting exports will be formulated.</p>	However, in reality, after the removal of quantitative restrictions the imports of agricultural commodities like rice, dry fruits and dairy products have increased substantially at present. The imports are being done on the basis of open general license which is issued to the traders. Larger amount of imports of these commodities are generally cheaper than that of our own commodities. This is adversely affecting the prices of our own commodities and ultimately farmers are suffering a lot due to lowering down of prices. Therefore, to safeguard the farmers suitable measures must be formulated in the national agricultural policy.

The possible favourable and unfavourable effects are discussed in Table 3. Agriculture was assiduously kept outside the domain of GATT for the seven rounds preceding the Uruguay Round. The trade distorting agricultural policies were ignored by GATT for all these years. Both developed and developing economies have practiced policies which led to highly distorted international trade in agriculture through rigorous controls and subsidy system, the developing countries did the reverse- promote industrialisation at the cost of agriculture. The extent of protection had been high uniformity both across

products and countries. The Uruguay Round Agreement agriculture is an attempt to correct these distortions. The agreement establishes a basis for initiation process of reforms of trade in agriculture with the long-term objective of establishing a fair and market oriented agricultural trading system. The reform processes are to be initiated by negotiations of the commitment of farm support and production through establishment of a strengthened GATT rules and disciplines. The commitments incorporated in the agreement on agriculture cover three areas viz., domestic support, market access and export subsidies.

**Table 3: Policy Matrix**

Sector-wise issues	Impediments	Policy Prescriptions	Actions to be taken
<p><b>I. Land and Soil:</b> More than 40 per cent area in arid and semi-arid tracts where soils are having poor fertility, low water holding capacity and high infiltration rate</p>	<p>There is specific tract in India where acidic, red lateritic and saline soils are not suitable for some specific crops.</p>	<p>In case of acidic soil, soil and water conservation along with cultivation of cash crops which are efficient for water and soil conservation, change in cropping pattern and use of land for seed production may be the policy for the future.</p> <p>In case of red and lateritic soils, change in cropping pattern, cultivation of coarse cereals and pulses instead of paddy in kharif season and selecting those variety which can withstand 15-20 days dry spell may be a good policy for the future.</p> <p>In case of saline soil, selecting deep water rice, conservation of rivers' bunds, improvement of drainage and expansion of area under land shaping may be recommended for long term policy.</p>	<p>Since it is a technological problem, MoA, Govt. of India in collaboration with State Agril. Universities, KVK and Central Agril. Institutes may formulate a comprehensive plan to percolate the area specific technologies.</p>
<p><b>II. Crop Husbandry:</b> <b>(a) Food Crop</b> Low growth rate of food grains in respect of area, production and yield except rice.</p> <p><b>(b) Non-food Crop</b> India is deficit state in terms of production of oilseeds. The yield is low in comparison to other states in India.</p> <p>In case of jute wide fluctuation in prices are hampering the growth in area and production.</p>	<p>Food grain crops like pulses, wheat etc. have very slow growth rate over the last two decades. It is evident that the area under pulses is decreasing from the 8th Plan onwards.</p> <p>Oilseeds are grown mainly in marginal land with un-irrigated condition. It is found that when irrigation is assured, the area is transferred to summer paddy.</p> <p>There is absolutely no control over price by the government.</p>	<p>Special component plan may be formulated to accelerate the growth in area and production of food grains specially pulses.</p> <p>Focus can be made on some selected varieties.</p> <p>MoA, Govt. of India can formulate a definite plan in the event of bumper production of this crop.</p>	<p>MoA, Govt. of India in collaboration with State Agril. Universities KVK and Central Agril. Institutes may formulate a comprehensive plan.</p> <p>MoA, Govt. of India in collaboration with state oilseeds and pulses research station may take initiative with a definite plan to percolate the appropriate technologies for increasing the yields in the rabi season.</p> <p>Dt. of marketing and inspection can take a leading role in collaboration with Jute Corporation of India.</p>

**Table 3: Policy Matrix (Contd.)**

Sector-wise issues	Impediments	Policy Prescriptions	Actions to be taken
<p><b>(c) Fruit and Vegetable:</b> A large number of horticultural crops suffer from low yields as compared to Asian countries and world average. If this corrected, per hectare yields would increase by 100 to 200 per cent to take care not only of the increase in domestic consumption but at the same time sizeable export surpluses will be generated.</p>	<p>Lack of development of human capital and basic infrastructure and non-availability of producer (economic) services are the impediments of public investment.</p>	<p>Increase in public investment will lead to increase in productivity of this sector.</p>	<p>In the plan periods, most of the infrastructure sectors has fallen well below the target. Ministry of Finance, Government of India could take initiative to provide adequate infrastructure and producer services.</p>
<p><b>III. Animal Husbandry:</b> This sector has very high potential for employment and contribution to the net domestic product. India is the third largest population countries in world.</p>	<p>Basically in India, the goat population is raised on sedentary system. The pattern of growth in livestock population reveals that there has been a shift away from bovines towards goats, reflecting the increased pressure on grazing resources. It is evident that area under total grazing land showed a diminishing trend over the years, the growth rate being -5.24 per cent per annum during 1982-92. The total grazing land available in 1982 was 225.44 thousand hectares which was decreased to 131.59 thousand hectares in 1992. During this period, the number of goats as well as total livestock per hectare of grazing land grew at the compound growth rates of 8.20 and 7.23 per cent per annum respectively. So, in the event of continuous shrinkage of grazing land over the decades will certainly affect the availability of feeds for livestock and this deficit if not checked, is expected to grow more in the future.</p>	<p>As India is regarded as the producer of excellent and superior quality of skin and which has great demand in abroad, the investment in this sector may be stepped up to exploit the full potential of this sector.</p>	<p>Central government may take specific scheme to increase the area under grazing land for the availability of feeds for livestock. Special research attention may be paid by the Animal Husbandry and Fisheries Universities for improvement of the indigenous breed.</p>

**Table 3: Policy Matrix (Contd.)**

Sector-wise issues	Impediments	Policy Prescriptions	Actions to be taken
<p><b>IV. Food and nutritional security:</b></p> <p>In the event of growing population and high poverty driven people, India should look after their food security concerns.</p>	<p>Due to high pressure of population, fragmented land structure and erratic nature of rains, it would be useful to understand the growth of food production in the Indian context to understand as to whether we have to raise food output adequately.</p>	<p>Selection of area specific varieties, particularly food crops, with higher nutritional value, development of rainfed irrigation, horticulture, floriculture, roots and tubers plantation development of husbandry, poultry, dairying and aquaculture, cultivation of fodder crops and fodder trees are to included in the prospective crop plan.</p>	<p>Special efforts may be taken by joining the different departments like agriculture, horticulture, animal resource, marketing etc. along with the existing universities for preparation of perspective plan for the coming years. Special monitoring groups can be formed to monitor and evaluate the situations periodically in order to enhance the growth.</p>
<p><b>V. Efficient use of productive resources:</b></p> <p>In India, the major challenge is how to intensify agriculture sustainable since appropriate land resources do not exist for horizontal expansion.</p>	<p>The problem of waste in universal. While unused land and water resources are often looked upon as reserves, in reality their idleness represents a loss of the services which they could not render to humanity if not managed well.</p>	<p>Intensification could be achieved not by using them more efficiently. Improved efficiency should reduce waste and loss. A comparative study of agricultural growth by adapting a strategy of full use of resources by waging war on waste. New arable land could be created through terracing and levelling of undulating land.</p>	<p>Water investigation and development department along with land use planning department could take a comprehensive plan in this regard.</p>
<p><b>VI. Cropping pattern:</b></p> <p>Allocation of crops in accordance with soil structure is called for the day.</p>	<p>There is no comprehensive micro-level survey report in relation to land situation, soil types etc.</p>	<p>Efforts need to be made to carry out micro level surveys for systematic identification of the extent, location and nature of lands suitable for cultivation of different crops. At the same time definite specific projects should be identified which area specific will work.</p>	<p>CSO may take initiative in this regard.</p>
<p><b>VII. Generation and transfer of technology:</b></p> <p>A major cause of low productivity of major crops due to</p>	<p>There is a serious lack in the development of art for utilising rivers and</p>	<p>The policy of full use of resources along with land extends to the</p>	<p>Water investigation and development in association with the</p>

