PART - I

PROLOGUE

CHAPTER 1

INTRODUCTION

India's economic resurgence surfacing intermittently during the last four and half decades often raised hopes of sustained growth to eradicate poverty, foster human development and propel India to its past glory. The annual growth rate of the Indian economy was literally stagnant till independence was attained in 1947 and remained below 4% till the end of 1970s, proverbially referred to as Hindu Rate of growth. It was only during the 1980s that the average growth rate crossed 5%. Between 1981-82 and 1990-01, the growth rate of the economy was 5.6% per annum. In the post-liberalisation period between 1991-92 and 2012-13, the average annual growth rate was 6.9%. Following the Global Financial Crisis in 2008, growth decelerated significantly and has been below 5% since 2012-13, a trend reversed only during the second quarter of 2014-15, with a reported GDP growth rate of 5.7%. During these periods of fortitudes and vicissitudes on the growth trajectory, India successfully negotiated the Asian economic crisis during 1997-98 and the global financial crisis during 2007-08. The policy re-engineering of the new government led by Prime Minister, Narendra Modi again raised hopes both within and outside the country. Issues relating to the various sectors of the Indian economy, governance aspects and human development indicators need to be addressed keeping in view the lessons from the past experience to avoid faltering again in achieving sustainable high growth. This book is a humble attempt to examine the various sectoral issues and some of the key risks to sustain the emerging economic resurgence, given the global challenges. Agenda for action in the last chapter suggests measures to contain the risks in the short, medium and long terms.

Post-Independence India's prism of planned economic development has rested on the tripod of politics, poverty and the patronage of governments—both at the Centre and in the states. The Nehruvian socialistic vision of society was grounded in

notions of community development and *panchayati raj*. The two wheels of the bullock cart of poverty, greased with heavy state subsidies, travelled on rugged roads in the hope that the most basic needs of safe drinking water, sanitation, public health, affordable housing and total literacy for vast sections of the Indian population would be met. However, these expectations have been only partially fulfilled. The poverty situation is markedly different from what prevailed three decades ago. The spatial map and social base of poverty have significantly changed over time; poverty is increasingly getting concentrated in a few geographical locations among specific social groups (Radhakrishna and Ray, 2005: xxii). India had a near balance of payments crisis in 1990–91 when its forex reserves were just adequate for one fortnight's imports. Economic exigencies prevailed over the political uncertainties and enabled a five-year politically stable government to give a tilt to the approaches to development from a centrally planned economic regime to globally driven market mechanisms. Reforms in industrial and trade policy, and in the banking and financial sectors, based, *inter alia,* on the recommendations of the Narasimham Committee I and II in 1991 and 1998 respectively and liberalisation of foreign direct investment have enabled a permanent shift towards a market-based approach. This reorientation exposed the economy to a new set of risks embedded in externalities. From then on, the gap between the rich and the poor started widening, irrespective of where the line between the two is drawn. The new government voted to power in 2014 has laid out a 10-point economic agenda with the broad objective of growth with equity, with "minimum government, maximum governance" as its mantra. Thus, equity and growth continue to be the twin objectives of economic policy for the world's largest democracy.

The UN Human Development Index ranked India at 136 in 2012, out of a total of 186 member countries–lower than Sri Lanka (92 rank) and just a few notches above Pakistan (146 rank), the two immediate neighbours–with a value of 0.554, compared to the world average of 0.694. As indicated in the Report, India's gross national income per capita (2005 constant PPP$) stood at US$ 3,976, while the GDP per capita was US$ 3,203. Unemployment at

9.9% has been on the rise despite an increase in the growth rate with a moving average of 8.5% during 2005–12. The lowest 10% of the population in terms of income had a household consumption of 3.6% of the GDP at constant prices (2004-05), while the highest 10% of the households had a consumption of 31.1% at the end of 2012. These statistics highlight the gap between the rich and the poor, on the one hand, and the formidable challenges ahead for economic policy, on the other. That the richest 85 individuals in the world have as much wealth as the poorest 3.5 billion people in the world[1] may only indicate that income inequalities are indeed a global challenge.

The assessment of poverty, regardless of how it is measured, leads one to the inescapable conclusion that the absolute number of poor increased, while the percentage of poor declined, indicating relativity. India has ably fought famines, destitution and depravity. It has improved its levels of literacy and the average life expectancy of its population, no doubt. But this comfort at once vanishes when one sees the instances of poor governance, endemic corruption, and emboldened financial and economic risks. The cry for good governance and inclusive growth, therefore, has become louder than ever.

