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INFUSION NOTES

WHEN ONLY THE BEST WILL DO

U.P.S.C.

ENGLISH MEDIUM

LATEST EDITION

HANDWRITTEN NOTES

PRE+ MAINS

General Study paper - 3

Part – 1 Indian Economy (part – 1)

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UNION PUBLIC SERVICE COMMISSION (U.P.S.C.)

GENERAL STUDY PAPER – 3

Part – 1 Indian Economy (Part - I)

PREFACE

Dear Aspirants, Presented Notes "**UPSC – CSE (PRE + MAINS)**" have been prepared by a team of teachers, colleagues and toppers who are expert in various subjects.

These notes will help the Aspirants to the fullest extent possible in the examination Of Civil Services conducted by the **UNION PUBLIC SERVICE COMMISSION (UPSC)**.

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Publisher :-

INFUSION NOTES

Jaipur, 302017 (RAJASTHAN)

Mob. : 01414045784, 8233195718

Email :- contact@infusionnotes.com

Website: http://www.infusionnotes.com

PRICE - ……

EDITION – LATEST (2022)

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CHAPTER -I

INTRODUCTION TO ECONOMICS

Economy and Economics

Economy is the social activity where people come together to produce, stock, distribute, trade and facilitate consumption of goods and services. The entire activity is meant for the market-that is for selling. Goods and services may either be exchanged for other goods and services (barter) as it used to happen as a practice in primitive economies or they are exchanged for money which is the practice for contemporary economies in the world. Economics as a term comes from Greek- means family, household, or estate and nomos stands for norm or law. The origin of the term itself is revealing. Be it household or village or a nation-state, the universally acknowledged reality is that people have limitless needs and the available resources to meet the needs are limited. What is the norm at the micro level (household) is true for the macro economy as well- be it at the national or even global level. The need for the field of economics as a branch of social science becomes relevant to balance the needs with resources. Study of rational management of scarce resources is the substance of economics, Rationality is choosing the right means for the chosen end. Since last century, economic rationality which started with the study of production, distribution and consumption, has come to include equity and sustainability as well.

Economic growth is the quantitative difference in the production of goods and services between two points of time. If the difference is negative, it is called degrowth.

Economic development on the other hand qualifies economic growth with development in terms of education, health, equity and so on.

Economic policy is a government policy aimed at generating growth and development, among other aims. It has many subsets like fiscal policy, monetary policy, industrial policy, agricultural policy, foreign trade policy and so on.

We need to understand economics as a discipline based on scarcity. Take for example, land. It is a scarce resource. India has 15% of the global population but only 2.4% of the global land. Thus there is huge pressure on land. It is needed for agriculture (food and non- food); manufacturing; residential purposes and so on. The task of economics is to arrive at optimal ways of prioritizing the use of such limited resources. Land Acquisition and Rehabilitation and Resettlement Act 2013 address the land claims of farmers, industry and other sections in a balanced manner.

Similarly, water is scarce and is becoming even more so. There are demands for agricultural,industrial, domestic and other uses. How to apportion the existing amount of water among all these users is a public policy challenge tackled in the Draft National Water Policy (NWP, 2012).

Same is the purpose of the food security law. Food security is essential for welfare as well as productivity. Being a welfare state, Government is committed to it. But there are many operational challenges relating to the quantity of food that can be given at concessional prices and the methods of distribution should it be through government outlets or by public private partnerships (PPP). Besides, the extent of food subsidy- the gap between the market price and the *government price- is also a critical matter as it impinges on government finances and influences the market prices. Economics as a field of study draws from experience, within the country and from other countries and advises on public policy.*

Initially, economics focused on wealth and later welfare. That is, initially, what mattered was creation of wealth at any cost. It did not interest economists to be sensitive to the human dimension- the misery that it produced. Later, by the late 19th century, there was hue and cry about children being made to overwork and receive paltry payment for their work; the inhuman conditions of work, the squalor and so on. Some even justified it on grounds that it gives comparative advantage in trade as it cuts down the cost of production. When there was relative prosperity and the government collected enough taxes and democratic dissent grew, welfare became the new concern of the discipline. Kuznets curve shows, in the form of an inverted U, the initial Increase in inequality and how inequality reduces with economic growth.

In the study of government policies,from the perspective of economics, there are trade offs because scarcity of resources is the overriding assumption of the discipline. Tradeoffs involve making choices in policies wherein there is a compromise on one goal to achieve another goal. It is a way of balancing among desirable goals. Multiple examples can be given.Reserve Bank of India aims at price stability which is the overriding objective of its monetary policy even as some growth is eroded in the process. Thus, a bit of growth is traded off for price stability.Similarly the government wants to give subsidies to the poor and weak.It may mean more borrowings and thus some fiscal excess but poverty is addressed and thus political stability is gained.thus, fiscal prudence may be traded off to some extent in pursuit of welfare. Similarly, public investment is crucial and so is the need to limit government borrowings. Setting the right level of balance between the two involves a trade off. Fiscal Responsibility and Budget Management (FRBM) Act laid down 3% of annual central government borrowing whereby infrastructure investment is facilitated even as government finances are partly strained. In the land acquisition law, compensation for the land owners is increased to balance the interests of the farmers and industrialists. Investment may moderate in the process, but social justice gets addressed. Land is to be acquired for manufacturing and consent of the land owner may be conditionally dispensed with in public interest- that is the tradeoff. Property rights are relaxed, compensation for the land owner is raised; and land is diverted to industrial use as its productivity is more compared to agricultural use.

The concept of tradeoffs is related to opportunity costs. Resources like money or land, for example, can be pulled to multiple uses. Choices have to be made as to what is the best way to use resources. The choice that is made is in preference over others. Among the competing choices, the best course of action is chosen and others are discarded. The cost of discarding the second best choice is the opportunity cost. Literally, it is the cost of the second best opportunity that is not chosen. For example, money can be deposited in a bank earning interest or invested in the stock market. If the latter is preferred, what is foregone, the interest that the money would have earned in a bank, is the opportunity cost. In government finance, the concept is at times relevant. For example, should the government borrow money and invest or allow the private sector to do so.