**Table 3: Policy Matrix (Contd.)**

Sector-wise issues	Impediments	Policy Prescriptions	Actions to be taken
<p>the inefficiency in the generation and transfer of technology.</p>	<p>irrigation canals for raising food, organic matter, feed, soil amelioration, fish, ducks and geese.</p>	<p>conservation of water and recycling of organic wastes. Conservation of water and soil should be carefully nurtured. The policy of organic recycling is obviously a key factor in yield increase.</p> <p>Encouragement in application of bio-technology, remote sensing technologies, pre and post harvest technologies, energy saving technologies and technology for environmental protection may be included in the policy document. Empowerment of women and build their capabilities and improve their access to inputs, technology and other farming resources should be censured.</p>	<p>department of non-conventional energy resources, department of science and technology could take a comprehensive plan in this regard.</p>
<p><b>VIII. Investment in agriculture:</b></p> <p>Efficiency in the use of investment has often been low in the past because of delays in implementation and insufficient attention paid to efficient management.</p>	<p>A major cause of low productivity in agriculture in India is the inefficiency in the use of investment due to inefficient project implementation.</p>	<p>Improvements in capacity utilisation and efficient project implementation in all areas, especially in irrigation, power, transport and food processing units may be included in the policy document. Improvement the terms of trade for agriculture and removal of quantitative restriction on inputs should be ensured.</p>	<p>Planning and Monitoring department, Government of India in collaboration with irrigation, transport and marketing departments may take appropriate initiatives in consultation with the directorate of agriculture for the benefit of the poor farmers and agricultural sector in general.</p>
<p><b>IX. Institutional structure:</b></p> <p><b>(a) Land ceiling</b></p> <p>The agricultural census data reveal continually increasing number of marginal and small farms together with a declining number of large farms with their decreasing area of holding over the years. The position of</p>	<p>Some states were rather late to adopt the new technology including irrigation and hyv seeds and chemical fertilisers. Due to the numerous uneconomic and heterogeneous holdings and scattered land</p>	<p>The policy document should include the change of land ceiling act in case of horticultural cultivation of attraction of big entrepreneurs. Consolidation of holdings on the pattern of north-western states can be</p>	<p>Central Government may take appropriate measures in this regard.</p>



**Table 3: Policy Matrix (Contd.)**

Sector-wise issues	Impediments	Policy Prescriptions	Actions to be taken
the medium holdings is exposed to the instability and slow economic debility with their declining average area of marginal and small holdings and their respective areas under operation are increasing over time.	parcels, the adoption of new technology has been thwarted and become very slow and patchy. The new technology is a capital-intensive package which the poor peasants usually cannot afford and avail of, when the rural sector is largely over-supplied with ever increasing surplus labour power.	done in this regard. Development of lease markets for increasing the size of holdings may be encouraged.	
<b>(b) Credit facilities</b> Poor banking facilities	It has been observed that only 40 per cent of the total population are availing banking services.	Banking facilities could be strengthened in consultation with the central government.	Finance ministry, Government of India can take proper initiatives in this regard.

## Conclusion

It appears from above discussion that the weaknesses of India on the front of agricultural and allied sectors are agriculture is primarily rain fed, as per the availability of data, it has been found that only 30 per cent of the net sown area is irrigated, more than 40 per cent area in arid and semi-arid tracts where soils are having poor fertility, low water holding capacity and high infiltration rate, the development of agriculture is much more quantitative than qualitative, there is very high growth rate of population. A high percentage of population lives below poverty line and are unable to adopt new technologies and risk. Majority of the cultivators are either marginal or small farmers. The average size of land holding is very low, the agricultural census data reveal that continually increasing number of marginal and small farms together with a declining

number of large farms with their decreasing area of holding over the years. The position of the medium holding is exposed to the instability and slow economic debility with their declining average area of production. It confirms that both the number of marginal and small holdings and their respective areas under operation are increasing over time, some states in India were rather late to adopt the new technology including irrigation and hyv seeds and chemical fertilisers. Due to the numerous uneconomic and heterogeneous holdings and scattered land parcels, the adoption of new technology has been thwarted and become very slow and patchy, inadequate network of retail outlets for agricultural inputs, coverage of banking facilities is very poor. It has been found that only 40 per cent of the total population are availing banking services, export markets are also very limited for horticultural products.

At the same time India has several opportunities with regard to overall development of the agricultural sector. These are (1) there are several agricultural universities and agricultural institutes, (2) there are also several animal husbandry and fisheries universities who are also engaged in research and extension in relation to the development of this sector, (3) there are separate directorates in relation to agriculture, horticulture and animal resource departments, (4) there are several organisations for documentation of data, (5) there is also separate department of agricultural marketing and inspection.

However, it is the high time to draw attention of the policy makers in relation to the possible threats of Indian agriculture.

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The Indian financial system remains stable in the face of some fragilities being observed in the global macro-financial environment. The growth is slackening in most parts of the world, even as the risks from global imbalances and sovereign debt crisis in Europe continue to hover. The uncertainties in global environment with persistently high energy and commodity prices have contributed to a slight moderation in India's growth momentum as well. The macroeconomic fundamentals for India, however, continue to stay strong, notwithstanding the prevailing inflationary pressures and concerns on fiscal front.

It is in this backdrop, a brief assessment of India's financial sector is being made to capture some recent development on both global as well as domestic fronts. The analysis is organised in four different sections. The first section presents assessment of Macroeconomic Outlook. The second section focuses on Financial Markets. The third section deals with Financial Sector Policies. Finally, the last section ends with Conclusion.

## I. Macro Economic Outlook

Improvement in macroeconomic conditions at the global level has contributed to some moderation in risks to global financial stability but considerable uncertainty remains. Fiscal

weakness and sovereign debt problems in the euro area, high leveraging in many advanced economies, banking sector default risks prevailing in some regions, the consequences of the Japanese earthquake, persistence of MENA turmoil and continuance of high energy and commodity prices may negatively impact investors' confidence and spending decisions of corporations and households. Whereas, on the domestic front, growth is likely to moderate while inflation is likely to remain firm due to rising commodity prices. This is expected to have an adverse impact on the fiscal consolidation process. The current account deficit (CAD) is likely to remain elevated due to rise in imports resulting from higher oil and commodity prices, along with challenges of financing, as global conditions increase volatility in capital flows. High input prices and interest costs may result in downward pressure on margins of corporates. The aggregate impact of moderately paced global recovery, domestic growth moderation, upside risks to inflation and higher interest rates on the financial sector is likely to remain somewhat adverse during the year. Major development on the global front can be highlighted as follows :

- (i) **Deceleration of global growth a concern but decline in unemployment rate provides a silver lining.**

Downside risks to global growth include:

- High food, commodity and energy prices.
- Withdrawal of fiscal stimulus measures and fiscal consolidation.
- Reemergence of sovereign debt problems in the Euro area periphery and high level of fiscal debt in some advanced economies.
- Continuance of structural global imbalances.
- Slowdown in the U.S.
- Weakness in real estate and household incomes in some advanced economies.
- Decline in GDP of Japan.
- Prolonged political disturbance in MENA nations.

But unemployment which peaked in 2009 and 2010 is trending downwards and is expected to improve the aggregate demand.

**(ii) Persistence of global imbalances is getting longer than what was expected whereas same has been the experience with sovereign debt.**

- The structural causes of global imbalances have not been fully addressed and are reflected in the persistence of global imbalances.
- The government debt is generally high and increasing in other advanced economies also.
- Though fiscal stress is lower for emerging economies due to better fiscal space and higher

growth prospects, fiscal risks remain high due to rising tension in growth and inflation dynamics.

**(iii) World trade recovering but may record moderate growth whereas Indian exports remain steady.**

- In volume terms, world trade expanded by 12 per cent in 2010.
- The robust growth in India's exports reflects diversification of products from labour intensive manufactures to higher value-added products in engineering and petroleum sectors and to destinations across emerging markets and developing economies.
- Significant indirect effects may, however, arise from the possible rise in oil prices and other commodity prices.

On the domestic front major highlights are as follows:

**(i) Real activity remains strong, though signs of moderation are visible.**

- The increase in the growth rate of real GDP during 2010-11 was mainly due to the sharp improvement in the growth of 'agriculture & allied activities', even as the contribution of industry and services were somewhat lower.