The Centre for Financial Inclusion (2013) has observed:[2]

"Demographic change is one of the most powerful forces shaping the world's future, and has implications for financial inclusion in every country over the next decade. At this moment, demographic transition is opening a unique window of opportunity for countries in development. As life expectancy increases and fertility rates fall, the working-age population grows faster than the young dependent population. In the developed world, this demographic dividend boosted economic growth for several decades, but rapid ageing and an expanding elderly population have now turned demographics into a headwind. Yet, as the window closes in the developed world, it is just opening in the developing world."

Literature suggests that the choice of wrong policies to fight against poverty was many a time due to the lack of an appropriate understanding of the problems and wanton neglect of the most critical aspects that affect the interests of the poor more than the

rich: health, education, employment, credit and insurance at the primary level.

The demographic dividend that India has at the moment can turn into a demographic disaster if growth, governance and risk management do not move in tandem—the main theme of this book, which it seeks to discuss from a multi-sector perspective.

Growth Concerns

In October 2013, both the IMF and the World Bank lowered their estimates of India's real GDP growth rate to 3.75% and 4.7%, respectively, for 2013–14. The Finance Minister of India questioned the estimates of the IMF and stated that the Indian economy could grow between 5 and 5.5% during 2013–14. According to the provisional estimates of the Central Statistics Office, India registered growth rate of 4.7% in 2013–14, i.e., less than 5% growth rate for the consecutive second year. The broad message is clear: The Indian economy, which grew at around 8% in the first decade of the 21st century, has decelerated significantly and it is likely that in future the growth will be lower than this trend.[3] Indeed, the country did face the possibility of a sovereign rating downgrade, but nimble policy-making towards the end of 2013 ensured that India's macroeconomic management has significantly improved. In general, India has been in the news in recent years mostly for the wrong reasons: falling economic growth; widening current account deficits; deteriorating fiscal situation; persistent high inflation; depreciation of the Indian currency associated with elevated levels of exchange rate volatility; increase in the external debt of the country, particularly short-term debt, and so on. All these problems have affected the image of the country, its investment climate, the income and employment of the people, and overall confidence in the country's governance quality.

After recording significant economic growth in excess of 8% during 2003–08, India has had to deal with the recent global crises—the global financial crisis of 2008 and the European sovereign debt crisis of 2010—as well the domestic problems—the persistent increase in inflation and currency volatility in 2013. The resilience of the Indian economy and the strength of its

institutions, such as the central bank and financial sector regulators, have enabled the country to ward off the external crises to a large extent. However, domestic inflationary pressures continue to pose serious challenges to macroeconomic management, especially 2010–11 onwards.

The macroeconomic problems of India are much more important than their apparent implications. Collectively, they represent persistent obstacles in India's efforts to sustain a period of rapid economic growth and utilise the opportunity to pull millions of poor out of poverty. Precious policy time and resources are spent on either preventing or resolving the various macroeconomic problems, including the financial crises, rather than focussing on the more fundamental and structural problem of poverty eradication and human development through stable, sustainable and inclusive growth. The NSS estimates suggest that in 2010, poor people in India numbered around 354 million, or constituted 30 % of the world's poor people (1.2 billion). Thus, every third person in the world living in poverty was in India. The situation has reportedly improved recently as the number of poor in India declined to 269 million in 2011–12,[4] thanks to a rise in real wages and an increase in consumption expenditure. However, the Rangarajan Committee Report (2014) has suggested that 370 million Indians are still living below the poverty line as against the NSS estimates of 270 million people, based on the Tendulkar formula.[5]

The problem of poverty is accentuated by the exclusion of the rural and urban poor from the recent high economic growth process, resulting in a significant increase in income inequalities. "India has more absolutely poor people than Africa and more billionaires than Britain."[6] Statistics suggest that poverty in India is on a declining trend. However, the question persists whether the pace of poverty reduction is sufficient and whether the drivers of poverty and its risks have been adequately understood? In order to rapidly eliminate poverty, the various risks that people are exposed to need to be effectively managed. Perhaps, the problem can be tackled when economic growth picks up and becomes more inclusive. "India's growth story riding on the wave of fundamentals such as demographic transition, human capital

accumulation, improved incentive structures, diffusion of new technologies such as IT, total factor productivity accelerators ...and an improved security environment – will be growing at growth rates, which can be above 10%" (Kelkar, 2005).