There is government land in a city and it can be used in many ways and the work of the economist is to choose among the following models that we can speculate upon-

1. build hospital or school
2. build municipal park
3. give it free of cost to a private investor who will build a hospital or school and provide free services to poor and low income groups.
4. auction it to the highest bidder.

Which choice is made depends on many considerations- government's financial position, availability of private sector talent etc. Whichever choice is made will have an opportunity cost as described above.

As mentioned above, the study of economic activity called the discipline of economics began with focus on growth which may also be understood as wealth generation. Adam Smith, regarded as the Father of Economics and author of the classic "An Inquiry into the Nature and Causes of the Wealth of Nations" defined economics in two ways. One corresponds to the title of his book as the science of wealth. The other definition is a predictable one: the science relating to the laws of production, distribution and exchange. He called economics a science but that is debatable though the urge to make it science is laudable.

Initially, the definition in terms of wealth creation was attractive but later it dawned that it meant that economic growth at any cost in the name of wealth was at the expense of equity and the social groups that could not participate in the market economy were seen as liabilities. For example, women, children and old people. Misery of the week was taken as a necessary price for economic growth. Such a perspective being unconscionable in democratic terms underwent evolution with markets with a human face' opinion gaining ground. There was a demand to balance wealth creation with focus on social and human welfare. Thus came the shift in the focus to welfare economics-growth should be accompanied by equity. All social groups should benefit from economic growth. It was achieved partly by factory legislation demanding of the employers that they limit work hours and provide just and humane conditions of work. Partly, the fiscal position of the government with tax collections also enabled the emergence of a welfare economy. Economics as a study incorporated social justice and not money and goods alone.

As the production process evolved and as more problems cropped up, the discipline expanded bringing within its fold the need to balance growth with human development, environmental sustainability, human happiness and so on as we will see ahead.

Macro, Micro and meso economics

Macroeconomics, which deals with the entire economy of a given unit- province, nation or the world itself. For example, variables like the size of the economy in the form of national income, economic growth, inflation, employment, foreign trade, poverty, inequality are the phenomena that characterize the economy as a whole, though with local variations.

Microeconomics, on the other hand, studies the units of the economy and their behavior:consumers, sellers, business firms etc.

The two belong to the same economic system and influence each other. Interest rates are a macroeconomic feature but they impact the consumers, traders and firms. Taxes influence prices and thus consumption and investment decisions. Consumer and business confidence depends on the state of the economy. Consumer confidence or sentiment is the optimism of the consumer about the economy and their financial position. If they are confident, it is reflected in purchases and sales and thus economic growth. Similarly, business confidence helps in investment and growth picking up. These micro and macro factors feed into each other.

'Mesoeconomics' studies the intermediate level of economic organization in between the micro and the macroeconomics like study of a sector of economics like auto, infrastructure may be considered mesoeconomics while the study of each unit may fall under micro.

Political economy

We need to understand another approach to the study of economic activity. It is the school of political economy. Its position is that politics and economics need to be studied together to understand why public (government) policy takes a particular direction. For example, land reforms are a political decision for re-distributive justice. But its impact is on economic productivity, investment in agriculture, agri-exports, employment and so on. To understand land reforms, we need to understand the politics of social and economic justice. Similarly, bank nationalisation had costs and benefits. To see why the policy was adopted in 1969 and 1980, the political dimension of financial inclusion, checking concentration of economic wealth and planned economic development need to be grasped. The two can not be separated. Equally, the entire economic model based on liberalisation, privatisation and globalisation that became the global norm since 1980's can be understood only from the political perspective of retreat and demise of communism as a political idea. The de-globalisation that started some years after the 2008 global financial and economic crisis that is reflected in economic nationalism (nation's resources should be used for the nationals themselves with a limited view as to who make up the nationals), protectionism (protecting the domestic economy with high tariff walls on imports and restrictions on inbound foreign investments) and trade war (nations fighting with higher tariffs to weaken each other) can be understood only as a subject of political economy. It aims at addressing the anxieties of those who lost in the globalisation process like workers. Thus, it is a political response to popular demands expressed as economic policies.

If we take the example of demonetization that took place in India in 2016 which is a millennial event, the entire process of choosing to embark on it was a political choice aimed at eliminating black economy and enforcing fiscal laws strictly; while the economy went through so many fundamental effects of it- banking, fiscal, industrial, agricultural etc.

In China, a political party, Communist Party of China, decided how the economy should be structured. The priorities and policies of the economy drastically altered according to the beliefs and biases of the political party and its leaders.

Politics sets the larger framework in which the economy operates. Thus, understanding the two as they interconnect is the substance of political economy studies. While politics sets the values, economists set the prices! In simple terms, political economy describes production, buying and selling, and their relations with law, custom, and government, as well as with the distribution of national income and wealth. It refers to examining how political forces affect the choice of economic policies. We can further elucidate the political economy with the examples of liberalism, neo-liberalism and socialism.

Liberal and neo-liberal economics

Liberalism as an economic philosophy is founded on the belief that individuals are rational in the decisions they take in the economic system. Producers produce goods and services that are in demand. Consumers send their money to realise maximum value for it. The rationalities of all the economic actors- producers, traders, consumers and others add up to a collective and systemic that guides the economy well. Based on this premise, Adam Smith said that there is an 'invisible hand' (collective rationality) that steers the economy well and so there is no need for State regulation. In other words, the self interest of each when rationally followed becomes the common interest of all. State should only provide support services like public goods- police, judiciary, essential infrastructure etc. The euphoria in markets that is based on the principle of laissez faire(French term that literally means 'let do' and practically stands for minimum government controls by way of laws and regulations in economic transactions) did not find justification in decades that followed the industrial revolution in the mid-18th century. Thus, the central premises of liberal school were –

1. individual economic actors are rational and so
2. States need not regulate their actions by way of too many laws.
3. State should provide only public goods and thus facilitate economic activity; and
4. economy should be left to the market forces- laissez faire.

Liberalism as a philosophy suffers from many infirmities

- The rationality of the producer is to maximize profit and if human misery, steep economic inequality and environmental degradation result from it, liberals after Adam Smith had no answer.
- Market failure also is a relevant issue: market failure is defined as an inefficient distribution of goods and services in the free market which has negative implications for vast pockets of society and geographies.
- Consumer rationality is distorted by lack of reliable information.