**(ii) Industrial growth decelerates, partly reflecting moderation in investment demand.**

The volatility is largely due to fluctuations in capital goods production. Though the growth in capital goods sector has been rapid, the volatility reflects the uncertainties in the economy.

However, downside risks to growth during 2011-12 include:

- Slackening of global recovery and external demand conditions
- Moderation in investment
- High oil and commodity prices
- Impact of monetary policy actions of the past and future.

**(iv) The impact of Basel III proposal for higher capital charge likely to be minimal.**

- A preliminary assessment of the impact of increased capital requirements on GDP made by the Reserve Bank showed that under ceteris paribus assumption, one percentage point increase in Capital to Risk Weighted Assets Ratio (CRAR) could be associated with a marginal moderation in the average real GDP growth rate over a medium term horizon deriving from the impact of CRAR on bank credit growth and lending interest rate.

**(v) Inflation stays elevated while the underlying drivers change.**

- At home, inflation is likely to face upward pressure from fuller pass-through of oil and coal prices, higher subsidy expenditure of the government

and rise in wages and raw material prices.

- Downward stickiness of inflation would also arise from structural component of food inflation along with higher global food prices.

**(v) Gold prices continue to rise, while corrections are visible in housing prices in some centres.**

Since the crisis, the price of gold has recorded a secular rise. This may not pose much concern as its role as collateral, from anecdotal evidence, appears to be low.

**(vi) CAD to remain stretched due to combined impact of high global oil prices and moderation of growth in exports.**

Financing of CAD is going to be a challenge as advanced countries begin exiting from their accommodative monetary policy stance.

**(vii) CAD continued to be financed by volatile portfolio flows while FDI remained subdued.**

- In case of India, the portfolio flows were stable during 2009-10 but turned volatile during 2010-11 reflecting the uncertainties at both global and domestic level.
- Some of the measures to ameliorate risks arising from capital flows are development of deep and liquid domestic financial markets, stronger macroeconomic and prudential policies and supervision, fiscal restraint and strong institutions.

(viii) **Fiscal consolidation process to continue in 2011-12 but the quality and pace may matter.**

- The rising international oil prices may generate pressures on the fiscal situation in case there is a delay in the corresponding adjustment in domestic prices, leading to larger subsidy expenditure towards under recoveries of downstream oil public sector units. Furthermore, the introduction of the National Food Security Bill may also have additional expenditure implications. Moreover, the quality of fiscal consolidation remains a concern.

(ix) **Higher interest costs and commodity prices may put pressure on corporate margins.**

- Reflecting monetary tightening, interest payment by the corporate sector has been rising and is likely to continue in the near future. This is likely to adversely impact the margins.
- Further, high and rising commodity prices create cost pressures to firms and also reduce the real personal disposable income in the hands of households.

(x) **Share of household sector credit records a decline but asset impairment in household sector remains high compared to the systemic average.**

- The share of private consumption is expected to decline marginally during 2010-

11. In tandem, the share of retail credit in total advances also declined marginally thereby indicating that the risk from indebtedness of households to the banking sector has not increased during this period.

- Unlike the experience of some advanced economies, the asset impairment is relatively lower in housing sector and witnessing correction.

To conclude, despite some moderation, global imbalances continue to persist implying that the process of rebalancing may take long and may require stronger policy measures. Re-emergence and persistence of sovereign debt problems has posed additional challenges and is expected to prolong global recovery. Slackening of global recovery, high oil and commodity prices, sovereign debt problem in the Euro area periphery intensifying and some slowdown in domestic investment demand may pose downside risks to the growth of the domestic economy. High prices of commodities, including oil, are also expected to adversely impact the current account balance, fiscal balance, households spending, and margins of corporates which may collectively pose some downside risks to the performance of the financial sector. Elevated inflation rate and rising interest rate may also impact on the balance sheet of financial entities.

## II. Financial Markets

Several advanced economies (AEs) are trying to break the mutually

reinforcing cycle of low growth and high indebtedness. Very few have made progress that is promising, on this count. Heightened sovereign risk concerns may increase funding costs for not just sovereigns but financial institutions also which still face a substantial wall of financing needs. Competition among sovereigns and financial institutions for funding comes at a time when there is near-consensus among investors about stronger prospects in emerging market economies (EMEs). Given this backdrop, a small shock could have potential negative feedback effects that threaten markets beyond AEs. EMEs in turn are looking to shield themselves from capital flows in excess of their absorption capacity to prevent imbalances from developing in their own economies. In India, there are early signs of a greater reliance on foreign sources of funding. It seems that the flow and stock effects of greater internationalisation of the Indian markets, institutions and funding need to be prudently monitored and managed. Broadly, major development on the global front can be highlighted as follows :

**(i) Rate hike expectations for the year in US have fallen.**

- Monetary policy in AEs continues to remain accommodative. The second Quantitative Easing (QE II) programme of US\$ 600 billion is likely to conclude in June 2011 but the Federal Reserve would continue to reinvest the

principal payments from its securities holdings.

- The most notable development of this period has been the secular decline in the US dollar against most currencies, of both advanced and emerging markets. The US economic data has been soft enough to keep expectations of interest rate hike in check, but not weak enough to not sustain a strong growth. Expectations of rate hike by the Federal Reserve by December 2011 which were growing earlier in the year have since receded. This has allowed risk appetite to remain strong, and the US dollar to be used as a funding currency for risk asset trades.

**(ii) Withdrawal of monetary accommodation in Euro area has begun at an uncertain pace.**

The Euro fell heavily against major currencies after the May 2011 meeting, and has remained soft with the emergence of greater uncertainties in regard to Greece. European equity has remained range bound.

**(iii) Prospects for UK and Japan have muddled. An earthquake transmits shocks to the financial system.**

- In the UK, inflation remained above the target of the Bank of England (BoE) while growth remained weak.
- In Japan, the earthquake in

March 2011, which caused large scale destruction to capital stock, rattled financial markets.

- GDP growth for Japan in 2011 is expected to be lowered with Q1 growth at (-) 3.7 per cent despite the massive rebuilding effort sought to be launched by Japan in the second half of the year.

**(iv) Questions over sustainability of European sovereign debt remain.**

The concerns with regard to sustainability of sovereign debt in the Euro-area do not appear as be localised to Greece, Ireland and Portugal which have sought bailout packages from European Union and IMF. The adverse and mutually reinforcing facets of the problem, namely, low economic growth and high indebtedness in many advanced economies (AEs) has led to an unstable equilibrium.

**(v) Fiscal concerns could spread to bigger economies.**

The need to raise larger sums from the financial markets by AEs is coinciding with significant refunding requirements of international banks, mainly European ones. The wall of refinancing by such banks has to be carried in competition with not only domestic sovereigns but with emerging market assets which are perceived to have more favourable risk reward attributes. Geopolitical tensions and stagflation.

**(vi) Geopolitical tensions and stagflation risks.**

The oil industry's supply dynamics have always been prone to disruption owing to low excess capacity and inventory levels. Precautionary stockpiling during such periods of political tension can aggravate the price moves in the energy markets causing distress to importing countries. At the same time, the higher revenues earned by the producers do not translate into any significant rise in export potential for others when the price moves are sharp. These developments have come at a time of high food and energy led inflation the world over. A resurfacing of stagflation risks of decades ago owing to oil supply shocks cannot be ruled out if the unrest were to spread to bigger oil exporters.

**(vii) Financialisation of commodity markets increases asset correlation.**

Increased financialisation of the energy and commodities market i.e. securitised commodity - linked instruments that are considered an investment rather than a risk management tool through Exchange Traded Funds, structured products and other vehicles has caused fears that genuine hedgers might get 'crowded out'.

On the domestic front major highlights are as follows:



(i) **Autonomous factors cause banking system liquidity to remain in deficit.**

The Indian rupee remained in a range against the US dollar during the period under review despite several adverse factors, namely, high crude oil prices and slump in FDI. It was initially aided by a recovery in portfolio flows, including equity and debt capital (debt capital flows have remained strong since last year and narrowing of current account deficit. Banking capital which witnessed net outflows in Q3 2010-11 turned positive in Q4 2010-11. The general US dollar weakness globally has helped the Rupee further its gains. The correction in equity markets as a result of high inflation numbers and the attendant rate hikes during the period weakened the Rupee which gave up most of its gains.