Risks of the Poor People

The factors that cause the actual net income (adjusting for expenditure) to fall below the expected or projected income can be termed as risk. Risk can affect people on the income side and/or the expenditure side. A daily wage earner not finding employment on a given day, a farmer losing his crop due to unexpected rains, an entrepreneur not receiving timely payments for the supplies made by him, a barber not getting the expected number of customers, etc. illustrate the point that the poor—hereafter termed as low-income populace (LIP)—are exposed to significant financial risks. When the LIP is forced to incur major expenditure on account of ill-health, demise of an income-earning member of the family, social events like marriage, etc., they indeed face significant financial risk as the unexpected expenditure lowers their net income. In many cases, the LIP finds it difficult to finance such unexpected expenditure items and is forced to borrow. Given the time constraint, or lack of collateral security or awareness, they often borrow from informal channels, such as money- lenders, to meet those contingencies. The reluctance of banks and other formal financial institutions to lend to the LIP, unless mandated by the regulators/government, results in several restrictive practices and barriers to the LIP in borrowing from the formal financial system. Inclusiveness therefore has been suffering at the hands of formal financial institutions to a large degree.

Low human development indicators, such as poor health conditions, lack of adequate nutrition, alcoholism, etc., are often associated with the increasing financial risk of the LIP. Macro issues, too, can add to the risks emanating from the personal lives of LIP. Volatility of output in the agricultural sector has been very high, and this affects the income of a majority of the LIP. Two-thirds of India's LIP depends on agriculture for its livelihood; the volatility of output due to poor monsoons and other factors

directly expose the LIP to financial risks. A welcome change in this aspect is the decline in the absolute number (the share of agricultural labour in the total workforce has been declining for a while) of agricultural workers, beginning in 2009–10, probably for the first time in the history of independent India. This reflects an increase in the real wages in the agricultural sector and in the consumption expenditure of agricultural labour. But this has raised issues like urbanisation and associated challenges, and the sustainability of employment in the manufacturing and services sectors (particularly in the construction sector).

The recent focus on fiscal consolidation may have quite unintentionally added to financial risk of the LIP. Ever since the government reduced plan expenditure, micro, small and medium enterprises (MSMEs) that depended on governments departments for orders have faced severe business problems, leading to industrial slowdown and loss of jobs and thus aggravating the problems of the LIP. The piling up of receivables has resulted in serious cash flow problems for MSMEs, asset quality problems for the banks that have lent to these MSMEs, and salary arrears for the employees. This may be one of those cases where *well-intended policies can have unintended consequences*. The proposal mooted by the Raghuram Rajan Committee on Financial Sector Reforms in its 2008 report, *A Hundred Small Steps,* to develop exchanges to trade the receivables of SMEs is a ray of hope in this aspect (GoI, 2009). It is heartening that hoped that the innovative idea is being implemented to address the cash flow problems of MSMEs, which is their main source of financial risk.

India's power shortage is leading to the closure of several SSI (small scale industrial) units that do not have the capacity to opt for captive power plants. This has resulted in the loss of employment for thousands of LIP. The energy crisis has become a direct source of financial risk to the LIP.

India was able to register high growth during 2003–08 thanks to a booming services sector. One of the problems of predominantly services-led growth has been that high economic growth is not translating into employment generation. This may have aggravated income inequalities. The future growth strategy of

India should keep this critical aspect in mind, lest the LIP continue to suffer due to subdued growth in employment in the organised sector.

More recently, India has been going through a phase of high inflation and low growth. This has directly affected the LIP in several ways. Not only are they the worst sufferers due to high inflation, they are also the worst affected when output falls, causing contraction in employment and reducing wage earning opportunities. The level of interest rates in the economy, driven higher by the persisting inflation, may have adversely affected economic growth and the earnings of LIP quite significantly, at least in the short run. Issues relating to higher prices, viz., lack of adequate storage and transportation facilities, restrictions on the free movement of agricultural products across the states, minimum support prices and huge subsidies, etc., may also have affected growth and employment adversely.

The global economic outlook continues to look weak, though signs of recovery are noticeable. The growth of the world economy has declined from 3.9% in 2011 to 3.1% in 2012 and further to 3% in 2013, and is estimated to marginally improve to 3.6% and 3.9% during 2014 and 2015 respectively (IMF, 2014). This has exacerbated the fall in international trade, employment and tourism, thus increasing the financial risk of the LIP.