While the economies grew initially based on the above philosophy, there was widespread poverty and exclusion created by the economic growth. As a reaction, welfare and socialist schools of economics emerged. However, by the late 20th century, liberalism found renewed favour with the world after all other models of growth showed their inadequacies as we will see thead. The return of liberalism late last century is known as neo-liberalism (any school of thought that returns after decline is given the prefix, neo).

Neoliberal philosophy did not change much from liberal assumptions and policies. After all, it returned to popularity because its adherence to the free market economic model was proved historically right as communist command economies with state ownership did not yield long term growth and proved to be antithetical to innovation and entrepreneurship. Neoliberals championed earlier for withdrawal of State from economic activities, globalisation, privatisation, price deregulation, a reduced size of government (that government is the best which governs the least). Margaret Thatcher who was British Prime Minister between 1979 90 nationalised many industries and utilities: steel, railways, airways, airports, gas, electricity, telecoms and water. Donald Trump, American President, discarding the Obamacare health insurance programme and cutting down the corporate tax rates steeply are two typical examples of neoliberal preferences. Neoliberalism is the same as Washington Consensus - the free market approach of the IMF and other institutions. Individualism, competition and economic rationality and efficiency are its basic values.

India's economic reforms since 1991 are largely centred around it.

While supporters of neoliberal school cite the above advantages, critics hold that inclusivity suffers; inequality sharpens; public services will be neglected and even rolled back; education and health, when privatised will harm public interest; environmental degradation could deteriorate as profiteering and 'growth at any cost' may become the motive; and so on.

Keynesian economics

It essentially believes in the liberal economic principles but distinguishes itself by its prescription when the economy slows down dramatically or stops growing or goes into negative mode of degrowth. The Keynesian solution is known as stimulus or pump priming the economy which is –

- government should borrow and spend on infrastructure and other core economic activity that leads to more investment by the private sector and thus public and private sector investment converge to create employment, business and demand. For example, Bharat Mala for national highways and Pradhan Mantri Gram Sadak Yojana (PMGSY).
- The central bank should reduce interest rates and make more money available to consumers and investors and thus create demand and supply.

It is a time tested solution for general macroeconomic slowdown. It was tried successfully across the world, including India, in the aftermath of the global economic crisis and deep recession that lasted for a few years since 2008.

Socialist and communist economics

Communist economics is complete ownership of the national economy in government hands and there is no room for private property. Socialist economics believes that a large part of economic resources should be in government hands so that inequality can be minimized and can give workers greater control of the means of production. It comes in many forms- Nehruvian socialism where there is a public and private sector coexisting and complementing the mixed economy. An extreme form of socialist economics is communist control where the entire economy is held by the State and there is no private property at all. For example, the Soviet economy and China under Mao Zedong (1893 –1976).

- Nehruvian economics is a subset of socialist economics. It is the thought of Jawaharlal Nehru
(1889-1964) who was the first Prime Minister of India. It rests on state-ownership of basic parts of the economy like infrastructure, higher education, metal and other industries etc. through centralized socio-economic planning. India adopted Nehruvian socialism a variety of reasons: Soviet Russia showed that it could be an expeditious way of achieving equitable growth; Nehru personally believed in the values of welfare state and equity; given the historical circumstances in which it emerged, self-reliance in economic growth seemed to make more sense; India

CHAPTER – 2

ECONOMIC GROWTH

Measuring Economic Growth

Economic growth is the change- increase or decrease, in the value of goods and services produced by an economy. It needs to be measured as government and private sector decisions and policies need a base for their actions. All important aspects of an economy are linked to growth: tax collections; interest rates; inflation and its expectations; employment; foreign trade and so on. Without measuring growth, there is no rationality in behavior- both public and private. Investment decisions depend on the growth and inflation rate, to give one example. That is the reason for the Central Statistics Office (CSO) of India to project growth figures weeks before the Union Budget is presented facilitating rational projection of revenues and expenditure which in turn influences the private sector decisions.

Economic Growth: Its Benefits and Side Effects

The first benefit of economic growth is wealth creation. It helps create jobs and increase incomes. It ensures an increase in the standard of living. Government has more tax revenues: fiscal dividend. Economic growth boosts tax revenues and provides the government with extra money to finance spending projects. For example, the flagship programmes of the government like Pradhan Mantri Awas Yojana-Gramin (PMAY-G), Pradhan Mantri Ujjwala Yojana (PMUY), Deen Dayal Upadhyaya Gram Jyoti Yojana (DDUGJY), Pradhan Mantri Gram Sadak Yojana (PMGSY), Ayushman Bharat, Saubhagya are a direct result of the tax buoyancy of growth. It sets up the positive spiral: rising demand encourages investment in new capital machinery which helps accelerate economic growth and to create more employment.

Side effects are the inequalities, environmental degradation, mental stress etc.

Need To Measure Economic Growth

The following aims can be attributed to the study and measure of economic growth:

- When growth is quantified, we can understand whether it is adequate or not for the given goals of the economy. We can understand its potential and accordingly set targets.
- We can adjust growth rates for their sustainability.
- We can prevent inflation or deflation to some extent if we see the performance of the economy in quantitative terms.
- We can balance the contributions of the three sectors of the economy and steer the direction of growth towards national goals- away from agriculture to manufacturing as in the case of India in recent years.
- target appropriate levels of employment creation and poverty alleviation.
- forecast tax revenues for governmental objectives.
- Corporates can plan their business investments.

Economic growth can also have a self-defeating effect: Environmental costs can be huge unless properly managed; Inequality can have polarizing effects causing instability due to radicalisation.

Thus, unless growth is measured, growth rates can not be calculated. In the absence of such data, economic rationality- both investment and consumption diminishes. The US economy in the Great Depression (1929-39) could have ended only when data was available. Therefore, Simon Kuznets, an economist, gave the notion of National Income in mid 1930's to capture all economic production by individuals, companies, and the government in a single measure. It is popularly known as Gross Domestic Product (GDP) and its variant, Gross National Product (GNP). Calculation of national income is a complex and elaborate exercise. The rules and formulae that are used to capture economic growth data and conclude on relevant statistics is known as national income accounting.