(ii) **Financialisation versus Internationalisation of Rupee.**

- Report shows that as the GDP rises, a currency trades in greater multiples of the home economy's underlying international trade ("financialisation") and trades to a greater extent outside its home market ("internationalisation").
- The relatively higher financialisation of the Indian rupee compared to the Chinese renminbi reflects the more liberal foreign exchange regime

put in place in India. India has already achieved current account convertibility and has a more open capital account.

(iii) **Increasing reliance by corporates on foreign currency borrowing.**

- Over the past few months, there has been a discernible increase in External Commercial Borrowings (ECBs) registered with the Reserve Bank, both under the Automatic as well as the Approval Routes (Table 1).
- The aggregate ECB flows for 2010-11 were almost at the pre-crisis levels. Increased reliance by corporate on foreign currency funding also increases the currency mismatches in their balance sheets.

**Table 1**  
**ECBs Registered with the Reserve Bank (in US\$ million)**

	2007-08	2008-09	2009-10	2010-11
ECB	22,224	15,462	17,363	24,481
FCCBs	6,103	463	3,362	1,270
<b>Total</b>	<b>28,327</b>	<b>15,925</b>	<b>20,725</b>	<b>25,751</b>

Source: RBI

(iv) **Substitution of domestic bank credit.**

An internal study of RBI found that the relationship between ECB and corporate bond out standings and the outstanding bank credit Granger Causality test under VAR(1)7 framework has been used for this study. The first difference of log of all the

three variables was taken for the modeling exercise. The result for Granger Causality of changes in outstandings of corporate bond and ECB to bank credit outstandings is presented in Table 2.

**Table 2**  
**VAR Granger Causality**

Excluded Variable	DLCorporate_Bonds	DLECB	All
Chi-sq	5.94	2.36	7.5
p-value	0.01	0.12	0.02
Source: RBI			

**(v) Growing currency mismatches of the national balance sheet**

India's net external liabilities have increased from US\$ 47 billion as on March 31, 2004 to US\$ 158 billion as on March 31, 2010. It

may be mentioned that these external liabilities include the foreign currency loans given by overseas branches of Indian banks to domestic corporates. There has been a consistent increase in such borrowings over the past few years (Table 3).

**(vi) Rising refunding risks of corporates.**

- FCCBs, which are normally issued for a maturity period of more than five years, worth more than US\$ 7 billion are maturing by March 2013. Of these, CRISIL estimates that "FCCBs worth ` 220 – 240 billion may not get converted into equity shares, as the current stock prices of issuing companies are significantly below their

**Table 3**  
**Lenders' Profile of ECBs (in US\$ million)**

	2007-08	2008-09	2009-10	2010-11
Total ECB	28,327	15,925	20,725	25,751
Of which lent by:				
Overseas branches of Indian banks	2,880	1,495	2,303	5,127
	10.2	9.4	11.1	19.9
Foreign Bank	17,272	8,864	8,438	13,692
	61	55.8	40.7	53.2
International Financial Institutions	1,180	2,643	3,133	2,849
	4.2	16.6	15.1	11.1
International Investors	6,373	463	3,334	1,455
	22.5	2.9	16.1	5.7
Foreign Collaborator/ Equity Holder	621	2,458	3,514	2,597
	2.2	15.4	17	10.1

*Note: figures in brackets represent the percentage for each category of lenders.*

Source: RBI.

conversion prices... The Nifty is now only about 10 per cent below its highs in January 2008.

- But many of these companies, accounting for more than half of the outstanding FCCBs, are trading at a discount of more than 50 per cent to their January 2008 prices". More than a few firms potentially face severe funding problems in the next two years which may not remain confined to their industries.

**(vii) Herd behavior of portfolio.**

- Between August and October 2010, as much as US\$ 18 billion was received under portfolio equity capital. IMF has stated that "Econometric results suggest portfolio flows to emerging markets tend to be persistent and have high degrees of autocorrelation... high persistence in flows is often attributed to herding behaviour".

- To test for persistence of flows, autocorrelation exercise for capital flows into India was done for various time periods beginning 2007 (Table 4).

The study shows that capital flows tend to be influenced by past behaviour. The inflow of funds into EM countries, like India, is often self reinforcing with success in initial investments by a fund leading to further allocation by the same fund as well as emulation by others. Likewise, withdrawal at times of stress by a few becomes more widespread owing to herd behaviour even when fundamentals do not warrant action by all.

To conclude, the sovereign debt situation in Europe appears to be spreading to the rest of the AEs which are bigger and have much greater systemic significance. Robust demand and growth in EMEs have strong structural and cyclical impetus to commodity prices but the increasing financialisation of commodity markets

**Table 4**  
**Autocorrelation Coefficients at the First and Second Lag Level for Daily Net FII Flows in Equity and Debt into India**

Period	Lag	FII Debt	FII Equity	Total FII
Jan 2007 until May 2011	1	-0.03(0.39)	0.41(0.00)	0.29(0.00)
	2	0.04(0.33)	0.29(0.00)	0.24(0.00)
Jan 2010 until May 2011	1	0.23(0.00)	0.43(0.00)	0.36(0.00)
	2	0.05(0.00)	0.33(0.00)	0.25(0.00)

**Note:** The number given in the bracket is the p-value for the test statistic. It is the lowest level of significance at which the null hypothesis that the test statistic does not have any autocorrelation (upto the specified lag level).

Source: RBI, Bloomberg

together with higher speculative interest might be distorting the tradeoffs between inflation and growth for many AEs and EMEs and escalating volatility. This in turn causes shocks from commodity markets to spread to other markets. The impact of the two major systemic events of the period under review, viz. conflict in Libya (and unrest in MENA) and the Japanese earthquake has been limited so far. If tensions in MENA continue or spill over into bigger economies in the region, the impact on Indian financial markets would be difficult to contain, particularly because India's fiscal improvement is expected to slow this year.

In India, the higher inflation and the attendant rate hikes have increased the attractiveness of overseas borrowing in terms of interest rate differential and availability of credit. Firms are exploring overseas markets to raise money even without offsets for the foreign currency liabilities that follow. Moreover, many of them face bunched up maturities on Foreign Currency Convertible Bond (FCCBs) in the next two years. The high and growing net external liability position of residents exposes the country to the risk of a sharp fall in the currency.

## II. Financial Sector Policies

In 2013, the phase-in period for Basel III measures commences. Efforts are already underway to migrate to advanced approaches under Basel II. Regulators and banks across the world, and especially in emerging markets like India, will face immense

challenges in the days ahead. Gaps in the regulatory arrangements for the cooperative sector enabling cooperative societies to raise deposits, including from external sources, without being subject to prudential norms needs to be addressed. Payment and settlement systems in the country are robust, but are characterised by a significant degree of interdependencies which leave them vulnerable to idiosyncratic shocks. Safety net arrangements need to address critical issues in respect of adequacy and management of funds, coverage, recovery performance and time taken for settlement.

However, significant progress has been made in crystallizing the global regulatory reforms agenda which was set in motion with a view to strengthen the resilience of the banking sector and to removing the fault lines which permitted the cyclical build up of risks. Going forward, several challenges remain viz., migration to advanced approaches under Basel II, adoption of Basel III proposals for capital, liquidity and leverage, calibration of the countercyclical buffer, convergence with the revised accounting standards, etc., which are likely to test both the regulators and the regulated entities in the days to come.

### (i) Higher capital requirements under Basel III

- Collectively, the new global standards to address both firm-specific and broader, systemic risks have been referred to as "Basel III", given the comfortable capital adequacy position of banks in India,

the Indian banking system is unlikely to be unduly stretched in meeting the more stringent requirements of the Basel III proposals.

- For emerging economies like India, the implementation comes at a time when credit demand is expected to pick up given, inter alia, the compulsions of robust growth, the investment needs of infrastructure and the demand ushered in by increasing financial inclusion. Thus, notwithstanding the current position at the aggregate level, a few individual banks may need to augment their capital.