Thus, there are a number of risk factors impacting the earnings and livelihoods of the LIP. But, what has been the response to tackle them? The following sections look at the legislative, executive and regulatory institutions in this regard.

Governance Challenges

Legislative: The legislative process, probably due to the multi-party democratic set-up of the country, has been slow and not very conducive to the enacting of sound legislations. For instance, during the **August 2013** session, Parliament could pass only **12** out of the **63 bills** that were scheduled for discussion. The major bills passed included the Food Security Bill, the Land Acquisition Bill, the Pensions Bill and the Companies Bill. In **2012**, Parliament passed **22 out of the 94 bills** listed for consideration during the

three sessions. As of February, 2014, there were **130 bills pending** in Parliament[7]. These included the Women's Reservation Bill 2010, the National Identification Authority of India Bill, 2010, the Direct Taxes Code Bill, 2010, and the Insurance Laws (Amendment) Bill, 2008. It took several years for many important bills, like Lokpal, Land Acquisition and Food Security, to be passed by Parliament. Measures such as FDI in retail and insurance providing for FDI investment have been passed only in the 2014 Budget session. Though MGNREGS has been put in place, there is considerable scope for improvement in its implementation. The scheme has given temporary financial relief to the LIP, but it may have increased their risks as the productivity of the target population has been crippled and the input cost of labour, especially in agriculture and the rural economy, has structurally pushed inflation upwards. Although the Food Security Bill has been passed, and could provide the necessary support to the LIP, its effective implementation remains a question mark as it involves the cooperation of the state governments in full measure.

Executive: Corruption charges were at their peak across all segments of the administration and at all levels of government in the recent past. Corruption at the grassroots level directly impacts the LIP. Corruption at the top indirectly affects the LIP due to the transfer of public resources to the private sector/entities, policy inaction or delay, or regional imbalances. The political executive and the bureaucracy are supposed to keep each other under check to protect the interest of the people. However, the ordinary citizen often finds that they have joined hands in pursuit of mutual interests at their expense. Corruption has, therefore, become a major tax on the LIP; and the governance function, instead of reducing the risks to the earnings of the poor, has itself become another source of risk to the LIP. A major disappointment in this area has been the non-implementation of the recommendations of the Second Administrative Reforms Commission made in its report[8]. Indeed, one area that has not been subjected to major reforms since the introduction of economic reforms in India has been that of public services. Take, for instance, the case of entry barriers to civil services. Lack of lateral entry into the civil services deprives the country of the benefit of utilising the expertise of

many an accomplished Indian wanting to join the services and make a difference to public policy formulation and implementation. Reforms are urgently needed to improve the overall competence, commitment and composition of the administration machinery, since those who man it are responsible for the implementation of policies. *Policies can only be as effective as their implementation; therefore, implementation issues need to be addressed urgently.*

A related issue is that of electoral reforms. Increasingly, the demand to make voting compulsory is getting louder. Further, the Supreme Court has already mandated that the voter be given the choice to reject all the candidates in a particular election. This was implemented in the 2014 general elections by providing the electorate with the NOTA (none of the above) option. The Aadhaar card—carrying the unique identification number issued to each citizen by the Unique Identification Authority of India (UIDAI)—and other voter ID initiatives could lower the incidence of bogus voting. However, certain problematic issues with *Aadhaar* need to be addressed. For instance, the Supreme Court has ruled that *Aadhaar* suffers from process and sustainability issues and is causing unintended consequences for the personal security of the citizens. It called for dissociating the instrument from all the enabled payments. The government, however, has decided to better manage the subsidy regime and plans to revitalise and use the *Aadhaar* cards extensively so as to effectively target the subsidies to the deserving populace. Very few would disagree on the need for a unique citizenship identity that will enable access to information and assets as also facilitate receiving all the entitlements in a rightful manner.

In a country with world-class IT prowess, India needs to develop an IT-enabled voting option to boost the voting percentage and make the election process more simple and relevant. If this can at least start with the Companies and Cooperatives, it will usher in good governance in the organised sector, first.