GDP is defined as the total market value of all final goods and services produced within the country in a given period of time- usually a calendar year or financial year or a fraction like quarter.

GDP and GNP

While GDP includes the production within a country by all producers- citizens as well as foreign multinational corporations, GNP captures all that is produced by the citizens of a country whether it is within the geography of the country or abroad. In other words, GDP is a geography related concept while GNP is a citizen related concept. GDP focuses on where the output is produced while GNP shows who produced it. GNP is GDP plus net factor income from abroad. That is, from the domestic product, we need to deduct what the foreigners have produced in the country and to that amount we need to add what citizens have produced outside the country. In the age of MNCs and globalization, one country's GDP is another country's GNP. For example: in the case of a German-owned car factory operating in the US, the profits from the factory would be counted as part of German GNP and US GDP.

If it is a highly globalized and competitive economy and many of its MNCs are operating in other countries, its GNP tends to be more. For example, Japan. Chinese GDP till last decade was almost equal to its GNP. But till last decade, there were many foreign MNCs operating in China and thus its GDP was far more than its GDP. But with China's Belt and Road initiative gaining ground, its GNP will outweigh its GDP.

In a closed economy relatively, GDP is more. For example, India till we opened up in 1991.

For most countries, however, GDP and GNP have more or less the same values.

Take the case of Ireland. Its GNP is much larger than its GDP. In Ireland, Google, Apple, Microsoft, Accenture and such other multinational corporations are headquartered due to the tax advantage they get as corporate tax rates are very low. They only have registered offices in Ireland without any production activity. The higher GDP value however is illusory as these companies are in reality non-Irish. Ireland is a tax haven, thus attracting companies to register there rather than giving them the ecosystem for production and innovation as China did since 1980's.

India's GDP is a little more than its GNP as inbound Foreign Direct Investment(FDI) is many times that of outbound FDI. That is, the Indian MNCs produce far less abroad than what foreign MNCS produce in India. There are remittances from abroad sent by Indians working across the world and they amounted to about US $69 billion in 2017 but that is outnumbered by the outflows on a variety of accounts- interest payments, royalty on technology etc.

GDP vs GNP

Analysts tend to say that GDP is a better measure than GNP. The reason is that GDP is domestic production where employment is created; inflation is moderated; tax revenues are more, exports can be made for foreign currency earnings that helps in foreign exchange reserve build up and so on. GNP also has its advantages and India is a big beneficiary of it- remittances from abroad; acquisition of foreign companies; invest abroad to tap on foreign opportunities etc. But the consensus is that former is of greater value than the latter for the reasons cited.

National Income and Gross Value Added (GVA)

National Income is calculated by deducting indirect taxes from Net National Product and adding subsidies. National Income (NI) is the NNP at factor cost.

NI= NNP- Indirect Taxes + Subsidies

GVA is GDP minus indirect taxes. It helps us know the tax-GDP link. If the output grows and the tax buoyancy is not commensurate, the meaning is one of the following or both: non-taxed part of GDP is growing (for example, agriculture) or there is tax evasion.

Potential GDP

The actual GDP is what is being produced. It can be boosted by a variety of means. Government can borrow more than is advisable and enable consumption through subsidies. Interest rates can be reduced to encourage consumption and investment but it has its own risks if the broader economy is not responding. Imports can be liberalized to encourage consumption. But its impact on trade deficit and currency valuation can be destabilizing. Thus, output growth has to be non inflationary and sustainable. Potential gross domestic product (GDP) is the level of output that an economy can produce sustainably and. without inflating the economy excessively. It is the 7 highest level of real gross domestic product (output) that can be sustained over the long term. Sustainability, as mentioned above, is in terms of prices, fiscal deficit, current account deficit (exports can not be boosted by devaluing the exchange rate as it can be dysfunctional), financial sector not accumulating non-performing assets (NPAs) etc. Potential output in the long run, depends on a variety of factors like infrastructure, human capital and skills, potential labour force (which depends on demographic factors), level of technological development and labour productivity. The limits thus relate to natural and institutional factors.

An associated concept is output gap. It means the difference between the actual and potential GDP. If actual GDP rises and stays above potential output, it is called a positive gap. It is inflationary as demand exceeds supply due to excess money which may once again be due to fiscal excess or reduction in interest rate. Rise in demand can also be due to wage rise which is once again inflationary. In the opposite set of conditions, if actual GDP is below potential GDP, called negative gap, inflation will come down. Employment implications are that when the gap is positive, there will be full employment (all those looking for work, find work) and in fact productivity will also rise. Ideally, potential GDP is not to be exceeded for the reasons given above. Towards this objective, the government's fiscal policy and Reserve Bank of India (RBI) monetary policy is suitably used.

Per capita income

GDP/GNP divided by mid year population of the corresponding year. Per capita income is shown as an indicator of how rich or poor the country is; its standard of living and so on. But like all averages, per capita income is indicative of the prosperity of a country to a limited degree as there can be steep inequality which is often the case in the majority of the countries.

Estimating GDP

There are three different ways of calculating GDP. Output approach adds the market value of final goods and services. The expenditure approach adds consumption, investment, government expenditure and net exports (exports minus imports). The income approach adds what factors carn: wages, profits, rents etc. The three methods must yield the same results because the total expenditures on goods and services (GNE) must by value of the goods and services produced (GNP) which must be equal to the total income paid to be equal to the factors that produced these goods and services. In reality, there will be minor differences in the results obtained from the various methods due to changes in inventory levels. This is because goods in inventory have been produced (and therefore included in GDP), but not yet sold. Also, payments may not have been made, that is interest on loans; salaries or rents are not paid. So the value of goods and services is arrived at but it does not match the income or expenditure as the case may be. Inventory is a detailed list of all the items in stock.

GDP considers only marketed goods. If a cleaner is hired, his pay is included in GDP. If one does the work himself, it does not add to the GDP. Thus, much of the work done by women at home-taking care of the children, aged; chores etc. which is called 'care economy' is outside the GDP. Even when the elder sibling teaches the younger one is outside the scope of national accounts.