**(ii) Calibration of a countercyclical buffer presents challenges.**

The Basel III proposals contemplate two capital buffers for the banking system – a capital conservation and a countercyclical buffer. The calibration of the countercyclical buffers proposed under Basel III poses a number of challenges. The primary aim of the buffer is to achieve the broader macro prudential goal of protecting the banking sector from periods of excess aggregate credit growth which are often associated with the build-up of systemic risks. Credit-to-GDP gap may not be a reliable indicator for calibrating the buffer.

**(iii) Credit-to-GDP gap may not be a reliable indicator for calibrating the buffer.**

The common reference guide

suggested by the Basel Committee is based on the aggregate private sector credit-to-GDP gap. This indicator does not work well in all jurisdictions at all times. This is especially so in emerging economies like India, where it tends to rise for structural reasons – higher credit off take due to higher growth and greater financial inclusion. Also, some economic sectors are relatively new in India and banks have only recently begun financing them in a big way. The risk build-up, if any, in such sectors cannot accurately be captured by this ratio.

**(iv) A mix of quantitative and qualitative indicators will have to guide the calibration of the buffer.**

- An examination, in the Indian context, of some of the other possible indicators suggested by the Basel Committee reveal that none of these indicators can be, on a standalone basis, considered reliable indicators for the calibration of the countercyclical buffer. The calibration of the buffer in the Indian context will, therefore, have to rely on a mix of qualitative and quantitative indicators and will require a considerable degree of judgment.
- Further, in India, sectoral approaches to countercyclical policies have stood the test in the past. The tools used in India to contain pro cyclicity are essentially time-varying provisioning for standard assets

and differentiated risk weights for sensitive sectors.

**(v) Migrating to higher approaches under Basel II presents many challenges.**

■ Migration to advanced approaches under Basel II norms will facilitate a closer alignment of capital requirement with the risk profile of banks, improved quantification of Pillar II risks and enhanced monitoring and reporting processes. The process of migration, however, comes with inherent challenges. The foremost constraint is the availability of skilled personnel and robust data, especially in case of credit and operational risks.

■ Internal rating systems to support the quantification of default and loss estimates, calibration of the exposure at default (EAD) and loss estimates to downturns and validation of risk models are integral to the advanced approach for credit risk. These systems require a large time series data, understanding of credit cycles and quantitative modeling of macro and micro level risk factors. On the other hand, operational risk modeling is a relatively new discipline and the methodologies are still evolving.

**(vi) Credit risk capital under the standardised approaches Reliance on credit rating agencies will continue.**

The reliance of banks on external

ratings for arriving at their capital requirements using the Standardised Approach under Basel II is likely to continue in many jurisdictions, including India, for some time.

**(vii) Supervisory framework for Financial Conglomerates (FCs) being strengthened – issues relating to resolution and interconnectedness remain germane.**

The supervisory processes for the major banking groups are being strengthened: a revised offsite reporting format has been introduced to improve capturing of the group risk profile; the criteria for the identification of FCs has been revised to include off balance sheet position of banks and NBFCs; and guidelines on the corporate governance framework and management / monitoring of risks arising of intra-group transactions and exposures are being issued.

■ **The financial holding company model - the preferred model in India.**

A Working Group on the Introduction of Financial Holding Company Structure in India<sup>5</sup> constituted by the Reserve Bank has since recommended that the financial holding company model should be pursued as the preferred model for the financial sector in India. It has recommended that a separate legislation should be enacted for the regulation of financial holding companies and that the Reserve Bank should be

designated as the regulator for such companies.

**(viii) MoUs with overseas supervisors to enhance cross border supervisory cooperation.**

International initiatives underlining the importance of cross border supervisory co-operation and information sharing gain importance in view of increasing cross border operations of Indian banks and growing presence of foreign banks in India. The first such MoU has been signed between the Reserve Bank and the China Banking Regulatory Commission (CBRC) in December 2010 and a few other MoUs are in the pipeline.

On the Regulatory

**(i) FSDC and its Sub-Committee – coordinated oversight for financial stability.**

- The post crisis focus on establishing an institutional mechanism for coordination among regulators and the Government has culminated in the establishment, in December 2010, of the Financial Stability and Development Council (FSDC) to be chaired by the Union Finance Minister. The FSDC is to be assisted by a Sub-Committee to be chaired by the Governor of the Reserve Bank.
- This structure attempts to strike a balance between the sovereign's objective of ensuring financial stability to reduce the probability of a crisis and the

operative arrangements involving the central bank and the other regulators. While the Sub-Committee is expected to evolve as a more active, hands on body for financial stability in normal times, the FSDC would have a broad oversight and will assume a central role in crisis times.

On the Legislative

**(i) FSLRC constituted – revision to legislations in tune with the current policy framework.**

The FSLRC has since been formed under the chairmanship of Justice (Retd.) B. N. Srikrishna and has constituted eight sub-committees that will look into areas such as banking, pension, insurance, capital markets, debt management office, forward markets and legal processes.

**(ii) Proposed amendments to the legislative framework for banks to make regulatory powers of the Reserve Bank more effective.**

The Banking Laws (Amendment) Act, 2011 has been introduced in the Parliament in March 2011 seeking to amend the Banking Regulation Act, 1949, the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 and the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 to, inter alia, make the regulatory powers of the Reserve Bank more effective and to increase the access of the nationalised banks to capital market.

**(i) The non-banking financial sector in India – within a regulatory ambit.**

In the Indian context, the NBFC sector is not typically a shadow banking sector as in the case of advanced economies since the sector is largely regulated by the Reserve Bank, SEBI, IRDA and NHB. Money market instruments like commercial paper and short term non-convertible debentures (NCDs) are regulated by the Reserve Bank while SEBI regulates mutual funds and longer tenure NCDs.

**(ii) Gaps in regulation remain even as the entities continue to be closely interconnected.**

Both banks and mutual funds also invest in corporate paper of NBFCs thereby enhancing the financial integration of these entities. Some restrictions exist on the NBFC exposures that banks can take and the Reserve Bank has recently announced a prudential cap on banks' exposures to debt oriented mutual funds. these entities remain closely interconnected.

**(iii) Systemic importance of Government sponsored NBFCs warrants their being subject to prudential regulation.**

- There are at present 37 Government owned NBFCs (five NBFCs owned by the Central Government and 32 by various State Governments). Nine of these entities are deposit taking NBFCs, with deposits amounting

to nearly ` 2,000 crore as on March 31, 2010, while the total advances of the 37 companies stood at nearly ` 2.9 lakh crore. Further, the assets of these companies have been progressively increasing over the years with funding largely through public markets.

- These entities have so far been exempted from the prudential regulatory framework for NBFCs as they are under the administrative control of a ministry of the Government and because they were deemed to pose less supervisory concern with regard to protection of depositors' interest. Over time, the systemic importance of the Government entities has increased with the expanding size of their balances sheets and their growing interaction with the financial system. At the same time, the regulatory framework for NBFCs has also acquired an explicit focus on the systemic risks posed by the sector and on regulatory arbitrage. It has, therefore, been decided to revisit the exemptions granted to these NBFCs in consultation with the Government.

**(iv) The regulatory framework for wealth management services warrants examination.**

Reserve Bank is in the process of conducting a survey in respect of wealth management activities being provided by banks. SEBI is also considering putting in



place an appropriate regulatory framework for such activities. Above all, the issue of banks selling third party products and the conflicts of interest entails greater examination.

**(v) Proliferation of structured products in an unregulated space may pose systemic concerns.**

- Structured products, in the Indian context, are being issued mainly by NBFCs in the form of debt securities with returns linked to equity, commodities etc. These products, which are issued as debentures and are typically privately placed, are currently not subject to any specific regulatory regime.
- While the quantum of outstanding structured products is not very significant at the current juncture, the complexity and lack of transparency of such products, their illiquidity and concerns over valuation, and their potential ability to influence asset prices through the derivatives markets may give rise to systemic concerns, especially if such products proliferate in an unregulated space.

**(vi) Regulatory gaps permitting deposit raising activities of cooperative societies without being subject to prudential norms need to be plugged.**

- Under the current legal environment, a cooperative society may enroll any number of members, receive deposits

from the members, raise loans and receive grants from external sources. The cap on funds raised from the external sources in the case of a cooperative society registered under the Multi-State Cooperative Societies Act is ten times of the sum of its subscribed share capital and accumulated reserves and in the case of those registered under the State Acts, the cap is prescribed in the byelaws of the society.