Regulators and Institutions: Regulators have begun focussing on the LIP recently through rigorous financial inclusion and literacy

drives, and consumer protection policies. A national financial literacy plan has been announced. Banks have been directed to make savings and credit products available to the LIP. Their access to credit from the formal financial channels is miniscule. Development finance needs to be encouraged by the regulators and financial institutions in a significant way. This requires a fundamental shift in the way banking is understood and banks function. Micro-savings, micro-finance, remittances and insurance are the four pillars on which a bank for the LIP should operate. Institutional innovations are required to help the LIP do banking in a cost-effective and convenient way. The recommendations made in the Report of the Nachiket Mor Committee on Financial Inclusion (2014), in particular on licensing payment banks, are encouraging in this direction. While the efforts to push through financial inclusion via the existing institutions are laudable, the impact may not be significant. Take the case of farmers. How many of them enjoy timely and adequate credit from banks? And is the delivery painless? The answers to these questions are, unfortunately, negative. The story of marginal and small farmers and MSMEs is even worrisome. Millions of daily wage earners, self-employed people, unorganised service sector professionals, etc., in the country may not be able to borrow for genuine business and personal needs. The credit flow to MSMEs is also not very encouraging. If India is to eradicate poverty, this scenario must change. Timely and adequate availability of credit to those who need it in the unorganised sector and to the millions of MSMEs is an essential aspect of financial inclusion. MSMEs create jobs and enable the LIP to free themselves from the clutches of moneylenders and make use of the financial services offered by the formal financial system.

The above-mentioned growth concerns, the emerging risks and governance responses are discussed in greater detail in the subsequent chapters of the book. In order to present the discussion in a cohesive manner, the following aspects have been kept in mind.

(i) In an inter-connected world, the growth process is dependent on not just the domestic drivers, but also the global developments.

(ii) Growth is critical to the welfare of the LIP. Sustainable and stable growth in a low inflationary environment benefits the LIP in the long run.

(iii) Given the nature and impact of different risk factors on economic growth and on the LIP, sound policies and governance mechanisms are required to measure, mitigate and manage these risks.

(iv) Ultimately, growth should lead to human development. High growth and poor indicators on human development could suggest governance deficit. Growth and Governance is the need of the hour for the country to pull millions out of the poverty.

Structure of the Book

The Prologue (Part I) opens with the Introduction and is followed by Chapter 2, which has a brief discussion on the problems of the Indian economy. Part II of the book, titled Sectoral Risks and Emerging Challenges, contains Chapters 3, 4, 5, 6 and 7—each devoted to a detailed discussion on a specific sector of the economy. The Epilogue comprises Chapter 8, which delineates the governance challenges, and Chapter 9, which proposes an agenda for action. Brief summaries of the various chapters are presented below.

Chapter 2: Problems of the Indian Economy

The Indian economy faces several problems, some of which are specific to the domestic environment while the others originate from the global economic environment. The discussion on domestic problems is organised on three different trajectories. These are: problems related to the agricultural sector, the manufacturing sector and the services sectors; the problems being tackled through fiscal and monetary policies; and the problems related to economic performance with reference to growth, inflation, fiscal and current account deficits, human development, and governance. Problems related to the international environment and their impact on India is presented mainly with reference to the financial crises, global competitiveness and management of the external sector.

India's current problems are low growth, high inflation, high deficits (fiscal and current account), low human development, non-inclusive growth, and poor perception of governance. Trade deficits and reliance on foreign capital are the worries on the external front. The frequency of the financial crises, the pressure to comply with the expectations of international investors and opinion-makers (like rating agencies), and persistent volatility in the currency markets are consuming scarce resources and require a lot of attention from policy makers. As a result, the more fundamental and persistent problem of human development, especially poverty, has been relegated to the back seat. The various drivers of human development—literacy, income, food security, housing, healthcare, sanitation, access to financial services—need to be strengthened with urgency and purpose. Newer problems, like energy shortage, water scarcity and inter-state river water disputes, pollution, loss of productivity due to lifestyle diseases, and urbanisation, require innovative and durable solutions.

Chapter 3: Agricultural Sector

While the share of agriculture in India's GDP has declined over the years, the economy is still largely dependent on agriculture and the monsoons. Agriculture suffers from low productivity and is highly risk-prone. Agricultural markets are unorganised and dominated by middlemen, with the producer hardly getting a fifth of the market price. Urbanisation, and demand from industries, services and the infrastructure sector have put pressure on land, leading to further fragmentation and depletion of cultivable land. The labour shortage has been aggravated by the growth of the services sector in urban areas; the introduction of MGNREGA may have pushed up the cost of cultivation, thereby impacting production. Mechanisation remains expensive and is not easily accessible to small and marginal holders.