In estimating GDP, only final goods and services are considered. That is, goods that go into making other goods - input goods, are counted only once when the final product is valued. Otherwise it becomes double counting- counted as an input and again counted as an output. Final goods are goods that are either consumed or used in the production of another good or service. For example, a car sold to a consumer is a final good and so is a car that is used as a cab. Former is consumption and the latter is investment.

Some goods are used both as inputs and also as final goods. Car tyres sold to the car manufacturer are intermediate (input) goods. The same tires, if sold to a consumer, would be a final product. If intermediate goods were included in the calculation of GDP, this would lead to double counting; for example, the value of tyres would be counted once when they are sold to the car manufacturer, and again when the car is sold to the consumer. It artificially inflates/deflates the value of production.

In calculating GDP, only newly produced goods are counted. Transactions in existing goods, such as second-hand cars, are not included, as these do not involve the production of new goods. Resale is excluded but the services provided by the agents are counted. That is, when a used car or house is sold, no new goods are being produced. But the auto or the real estate agent makes some money through commission which adds to the service economy.

There are 'imputed values' as a part of the GDP. All houses are assumed to be rented as it is not possible for the government to check which one is owner- occupied and which one is not. Thus, the rental value of all houses is a part of GDP. It is called imputation.

Transfer payments- pensions, scholarships and universal basic income (UBI), if any, that the government gives does not fetch any direct returns in terms of addition to the GDP and thus such expenditure is not included in the GDP.

Factors of Production

Economic production is essentially value addition: inputs are added value to, to produce goods and services. Inputs are called factors of production or resources. There are four factors of production: land, labor, capital and enterprise. The first three are brought together to produce a commodity. There are two types of factors: primary and secondary. Primary factors are land, labor (the capacity to work), and capital goods. Materials and energy (fuel) are secondary factors as they are produced from land, labor and capital. Land includes not only the site of production but natural resources above or below the soil. Capital has many forms: physical, technological, financial, human, intellectual and social capital (networks of relationships necessary for cooperative work for production of value) and even civic capital (citizens working together for facilitating rights that include rule of law, right to business, good governance which are crucial for economic growth).

Market Price and Factor Cost

Market price refers to the actual transacted price and it includes indirect taxes- GST, custom duty, etc. Factor costs are the actual production costs at which goods and services are produced by the firms and industries in an economy. They are the costs of all the factors of production such as land, labor and capital. It means the rent for the land along with the cost of resources that land supports; interest on the capital that is used to buy various inputs; and labour which has to be paid wages. Factor cost refers to the price arrived at after deducting from the market price the indirect taxes and adding to the resulting number government subsidies if any.

MP=FC+ Indirect taxes - Subsidies

The concept of GDP at factor cost is useful to see how competitive market forces are and how distortionary indirect taxes are. If there is high productivity of factors, there is no need to subsidise. The differences between the two values shows the extent to which the GDP is impacted due to indirect taxes. The differentiation helps public policy to rationalize both indirect taxes and subsidies. If the government is imposing high indirect taxes and also subsidizing significantly, the two can be reduced proportionately to simplify the accounting process.

Transfer Payments

Some government expenditures are related to acquisition of goods and services and go into the production process directly. They are a part of GDP. Some expenditures like pensions, scholarships, and UBI are direct transfers of money and do not directly absorb resources or create output. They are called transfer payments. They are a 'one-way' payment of money for which no good, or service is received in exchange. Governments use such payments as means of income redistribution (universal basic income) under social welfare programs such as social security, old age or disability pensions, student grants, unemployment compensation, etc. There is a need to differentiate them from subsidies. Transfer payments are a part of personal income. Subsidies -paid to exporters, farmers, manufacturers are not considered transfer payments because they are linked to an economic transaction.

Transfer payments may be conditional cash transfers or unconditional cash transfers (universal basic income). Under Indira Gandhi Matritva Sahyog Yojana (IGMSY) GOI provides financial aid to pregnant women who undergo institutional delivery in hospital. The sum is also meant to help with their child's vaccination, as well as nutritional food. The money is directly transferred to

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EXAM (परीक्षा)	EXAM DATE	हमारे नोट्स में से आये हुए प्रश्न
RAS PRE. 2021	27 अक्तूबर 2021	74 प्रश्न (150 में से) CUT OFF – 64
UPSC – IAS PRE. (2022)	05 JUNE 2022	69 (100 में से)
SSC GD 2021	16 नवम्बर	68 (100 में से)
SSC GD 2021	01 दिसम्बर	65 (100 में से)
SSC GD 2021	08 दिसम्बर	67 (100 में से)
राजस्थान S.I. 2021	13 सितम्बर	113 (200 में से)
राजस्थान S.I. 2021	14 सितम्बर	119 (200 में से)

राजस्थान S.I. 2021	15 सितम्बर	126 (200 में से)
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RAJASTHAN PATWARI 2021	24 अक्तूबर (1st शिफ्ट)	95 (150 में से)
RAJASTHAN PATWARI 2021	24 अक्तूबर (2nd शिफ्ट)	91 (150 में से)
RAJASTHAN VDO 2021	27 दिसंबर (1st शिफ्ट)	59 (100 में से)
RAJASTHAN VDO 2021	27 दिसंबर (2nd शिफ्ट)	61 (100 में से)
RAJASTHAN VDO 2021	28 दिसंबर (1st शिफ्ट)	56 (100 में से)
RAJASTHAN VDO 2021	28 दिसंबर (2nd शिफ्ट)	57 (100 में से)
U.P. SI 2021	14 नवम्बर 2021 1st शिफ्ट	91 (160 में से)
U.P. SI 2021	21नवम्बर2021 (1st शिफ्ट)	89 (160 में से)

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VDO PRE. – https://www.youtube.com/watch?v=gXdAk856WI8&t=202s

Patwari – https://www.youtube.com/watch?v=X6mKGdtXyu4&t=103s

अन्य परीक्षाओं में भी इसी तरह प्रश्न आये हैं Proof देखने के लिए हमारे youtube चैनल (Infusion Notes) पर इसकी वीडियो देखें या हमारे नंबरों पर कॉल करें I

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a. Training of law enforcement agencies on handling any threats
b. Creating a policy of basic information assessed while issuing, verifying someone's digital currency.