- The aforesaid position represents a regulatory gap which enables entities to raise public deposits without being subject to any prudential norms. The entire gamut of issues related to raising of funds, especially from external sources, by these entities needs to be examined.

To conclude, significant strides have been made to strengthen the regulatory arrangements for the financial system, both internationally and domestically. Going forward, several issues and challenges are likely to emerge. Some banks may need to raise additional capital for funding credit growth and for meeting the requirements of Basel III. This may present difficulties given the sluggish performance of the equity markets. Amendments to banking sector legislations easing the access of nationalised banks to the capital market may alleviate this. Prescribed indicators for calibrating the countercyclical buffers may not be appropriate in emerging markets like India and a mix of qualitative and quantitative indicators as well as a good dose of regulatory discretion will need to be employed for calibrating

the buffers. Guidelines for migration to advanced approaches under Basel II have been issued and many challenges - availability of robust data and skilled personnel, need to develop internal rating systems to support the quantification of default and loss estimates, sound stress testing processes and validated risk models, etc. - are likely to emerge. Efforts are ongoing to improve the supervisory arrangements for FCs though issues such as orderly resolution remain germane.

#### IV. Conclusion

During the period since December 2010, Indian financial markets have remained stress free even as the reliance of domestic firms on international sources of finance denominated in foreign currency has been growing. The regulatory arrangements are being strengthened, emphasising a coordinated approach, in line with the current international developments and best practices.

Most importantly as the analysis shows the global macroeconomic developments slowdown in growth even as the risk scenario improves whereas the global imbalances remains. Again, sovereign debt crisis threatening to spill over to other areas. On the domestic front, slight fall in growth rate is being experienced as management of fiscal position and inflation takes precedence. In addition, inflation

remains a big challenge, as asset prices stay high. Moreover, Current Account Deficit (CAD) may remain under pressure and lastly, quality and pace of fiscal consolidation remains a concern.

On the financial market as the information confirmed, there has been improvement in stability of markets at global and domestic levels. Secondly sovereign debt crisis could affect institutions and markets. Third, increasing financialisation of commodity markets adding to asset correlation. Fourth, domestic markets functioned without any stress, with liquidity conditions remaining tight for the banking system. Fifth, increased reliance by Indian firms on foreign funding causing currency mismatches even as refunding risks of corporates escalate due to maturing FCCBs.

On the regulatory environment proposed amendments to banking legislations will fortify the regulatory structure and also implementation issues remain with migration to the advanced approaches under Basel II. In addition, data and analytical requirements for Basel III will be challenging as will the calibration of the countercyclical buffers. Again, the supervisory framework for Financial Conglomerates (FCs) is being enhanced. Lastly, gaps in regulation permitting cooperative societies to raise funds outside any regulatory ambit need to be addressed.



# Select Economic Indicators

Economic Growth								
Item	Constant (2004-05) Prices							
	2010-11				2009-10			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP at Factor Cost (Rs. In Crore)	1143590 (9.3)*	1153270 (8.9)*	1263428 (8.9)*	1317554 (7.8)*	1046306 (6.3)*	1058777 (8.6)*	1166082 (7.3)*	1222573 (9.4)*
GDP at Market Price (Rs. In Crore)	1217270	1241332	1370188	1469339	1112318	1137985	1255040	1363974
<b>Growth Rate (Per cent)</b>								
Private Final Consumption Expenditure	61.6	60.1	60.1	52.6	61.8	60.2	60.5	52.4
Government Final Consumption Expenditure	11.0	10.9	12.2	10.5	11.3	11.2	13.1	10.8
Gross Fixed Capital Formation	32.6	32.7	30.5	32.1	30.4	31.9	30.9	34.5
Change in Stocks	3.6	3.6	3.3	3.4	3.5	3.6	3.5	3.5
Valuables	2.0	2.3	2.2	2.2	1.7	2.1	2.0	1.8
Exports	21.2	21.1	21.9	23.1	21.1	20.8	19.2	19.9
Less Imports	28.9	28.7	25.7	27.0	27.4	28.1	28.0	26.4
Discrepancies	-3.1	-2.1	-4.6	3.1	-2.5	-1.7	-1.1	3.5

Economic Growth								
Item	Current Prices							
	2010-11				2009-10			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP at Factor Cost (Rs. In Crore)	1667160 (21.6)*	1692800 (19.2)*	1934502 (19.0)*	2012528 (17.2)*	1370545 (10.5)*	1420213 (13.0)*	1625706 (16.8)*	1716765 (23.3)*
GDP at Market Price (Rs. In Crore)	1762793	1808963	2079416	2224454	1439372	1505048	1723918	1881933
<b>Growth Rate (Per cent)</b>								
Private Final Consumption Expenditure	58.5	59.5	58.9	52.6	59.4	59.2	60.1	53.2
Government Final Consumption Expenditure	11.1	10.9	12.5	11.5	11.2	11.1	13.5	11.8
Gross Fixed Capital Formation	30.4	30.5	27.7	29.6	30.0	31.1	29.2	32.7
Change in Stocks	3.4	3.5	3.1	3.3	3.3	3.4	3.2	3.2
Valuables	2.0	2.2	2.1	1.7	1.7	2.0	1.9	1.4
Exports	20.7	20.7	21.6	22.8	20.6	20.4	18.9	19.6
Less Imports	25.7	25.6	23.1	24.9	24.8	25.5	25.7	24.3
Discrepancies	-0.4	-1.7	-2.7	3.5	-1.4	-1.7	-1.1	2.4
* Percentage Change over previous years.								
Source: Ministry of Statistics & Programme Implementation, Government of India. Estimates of Gross Domestic Product for First Quarter (Jan-Mar) of 2010-11.								

## Agriculture & Industrial Production

### Sector-wise Percentage Change over Previous Year

Item	Constant (2004-05) Prices							
	2010-11				2009-10			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Agriculture, Forestry & Fishing	2.4	5.4	9.9	7.5	1.8	1.2	-1.6	1.1
<b>Industry</b>								
Mining and Quarrying	7.1	8.2	6.9	1.7	6.9	6.6	5.2	8.9
Manufacturing	12.7	10.0	6.0	5.5	2.0	6.1	11.4	15.2
Electricity, Gas & Water Supply	5.6	2.8	6.4	7.8	6.2	7.5	4.5	7.3
<b>Services</b>								
Construction	7.7	6.7	9.7	8.2	5.4	5.1	8.3	9.2
Trade, Hotels, Transport and Communications	12.6	10.9	8.6	9.3	5.4	8.2	10.8	13.7
Financing Institutions, Real Estates & Business Services	9.8	10.0	10.8	9.0	11.5	10.9	8.5	6.3
Community, Social & Personal Services	8.2	7.9	5.1	7.0	13.0	19.4	7.6	8.3

## Agriculture & Industrial Production

### Sector-wise Percentage Change over Previous Year

Item	Current Prices							
	2010-11				2009-10			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Agriculture, Forestry & Fishing	26.3	27.0	29.8	25.6	11.5	13.2	18.1	24.1
<b>Industry</b>								
Mining and Quarrying	26.5	25.7	26.3	19.1	7.7	5.2	6.9	25.4
Manufacturing	19.5	15.8	11.5	11.3	2.3	5.8	13.8	21
Electricity, Gas & Water Supply	12.9	9.1	11.7	11.6	7.3	11.2	9.2	12.7
<b>Services</b>								
Construction	18.9	16.3	19.2	17.6	6.0	5.5	13.0	19.7
Trade, Hotels, Transport and Communications	21.2	17.7	15.1	14.1	5.2	7.7	14.6	23.1
Financing Institutions, Real Estates & Business Services	21.3	20.0	20.2	18.8	19.4	18.6	21.1	24.6
Community, Social & Personal Services	21.1	18.5	14.7	16.7	22.9	31.1	21.6	26.7

Source: Ministry of Statistics and Programme Implementation, Government of India. Estimates of Gross Domestic Product for Third Quarter (October-December) of 2010-11.