Supply of surface water is riddled with uncertain monsoons and untimely rains. The demand for water from industries and urban populations results in scarcity, which is further exacerbated by inter-state disputes. Climate change adds to the desperation of farmers. Resort to ground water needs substantial investments and large quantities of power, resulting in shortages and problems

of low voltage. Lack of adequate fuel resources, the high cost of fuel, populist politics and irrational subsidies have compounded the problems of the energy sector. Spurious inputs, such as poor quality seeds and fertilizers at high prices, pervade the market. State governments have failed to make adequate quality inputs available on time. Extension work and technical inputs are hardly visible these days.

Capital formation in agriculture is negligible thanks to unremunerative operations. The entry of large corporations and contract farming is confined to isolated pockets and is sporadic, devoid of adequate safeguards for farmers. Credit flows to the agricultural sector from banks are not up to the desired level; moreover, they are hindered by the loan waiver policies of the state governments, destroying the credit discipline of farmers in the process. The huge amounts involved in the write-offs of loans could be productively invested in creating a robust risk-mitigating mechanism for lasting long-term benefits.

If food security, as envisaged in the National Food Security Act, 2013, is to be achieved, substantial investments are needed in R&D in various areas that impact agricultural production. Appropriate and rational self-sustaining insurance schemes have to be introduced to safeguard against unforeseen crop failures. Creation of good storage and transportation infrastructure closer to the producing locations will not only help farmers but society at large by avoiding wastage and damage. Information-based marketing inputs should be easily accessible to the farmers.

Agriculture by itself cannot be viable. It has to be supported by the coordinated development of allied activities for supplementing the resources of farmers and providing a measure of protection against the ups and downs associated with agriculture, particularly on account of the vagaries of weather.

The growing population coupled with the increased global demand for quality food (such as increased protein intake) will pose a formidable challenge to agricultural production and the management of food inflation. The quality of governance could decide the future course of the agricultural sector and food security in India.

Chapter 4: Manufacturing, MSMEs and Global Trade

The manufacturing sector seems to be at the tail end of the structural changes that the Indian economy is undergoing, with its share hovering around 14–16% of GDP. With a share of just 1.8% in world manufacturing, India is way behind China, which has a share of 13.7%. The National Manufacturing Policy, 2013 aims to increase the share of manufacturing to 25% of GDP by 2025, which would take India to the fifth rank in world manufacturing. Technology and quality, skill development, the business regulatory framework and environmental sustainability are the identified areas for bringing in the paradigm shift. The National Business Facilitation Grid, a catalogue of all industrial regulations, national investment manufacturing zones, and several sectoral initiatives constitute important pathways in the process. The risk map indicates that land acquisition, water and power availability, contractual rules, and implementation management would be the key drivers in the mitigation effort.

MSMEs are seedbeds of entrepreneurship. They are viewed as effective instruments of inclusive growth. Their heterogeneity and unorganised nature, spread over 6,500 products, have to be factored into the policy framework for growth. The risks in this sub-sector are manifold, as detailed in Chapter 4: entrepreneurial risks, enterprise risks, financial risks, environmental risks and sovereignty risks, often overlap, thus affecting the sustainability of MSMEs.

An elaborate elucidation of the financial risks which could affect the growth of the economy highlights, the measures taken so far have not taken this sector very far, in terms of insulation from the risks. Credit delivery systems, the Cluster approach, and guarantee mechanisms have also been dealt with in considerable detail. The Chapter suggests a greater and more productive role for factors as means of payments and settlements between the MSME vendors and the PSUs and the government as vendees. Apart from promoting without recourse factors, for which legal amendments may be necessary in the appropriate law of contracts governing them, there is a suggestion that the GoI may give budgetary grants to hedge the viability gap funding of factors.

This would substantially reduce the NPAs of the MSME sector. An active role for the business development service (BDS) providers, setting up financial parks for MSMEs in key states, monitoring attitudinal changes within financial institutions, and actively promoting SME exchange, limited liability partnerships (LLPs), and venture capital funding for start-ups are some of the other risk management mechanisms suggested in this chapter.

While diminished, the downside risks to the global economy persist. These include stalling of progress on the euro area crisis, debt and fiscal issues in the United States, the possibility of a sharp slowing down of investment in China, and a disruption in global oil supplies. In this weak external environment, growth for developing countries will need to come from within, by strengthening governance and investing in infrastructure, education and healthcare.