4. **Preventing Bank runs & extent of disintermediation:** Limits on individual holdings of CBDC could help ensure that CBDC is used primarily for payments and not for large savings. It will also reduce the extent of disintermediation of the banking system.

5. **Two-tiered approach by RBI:** RBI is a regulating entity and does not compete with commercial banks. So, a two-tiered approach would be useful wherein, under **Tier 1:** RBI creates the digital version of its currency, and under **Tier 2:** distribution of currency and the maintenance of CBDC wallets is left to existing financial intermediaries.

Introduction of a CBDC or a National Digital currency prevents various threats associated with the private-owned cryptocurrencies and will take India towards a progressive digital economy. But the government has to create necessary safeguards before rolling it out.

CHAPTER -10

BANKING IN INDIA – PART I

HISTORY AND EVOLUTION OF BANKING IN INDIA

- The term Banking originated in the western world.
- Earliest evidence of Banking in India is found from the period of Vedic Civilization. During those days, loan deeds called rnapatra or rnalekhya were prevalent.
- Various types of instruments were found in Buddhist, Mauryan and Mughal periods.
- The Arthashastra of Kautilya mentions the presence of bankers during Mauryan era, known as "Adesha" which are equivalent to Bill of exchange of current times.
- The first bank of India called Bank of Hindostan was established in 1770.

A bank is a financial institution that accepts deposits from the public and creates credit. Lending activities can be performed either directly or indirectly through capital markets.

THREE PRESIDENCY BANKS

- Three Presidency banks were set up under charters from the British East India Company- **Bank of Calcutta (1806), Bank of Bombay (1840) and Bank of Madras (1843).** These banks worked as **quasi central banks in India for many years.**

IMPERIAL BANK OF INDIA

- In 1921, the three presidency banks were amalgamated to form Imperial Bank of India.
- In 1955, this Imperial Bank of India was nationalized and renamed as State Bank

of India (SBI). Thus, SBI is the oldest Bank of India among the banks that exist today.

Banking in India is truly a reflection of a mixed economy with co-existence of public sector banks, private and foreign banks.

OLDEST JOINT STOCK BANK OF INDIA

- India's Oldest Joint Stock Bank is **Allahabad Bank**. It is also known as India's oldest public sector bank. It was established in 1865.

A bank that has multiple shareholders is called a joint-stock bank.

FIRST BANKS OWNED / MANAGED BY INDIANS

- The first bank purely managed by Indians was **Punjab National Bank**, established in Lahore in 1895. The PNB is one of the largest banks in India.
- However, the first Indian commercial bank which was wholly owned and managed by Indians was the **Central Bank of India** which was established in 1911.

Central Bank of India is called India's First Swadeshi bank. Its founder was Sir Sorabji Pochkhanawala and its first chairman was **Sir Pherozeshah Mehta.**

Bank of India was the first Indian bank to open a branch outside India, in London in 1946.

Year	Bank
1770	The first bank of India called Bank of Hindostan was established in 1770.
1861	Paper Currency Act was enacted by the British Government of India.
1865	Oldest Joint-Stock bank Allahabad Bank was established.
1881	Oudh Commercial Bank, the first Bank of India with Limited Liability to be managed by Indian Board was established at Faizabad.
1895	Punjab National Bank was established. It was the first bank purely managed by Indians.
1911	Central Bank of India, first Indian commercial bank which was wholly owned and managed by Indians, was established. It was called First Truly Swadeshi bank.
1921	Three presidency banks – Bank of Calcutta, Bank of Bombay and Bank of Madras amalgamated to form Imperial Bank of India.
1935	Creation of Reserve Bank of India.
1949	Nationalization of Reserve Bank of India.
1949	Enactment of Banking Regulation Act.
1955	Nationalization of Imperial Bank of India, which then became the SBI.
1969	Nationalization of 14 major Banks.
1980	Nationalization of 7 more banks with deposits over Rs. 200 Crore.

Reforms	**Committees made for reforms in the banking sector ????** Narasimham-I (1991), M Narasimham-I (1997), Dr. Raghuram Rajan Committee (2007) and P J Nayak Committee (2014).

2. FINANCIAL INTERMEDIARIES

- The institutions that channel funds between savers (surplus) to user (deficit) agents are called **financial intermediaries.**
- They serve as middlemen between savers (lenders, investors, households) and borrowers (entrepreneurs, business firms.)
- Such FI can be subdivided into (1) **Formal** (2) **Informal**.

Parameter	**Formal**	**Informal**
Definition	Formal system of finance is licensed by the central bank.	Informal system of finance is not licensed by the central bank.
Institution	Commercial & development banks – RRBs, post office banks etc.	Saving collectors, saving and credit associations, and moneylenders.
Principle clients	Large businesses, salaried workers, small and medium enterprises.	People who avail informal finance are either rural poor or self-employed peoples.

TYPES OF FINANCIAL INTERMEDIARIES

FLs

1. Banks

- **Commercial**
  - Public
  - Private
  - Foreign
  - RRB
- **Cooperative**
  - Urban
  - State
  - PACS

2. NBFI

- **AIFI**
  - EXIM
  - NHB
  - SIDBI
  - NABARD
- **PRIMARY DEALERS**
- **NBFC**

According to the alternative view of monetary and banking operations, banks are not intermediaries but 'fundamental money creation' institutions, while the other institutions in the category of supposed **'intermediaries'** are simply investment funds.

ADVANTAGES OF FINANCIAL INTERMEDIARIES

1. Risk Spreading
2. Convenience
3. Financial specialist
4. Economy of scale
5. Safe investment
6. Greater liquidity

IMPACT OF FI ON THE WHOLE ECONOMY

- FIs help circulate money in the system.
- Ensures high velocity of money.
- They promote the habit of savings.
- A needy businessman will easily get loans.
- Promotes new business, expands existing business, hires more employees, increases production of goods/services.