## Agriculture & Industrial Production (Contd.)

Performance of Core-Industries		
Sector-wise Growth Rate (%) in Production (Weight in IIP: 26.68%)	2009-10	2010-11
Overall Index	16.27	14.63
Crude Oil	14.97	35.97
Petroleum Refinery Products	4.13	-5.73
Coal	14.77	2.50
Electricity	15.93	13.20
Cement Production	22.90	13.47
Finished (CARBON) Steel Production	19.17	22.13

Overall Indices for the year 2009-10 & 2010-11.  
Compiled by BCCL.  
Source: Office of the Economic Advisor.

## External Sector

Exports and Imports (in US \$ million)					
Item	2009-10 (Apr-Mar)	2010-11 (Apr-Mar)	March-11	March-11	% Change in March 2011
Exports	178,751	245,868	20,254	29,135	43.8
Imports	288,373	350,695	29,627	34,743	17.3
Oil Imports	87,136	101,689	8,722	9,439	8.2
Non-Oil Imports	201,237	249,006	20,905	25,305	21.0
Trade Balance	-109,621	-104,827	-9,373	-5,608	-

Source: Provisional data as per the Press Note of the Ministry of Commerce and Industry.

Foreign Currency Assets				
	Amount		Variation	
	Rs. Crore	US \$ Million	Rs. Crore	US \$ Million
<b>At the end of</b>			<b>(over last year)</b>	
March, 2007	836,597	191,924	189,270	46,816
March, 2008	1,196,023	299,230	359,426	107,306
March, 2009	1,231,340	241,676	35,317	-57,554
March, 2010	1,150,778	254,935	-80,562	13,259
March, 2011	1,225,999	274,580	75,221	19,645
<b>2011-12</b>			<b>(over last month)</b>	
April, 2011	1,252,790	282,287	26,791	7,707

Source: Reserve Bank of India

Rupees per unit of Foreign Currency*				
	US Dollar	Pound Sterling	Japanese Yen	Euro
March, 2008	40.3561	80.8054	0.4009	62.6272
March, 2009	51.2287	72.9041	0.5251	66.9207
March, 2010	45.4965	68.4360	0.5018	61.7653
March, 2011	44.9684	72.7070	0.5498	62.966
<b>2010-11</b>				
April, 2011	44.3700	72.7237	0.5331	64.2505

\* FEDAI Indicative Market Rates (on Yearly/Monthly average basis).

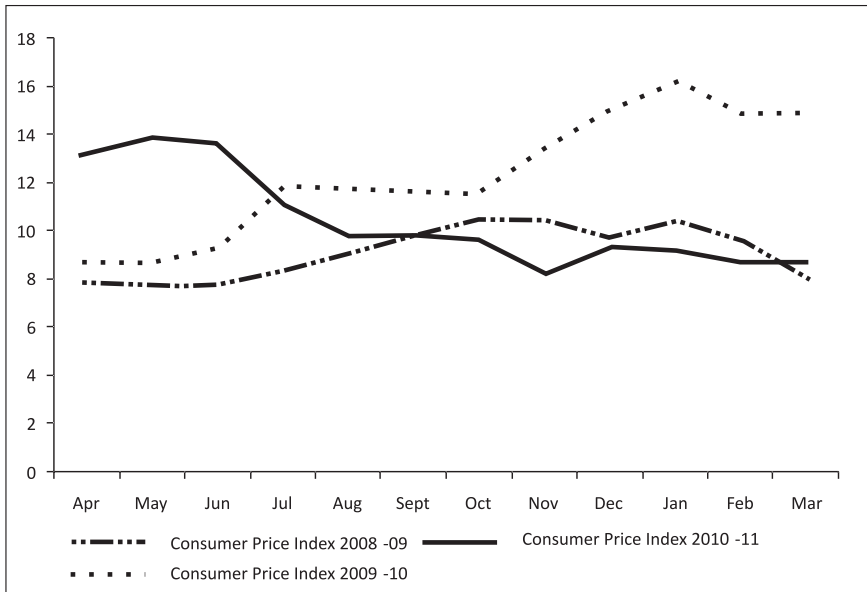
# Prices

Current price situation based on Monthly Wholesale Price Index in January, 2010 (Base: 2004-05=100)

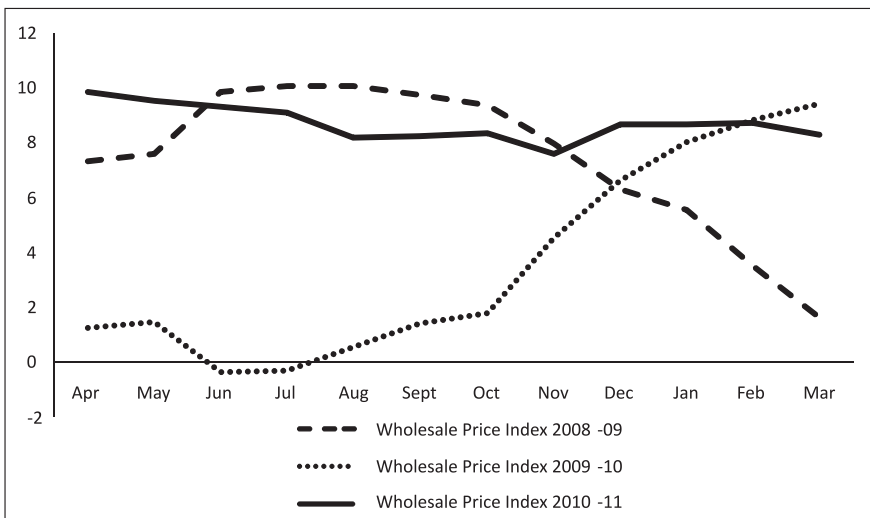
Items/Groups	Weight(%)	Latest Month Over Month		Build up from March		Year on Year	
		2010-11	2011-12	2010-11	2011-12	2010-11	2011-12
All Commodities	100	1.76	1.34	1.76	1.34	10.88	8.66
Primary articles	20.11	3.07	2.24	3.07	2.24	21.45	12.05
Food Articles	14.33	3.18	2.46	3.18	2.46	20.49	8.71
Fuel and Power group	14.91	0.71	1.07	0.71	1.07	13.61	13.32
Manufactured Products	64.97	1.35	1.04	1.35	1.04	6.41	6.18

## Point to Point Rate of Growth

CPI (Base Rate 2001 = 100)



WPI (Base - 2004-05 = 100)



World Prices of Select Commodities							
Commodity	Unit	Annual Averages			Monthly Averages		
		Jan-Dec 2009	Jan-Dec 2010	Jan-Apr 2011	Feb 2010	Mar 2011	Apr 2011
<b>Energy</b>							
Coal, Australia	\$/mt	71.8	98.9	127.4	128.3	126.1	123.0
Crude Oil, average	\$/bbl	61.7	79.0	103.8	97.9	108.6	116.2
Crude oil,Brent	\$/bbl	61.8	79.6	109.4	103.9	114.4	123.0
Crude oil,Dubai	\$/bbl	61.7	78.0	104.2	100.2	108.5	115.7
Crude oil,West Texas Int.	\$/bbl	61.6	79.4	97.9	89.5	102.9	109.9
Natural gas, US	\$/mmbtu	8.7	8.2	9.6	9.3	9.3	10.3
<b>Agriculture</b>							
Coffee,robusta	€/kg	317.1	432	630.4	634.7	634.9	661.7
Tea,auctions(3),average	€/kg	272.4	288.5	291.9	288.2	275.8	301.7
<b>Food</b>							
Coconut oil	\$/mt	725.0	1124.0	2077.0	2256.0	1925.0	2088.0
Copra	\$/mt	480.0	750.0	1390.0	1503.0	1280.0	1421.0
Groundnut oil	\$/mt	1184.0	1404.0	1712.0	1730.0	1650.0	1680.0
Palm oil	\$/mt	683.0	901.0	1226.0	1292.0	1180.0	1149.0
Palm kernel oil	\$/mt	700.0	1184.0	2073.0	2296.0	1977.0	1899.0
Soybean meal	\$/mt	408.0	378.0	429.0	442.0	418.0	403.0
Soybean oil	\$/mt	849.0	1005.0	1340.0	1365.0	1307.0	1314.0
Soybeans	\$/mt	437.0	450.0	563.0	570.0	553.0	556.0
<b>Grains</b>							
Barley	\$/mt	128.3	158.4	200.8	196.5	202.6	208.9
Maize	\$/mt	165.5	185.9	291.9	292.9	290.5	319.3
Rice,Thailand, 5%	\$/mt	485.1	441.5	461.1	473.0	455.5	448.3
Wheat,Canada	\$/mt	300.5	312.4	452.0	474.1	432.5	460.9
Sugar,world	€/kg	40.0	46.9	60.4	64.9	57.8	53.7
<b>Raw Materials</b>							
Timber							
Logs,Malaysia	\$/cum	287.2	278.2	328.9	328.6	334.8	337.0
Plywood	€/sheets	564.6	569.1	590.4	588.7	592.2	596.3
Cotton A Index	€/kg	138.2	228.3	462.1	470.0	506.3	477.6
Rubber, RSS3	€/kg	192.1	365.4	576.3	625.9	541.9	585.3
<b>Metals and Minerals</b>							
Aluminium	\$/mt	1665.0	2173.0	2545.0	2508.0	2556.0	2678.0
Copper	\$/mt	5150.0	7535.0	9605.0	9868.0	9503.0	9493.0
Gold	\$/toz	973.0	1225.0	1408.0	1373.0	1424.0	1480.0
Iron ore, contract, fob Brazil	€/dmtu	101.0	n.a.	n.a.	n.a.	n.a.	n.a.
Iron ore, spot, cfr China	\$/dmt	80.0	145.9	178.8	187.2	169.4	179.3
Steel cr coilsheet	\$/mt	783.0	816.0	875.0	850.0	900.0	900.0