This chapter also discusses at length the regional trade and free trade agreements vis-à-vis the WTO and the implications for the developing economies. Progress on agriculture is long overdue. Trade liberalization in farm products has moved slowly. The Agreement on Agriculture has been under discussion since 1998 with the last round at Bali in 2013 arriving at a modicum of consensus yet to be firmed up. WTO meanwhile clinched the first global trade deal in November, 2014. Japan has been one of the most egregious offenders with its duties on most grains still hovering around 60%. America and Europe have not been substantially accommodative on tariff reductions in farm products during the NAMA (non-agricultural market access) negotiations. Trade risks have been the focus of discussion in this chapter in the backdrop of TRIMs and TRIPs, recent judgments of the WTO and India's highest judiciary body, particularly the Supreme Court's rulings pertaining to the pharmaceutical sector.

Chapter 5: Services Sector

The services sector has witnessed speedy growth and its contribution to India's GDP has been substantial. The sector created large-scale employment opportunities across the spectrum, in the public and private sectors and at various levels of the pyramid. The services sector spans businesses of various sizes,

from a small self-employed entrepreneur to a multinational conglomerate. This sector too is exposed to a wide range of risks. While certain measures can be taken by the service provider, a key role is to be played by governments. Governance inputs play a major role in deciding the success or failure of a unit.

There can be business and financial (credit, market and operational) risks which have to be monitored, measured and mitigated effectively. Regulators of the different service sectors have stipulated certain measures that are to be taken by the service organisations to protect the interests of the consumers. Those organizations that are not subject to any regulation have to take cognizance of the risks and take appropriate and timely steps on their own to avoid failure or losses.

For financial institutions, risk management is critical as most of them deal with public funds as trustees. As a first step, they have to bring in enough capital for doing business and always have to maintain capital adequacy. The Basel Committee on Banking Supervision (BCBS), located in Basel at the Bank for International Settlements (BIS), has prescribed certain criteria for this purpose. In addition to its overriding objective of strengthening the security and reliability of the international financial system, BCBS also defines minimum international standards and guidelines for banking supervision and disseminates and fosters best practice and common methodologies in banking and supervision. In December 2010, the Basel Committee on Banking Supervision published a reform package called Basel III[9] (BC, BIS, 2010) to complement its existing international regulatory standards. It incorporates the lessons learnt from the recent financial crises. The reform aims at revising capital adequacy and liquidity requirements and making the banking sector more resilient. In the event of problems arising in the financial sector, the reform package should reduce the danger of a negative impact on the real economy, regardless of the shock trigger. BCBS has issued guidelines for identifying and measuring risks and assigning suitable risk weights to all assets for arriving at the capital requirement. It is necessary for business enterprises to have proper credit/loan policies to protect against default and losses. Rational credit appraisal and rating mechanisms have to be laid down for

assessing the risks associated with an asset. Effective recovery machinery for initiating prompt action should be in place, should a default occur.

Most organisations suffer due to changes in the market conditions. Whether it is movement of interest rates or market liquidity, if the unit does not assess the impact on its assets and liabilities and, in turn, its profitability and is not well prepared with contingency plans, it would suffer financial losses and a liquidity crunch. Inability to meet obligations in time could result even in closure of the organisation apart from huge financial losses. The failure of a large number of financial institutions of long standing, in the wake of the financial crisis of 2008, is a clear case in point. Asset liability management, therefore, assumes great importance in this context.

One fall-out of the globalisation of markets is the exposure of organisations across the board to exchange risks, which need special treatment by knowledgeable persons. The risks that arise on account of currency rates are not easily understood and need to be closely monitored to prevent losses arising out of international business or financial transactions. Chapter 5 discusses the exchange risks and efficacy of various tools available for risk mitigation, such as forward contracts, options, futures and a host of derivative products. Even the market regulators and courts had to intervene to stem the rot on account of speculative and imprudent use of complex derivatives in the recent past.

Operational risks are all-pervasive and can hit an organisation, big or small, due to the lack of proper systems and procedures for monitoring and checking the operations in all the functions at all geographical locations. These risks could be internal or external and arise out of faulty or inadequate policies and procedures or the people formulating or implementing them. While financial losses are common, it is not uncommon to suffer reputation risk, which in turn causes market risks and financial losses. HRD has a crucial role in monitoring and preventing operational risks. Technology and outsourcing of certain functions can lead to different kinds of operational risks. They too need to be mitigated with sound policies and close monitoring.