BANKS IN INDIA

Types of Banks in India

1. Central Bank
2. Scheduled Bank

a. Scheduled Commercial Bank

- Public sector
  - SBI Group
  - Nationalized Banks
  - Other Public sector banks
- Private sector
  - New
  - Old
    - Foreign
    - RRBs

b. Scheduled Cooperative Banks

- Rural
  - Primary Credit Societies
- Urban
  - District Cooperative Banks
  - State Cooperative Banks
  - Urban Cooperative Banks

3. Non-scheduled Banks

a.Local Area Banks
b.Non-scheduled Urban Cooperative Banks.

3. RBI : ORIGIN AND EVOLUTION

- Prior to the establishment of the RBI, the functions of a central bank were virtually done by the Imperial Bank of India . RBI started its operations from April 1, 1935.
- It was established via the RBI act 1934, so it is also known as a statutory body. Similarly, SBI is also a statutory body deriving its legality from SBI Act 1955.
- RBI did not start as a Government owned bank but as a privately held bank.
- Post-independence, the government passed Reserve Bank (Transfer to Public Ownership) Act, 1948 and took over RBI from private shareholders after paying appropriate compensation.
- Thus, nationalization of RBI took place in 1949 and from January 1, 1949, RBI started working as a government-owned bank.

TIMELINE

1926	The Royal Commission (Hilton Young commission) on Indian Currency and Finance recommended creation of a central bank for India. On the basis of this commission, the RBI Act, 1934 was passed.
1934	The RBI Bill was passed and received the Governor General's assent.
1 April 1935	Reserve Bank commenced operations as India's central bank as a private shareholders' bank with a paid up capital of rupees five crore.
1949	The Government of India nationalized the Reserve Bank under the Reserve Bank (Transfer of Public Ownership) Act, 1948.

- **REMOVAL** – The governor can be removed by the central government.

PRESENT GOVERNOR OF RBI– Shri. Shashikant Das (IAS)

3.4 SUBSIDIARIES OF RBI

- Deposit Insurance and Credit Guarantee Corporation (DICGC)
- Bharatiya Reserve Bank Note Mudran Private Limited (BRBNMPL)
- Reserve Bank Information Technology Private Ltd. (ReBIT)
- Indian Financial Technology And Allied Services (IFTAS).

ASSISTIVE BODIES IN RBI – Board of Financial Supervision (BFS) and Board for Payment and Settlement Systems (BPSS); Both of these are chaired by RBI Governor.

No. of Press	**Four printing presses prints and supply bank notes**
Location	1. Nashik – Maharashtra 2. Dewas – Madhya Pradesh 3. Mysore – Karnataka 4. Salboni – West Bengal
Owned by Govt.	The presses in Madhya Pradesh and Maharashtra are owned by the Security Printing and Minting Corporation Of India (SPMCIL), a wholly owned company of GoI. SPMCIL is the only PSU under the Dept. of Economic Affairs (MoF).
Owned by RBI	The presses in Karnataka and West Bengal are owned by Bharatiya Reserve Bank Note Mudran Private Limited (BRBNMPL), a wholly owned subsidiary of RBI.
Coins	GoI is the issuing authority of coins and supplies coins to the Reserve bank on demand. The RBI puts the coins into circulation on behalf of the Central Government.

3.5 FUNCTIONS OF THE RBI

1.Bank of Issue

- Issuing money is the exclusive right of RBI.
- All notes exceptI note and coins are issued by RBI.
- It also exchanges or destroys old damaged currencies.
- I notes and coins are issued by the Ministry of Finance and circulated by RBI.

2. Custodian and Manager of Foreign exchange

- RBI keeps the foreign exchange (i.e. foreign currency) which flows into the country.
- It also keeps the foreign exchange rate stable to a certain extent.

3.Banker and Debt Manager to Government

- It acts as a banker to both central and state governments (except Jammu and Kashmir and Sikkim).
- It keeps deposits of governments and lends to governments.

- RBI carries out lending and borrowing operations by issuing government securities on behalf of the government.
- Though RBI is not a banker to Sikkim and Jammu and Kashmir it manages their public debt to some extent.

4. Banker to bank–

- It is the banker of all the banks.
- It keeps the reserve of the banks like cash reserve ratio (CRR) with it.
- It provides financial assistance to banks against mortgaged securities.
- It rediscounts bills of exchange.
- Usually banks borrow and lend money among themselves via call money market, regulated by RBI.
- RBI provides enough money to banks and so called as lender of last resort.

5. Monetary Management – Controller of Money Supply, Makes Monetary Policy, Credit Control etc.

6. Financial Regulator – to Commercial banks, Credit information Companies, RRBs, Local Area Banks, NBFC etc.

7. Representative role – RBI represents govt. as a member of the IMF and World Bank.

8. Central Clearance and Accounts Settlement – As RBI keeps cash reserves from commercial banks therefore it rediscounts their bills of exchange easily.

9. Developmental role – Performing a variety of developmental and promotional functions under which it did set up institutions like IDBI, SIDBI, NABARD, NHB, etc.

10. Promotional Roles – Consumer protection, Ombudsman, Financial Inclusion through PSL norms, 25% rural branch requirements etc.

NEW INITIATIVE OF RBI IN CREDIT AND MONETARY POLICY REGIME

- Transition to bi-monthly monetary policy cycle
- Recognition of the glide path for disinflation (on recommendation of Urjit Patel Committee report). Under it, the CPI (C) is used by the RBI as the "Headline Inflation" for monetary management.
- A Monetary Policy Framework (2015) has been put in place – an agreement in this regard was signed between the Government of India and the RBI late February 2015. Under the framework, the RBI is to 'target inflation' at 4 per cent with a variation of +/- 2 per cent. (of the CPI-C).
- Besides the existing repo route, term repos have been introduced for three sets of tenors – 7, 14 and 28 days – Move aimed at improving the transmission of policy and stability to the loan market.
- As per the Union Budget 2016-17, individuals will also be allowed by the RBI to participate in the government security market (similar to the developed economies like the USA).
- RBI is progressively reducing banks' access to overnight liquidity (at the fixed repo rate), and encouraging the banks to increase their dependency on the term repos.