Source: World Bank -The Pink Sheet

# Government Accounts

## Trends in Central Government Finances: April-February 2010-11

	Budget Estimates 2010-11	April-February		Col. 3 as % of	Col.4 as % of	% Change over preceeding year	
		2009-10	2010-11	2009-10 (BE)	2010-11 (BE)	2009-10	2010-11 (4/3)
(Rs. Crore)							
<b>1. Revenue Receipts</b>	682,212	458,732	670,366	74.7	98.3	4.9	46.1
Gross tax revenue	746,651	490,694	627,568	76.5	84.1	-1.6	27.9
Tax(net to Centre)	534,094	358,641	460,624	75.6	86.2	0.6	27.9
Non Tax	148,118	100,091	209,742	71.4	141.6	23.6	109.6
<b>2. Capital Receipts of which:</b>	426,537	399,573	308,339	98.3	72.3	28.5	-22.8
Recovery of loans	5,129	5,886	10,506	139.3	204.8	56.9	78.5
Other Receipts	40,000	12,786	22,745	1141.6	56.9		77.9
Borrowings and other liabilities	381,408	380,901	275,088	95.0	72.1	24.0	-27.8
<b>3. Total Receipts(1+2)</b>	1,108,749	858,305	978,705	84.1	88.3	14.7	14.0
<b>4. Non-Plan Expenditure (a) + (b)</b>	735,657	601,198	668,140	86.4	90.8	16.6	11.1
(a) Revenue Account of which:	643,599	557,414	607,814	90.1	94.4	15.6	9.0
Interest payments	248,664	177,257	201,169	78.6	80.9	6.9	13.5
Major Subsidies	108,667	177,257	113,668	103.9	104.6	-6.5	3.7
Pensions	42,840	41,727	49,671	119.3	115.9	50.4	19.0
(b) Capital Account	92,058	43,784	60,326	57.0	65.5	30.0	37.8
<b>5. Plan Expenditure (i) + (ii)</b>	373,092	257,107	310,565	79.1	83.2	10.5	20.8
(i) Revenue Account	315,125	217,191	263,259	78.0	83.5	8.7	21.2
(ii) Capital Account	57,967	39,916	47,306	85.4	81.6	22.0	18.5
<b>6. Total Expenditure (4) + (5) = (a) + (b)</b>	1,108,749	858,305	978,705	84.1	88.3	14.7	14.0
(a) Revenue Expenditure	958,724	774,605	871,073	86.3	90.9	13.6	12.5
(b) Capital Expenditure	150,025	83,700	107,632	67.7	71.7	26	28.6
<b>7. Revenue Deficit</b>	276,512	315,873	200,707	111.7	72.6	29.2	-36.5
<b>8. Effective Revenue Deficit</b>	245,195		155,141		63.3		
<b>9. Fiscal Deficit</b>	381,408	380,901	275,088	95	72	24.0	-27.8
<b>10. Primary Deficit</b>	132,744	203,644	73,919	116.0	55.7	44.1	-63.7

Source: Review of Union Government Accounts, Apr-Feb 2010-11, Ministry of Finance.

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# Money & Banking

## Money Stock - Components and Sources

(Rs. Crore)

Item	Outstanding as on		Variation over			
	2010	2011	Financial Year so Far		Year on Year	
	Mar.31	Apr.22	2009-10	2010-11	2010	2011
M <sub>3</sub>	64,91,756	66,40,947	0.8	2.3	15.3	17.6
<b>Components (i+ii+iii+iv)</b>						
(i) Currency with the Public	9,14,170	9,47,024	4.0	3.6	16.2	18.6
(ii) Demand Deposits with Banks	7,13,735	6,58,496	-9.0	-7.7	17.0	0.7
(iii) Time Deposits with Banks	48,60,111	50,32,053	1.9	3.5	15.0	20.0
(iv) "Other" Deposits with Reserve Bank	3,740	3,374	-5.6	-9.8	-62.7	-6.9
<b>Sources (i+ii+iii+iv)</b>						
(i) Net Bank Credit to Government (a+b)	19,72,422	19,96,491	2.0	1.2	27.2	17.2
(a) Reserve Bank	3,95,436	3,65,280				
(b) Other Banks	15,76,986	16,31,211	3.8	3.4	17.5	7.8
(ii) Bank Credit to Commercial Sector (a+b)	42,10,535	41,91,024	-0.8	-0.5	16.1	21.0
(a) Reserve Bank	2,164	1,325	—	—	—	—
(b) Other Banks	42,08,371	41,89,698	-0.8	-0.4	16.6	21.0
(iii) Net Foreign Exchange Assets of Banking Sector*	13,75,762	13,87,369	-1.0	0.8	-4.9	9.4
(iv) Government's Currency Liabilities to the Public	12,586	12,586	-1.2	—	12.6	10.4
(v) Banking Sector's Net Non-Monetary Liabilities	10,79,549	9,46,523	-6.4	-12.3	4.5	18.9
of which						
Net Non-Monetary Liabilities of RBI	3,67,128	3,74,479	-2.7	2.0	-22.3	27.6

\*: Includes Investments in foreign currency denominated bonds issued by IIFC(UK) since March 20, 2009

## Select Scheduled Commercial Banks - Business in India

Item	Outstanding as on		Percentage Variation			
	(Rs. Crore)		Financial Year so Far		Year on Year	
	March 25, 2010	April 29, 2011	2009-10	2010-11	2009	2010
1. Bank Credit	3,938,659	3,921,487	-3.0	-5.0	17.5	21.2
Non-Food Credits	3,874,376	3,869,239	-0.8	-0.1	17.4	22.2
2. Aggregate Deposits	5,204,703	5,345,882	1.5	2.6	15.4	17.3
3. Investments in Govt. and other approved securities	1,500,039	1,565,497	3.0	4.3	12.4	9.8

## Policy Rates/ Interest Rates (per cent per annum)

Item / Week Ended	2011	2011
	April 30	April 29
Cash Reserve Ratio (per cent) (1)	6.00	6.00
Bank Rate	6.00	6.00
Repo Rate	5.25	6.75
Reverse Repo Rate	3.75	5.75
Prime Lending Rate (2)	11.00-12.00	8.50-9.50
Deposit Rate (3)	6.00-7.50	7.75-9.50
Call Money Rate (Low/High) (4)		
– Borrowings	3.79	6.86
– Lendings	3.79	6.86

(1) Cash Reserve Ratio relates to the Scheduled Commercial Banks (excluding Regional Rural Banks).

(2) Prime Lending Rate related to five major Banks.

(3) Deposit Rate related to major Banks for term deposits of more than one year maturity.

(4) Data cover 90-95 per cent of total transactions reported by participants.



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