Innovations can be positive but are not free from pitfalls. Knowledge management is important for innovation. An effective audit and inspection function within the organisation can support the audit by an external agency or statutory auditors.

It has been observed that in every sphere of risk management, the quality of governance by the managements or boards plays a crucial role. Good corporate governance leads to the healthy functioning of an organisation.

Chapter 6: Energy Risks

Energy is not just a commodity – it is the very basis of our existence. The demand for energy is inelastic. The growth of an economy is heavily dependent on the energy sector. The very nature and type of energy source that an economy predominantly relies upon is related not just to the domestic supply and demand position but also to global factors.

India is an energy-scarce country. The demand for energy will continue to be on a linear growth curve as the economy is on the growth path. Further, there are sub-sectoral deficiencies across the states, which are unable to manage either supply or demand effectively. The various sources of energy—hydel, thermal, bio-fuel, nuclear, solar and wind—have different cost and benefit streams. And when they join the national grid for distribution to the user system, both individual and systemic risks create fissures in the distribution channels. Climate change accentuates these risks. In the context of global experiences, the Chapter deals with energy risk management from the governance perspective. The chapter is divided into four major parts: *(i)* Sector Outlook: Characteristics of Energy Inputs; *(ii)* Global Positioning of the Energy Sector in so far as it relates to India; *(iii)* Risk Map; and *(iv)* Risk Mitigation Measures. Supply-side risks, demand-side risks, distribution risks, product and price risks, financial risk management of the energy sector, and manpower risks have found exhaustive analysis in this chapter in the backdrop of the objectives of energy policy set out in the Twelfth and draft Thirteenth Five-Year Plans drawn up by the Planning Commission.

Chapter 7: Water and Environment

With a population of over 1.3 billion (17% of the world's population), India has only around 4% of the world's renewable water resources. Its geographical area is 329 mha, of which 180.6 mha is arable; 142 mha is the net sown area, of which 57 mha is irrigated (GoI, 2013). India has the largest irrigated area in the world. The country's total drainage area is divided into 24 basins, of which 13 major basins have a drainage area more than 20,000 sq km.[10]

The first **National Water Policy of 1987**[11]explicitly stated water allocation priorities, but issued a caveat that the priorities might be modified if necessary in particular regions with reference to area specific considerations. The 2002 policy deviated from the National Water Policy of 1987 by removing this rejoinder, and juggled and added priorities to include ecology and navigation, and divided industry into agriculture-related (agro) and otherwise. The **2002 water policy** also encouraged private sector participation in planning, development and management of water resources. The Public-Private Partnership (PPP) model is envisaged to tackle supply-side risks and for effective demand management. The draft policy mentions that the "service provider" role of the state has to be gradually reduced and shifted to regulation and control of services. The policy states that water-related services would be transferred to the community and/or the private sector within an appropriate PPP model under the general superintendence of the state. The **water policy** of **2012**[12] highlights the promotion of climate change adaptation strategies like increasing water storage, better water use efficiency, proper demand management, incorporation of coping strategies for possible climate change effects during the formulation of mega water projects, and enhancing the capabilities of communities to adopt climate-resilient technological options. Chapter 7 also discusses various river water dispute resolution mechanisms and the risks of such disputes, which are detrimental to economic growth.

Chapter 8: Governance Challenges

Recent developments in India have starkly brought to the fore the need for governance reforms. Various studies have highlighted, inter alia, the positive impact of institutional quality and good governance on growth, poverty, reducing income inequality and financial development. India's governance is besmirched by corruption scandals; the lack of political will to come together to vote for growth-enabling reforms; lack of incentives for domestic industry to invest in India; state ownership in many areas that no longer serves the public interest; and a private sector that has tried to grow at the cost of the public sector. Except on political stability, India has not been rated well on the various governance parameters; the country's position has deteriorated in world rankings in the recent past. The need for reforms in the civil services and local governance has been highlighted by the Second Administrative Reforms Commission, which have not been implemented. The New Companies Act, 2013, and the guidelines issued by SEBI may improve corporate governance standards in the country; but the governance of other segments – such as MFIs– is still to be streamlined. Improving the decision-making process in a coalition government set-up; strengthening the implementation of various policies and schemes by the civil servants; improving the quality of boards and governance in the corporate sector; and regulating the financial sector to promote stable and inclusive growth are some of the governance challenges facing the country.

Chapter 9 presents an agenda for action and summarises the main conclusions of the authors.

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End Notes

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