3.6 SOURCES OF INCOME AND EXPENDITURE OF RBI

INCOME	EXPENDITURE

CHAPTER - II

MONETARY POLICY OF RBI

- Monetary Policy is an instrument under RBI aimed at regulating interest rates, money supply and availability of credit in an economy.
- RBI decides monetary policy cycle on bi-monthly basis.

OBJECTIVES OF MONETARY POLICY

- **Economic and financial stability** – To regulate monetary expansion so as to maintain a reasonable degree of price stability. Maintaining price stability.
- **Development** – To ensure adequate financial resources for the purpose of development.
- **flow of credit** – Adequate flow of credit to productive sectors.
- **Employment and growth** – Promotion of productive investments & trade. Equitable distribution of income. Employment generation
- **International trade and exports** – Promotion of exports and economic growth. Maintaining exchange rate stability.

TOOLS OF MONETARY POLICY

Quantitative Instruments

1. Liquidity Adjustment Facility (Repo and Rev. Repo
2. Open Market Operations
3. SLR, and CRR
4. Bank Rate
5. Credit Ceiling
6. Marginal Standing Facility

Qualitative Instruments

1. Credit Rationing
2. Moral Suasion
3. Prompt Corrective Action(PCA)
4. Direct action by RBI on banks
5. Differential Interests Rates

QUANTITATIVE INSTRUMENTS

1. RESERVE RATIO (CRR)

- CRR is the certain % (fixed by the RBI) of Net Time and Demand Deposits of a Scheduled bank in India need to kept with the RBI in the form of cash only.
- CRR aimed to have control over banks credit.
- The ratio between 3% (floor) -15% (ceiling) removed via RBI (Amendment) Bill 2006.

An increase in CRR ???? higher proportion of deposits to be kept with RBI by banks ???? less funds are available to be provided as credit to the economy ???? **money supply will decrease.**

2. STATUTORY LIQUIDITY RATIO (SLR)

- The scheduled banks also need to also keep certain % (fixed by the RBI) of their Net Time and Demand Deposits kept with itself (i.e. not with RBI) in the form of liquid assets such as cash, gold and select government securities.
- Need of SLR is to prevent banks from lending all its deposits which is too risky and it is mandatory under Banking Regulation Act 1949.
- Similar to CRR, SLR aimed to have control over banks credit.

- Through the LTRO, the RBI seeks to inject long term liquidity into the economy at a lower interest rate.
- The LTROs would be carried out through **e-Kuber**.

e-Kuber *is the Core Banking Solution (CBS) of the RBI which enables each bank to connect their single current account across the country.*

LATEST RBI BANK RATES IN INDIAN BANKING (July 2020)

Repo Rate - 4.00%
Reverse Repo Rate - 3.35%
MSF - 4.25%
Bank Rate -4.25%
Cash Reserve Ratio - 3.00%
Statutory liquidity ratio -18.00%

Source – https://www.rbi.org.in/

QUALITATIVE INSTRUMENTS

1. CREDIT RATIONING

- Rationing of credit is a method by which the RBI seeks to limit the maximum amount of loans and advances and, also in certain cases, fix ceilings for specific categories of loans and advances.

2. MARGIN REQUIREMENTS

- Qualitative tool used by the RBI in order to regulate the credit flow to a particular sector.
- When a bank advances credit to its customers it does so against collateral. However there is a difference between the value of the security and the loan offered. This difference is called **'Margin'**.

3. MORAL SUASION

- It refers to a method adopted by the Central Bank to persuade or convince the commercial banks to advance credit in the economic interest of the country.
- "Persuasion" without applying punitive measures.
- Since it involves no administrative compulsion or threats of punitive action it is a psychological and informal means of selective credit control.

4. DIFFERENCIAL RATE OF INTEREST

- The differential rate of interest (DRI) is a lending programme launched by the government in April 1972 which makes it obligatory upon all the public sector banks in India to lend 1 per cent of the total lending of the preceding year to 'the poorest among the poor' at an interest rate of 4 per cent per annum.

5. DIRECT ACTION

- This step is taken by the RBI against banks that don't fulfill conditions and requirements. RBI may refuse to rediscount their papers or may give excess credits or charge a penal rate of interest over and above the Bank rate, for credit demanded beyond a limit.

6. PROMPT CORRECTIVE ACTION (PCA)

- The PCA is triggered when banks breach certain regulatory requirements like minimum capital, and quantum of non-performing assets.
- To ensure that banks don't go bust, RBI has put in place some trigger points to assess, monitor, control and take corrective actions on banks which are weak and troubled.

7. CONSUMER CREDIT REGULATION

- RBI can issue rules to set the minimum/maximum level of down-payments and periods of payments for purchase of certain goods.

नोट – प्रिय IAS उम्मीदवारों, यहाँ हमने इस टॉपिक का मात्र SAMPLE ही दिया है, पूरा टॉपिक नही दिया है / यदि आपको हमारे नोट्स के सैंपल अच्छे लगे हों तो कम्पलीट नोट्स खरीदने के लिए नीचे दिए गये हमारे संपर्क नंबर पर कॉल कीजिए या लिंक पर क्लिक करें / दोस्तों, हमें पूर्ण विश्वास है कि ये नोट्स आपकी "UPSC IAS (PRE. & MAINS)" की परीक्षा में पूर्ण संभव मदद करेंगे और आप "INFUSION NOTES" के साथ IAS की परीक्षा में जरूर सफल होंगे, धन्यवाद /

संपर्क करें – 9887809083, 8233195718, 9694804063, 8504091672

प्रिय दोस्तों, अब तक हमारे विभिन्न नोट्स में से विभिन्न परीक्षाओं में आये हुए प्रश्नों के परिणाम –

EXAM (परीक्षा)	EXAM DATE	हमारे नोट्स में से आये हुए प्रश्न
RAS PRE. 2021	27 अक्तूबर 2021	74 प्रश्न (150 में से) CUT OFF – 64
UPSC – IAS PRE. (2022)	05 JUNE 2022	69 (100 में से)
SSC GD 2021	16 नवम्बर	68 (100 में से)
SSC GD 2021	01 दिसम्बर	65 (100 में से)
SSC GD 2021	08 दिसम्बर	67 (100 में से)
राजस्थान S.I. 2021	13 सितम्बर	113 (200 में से)
राजस्थान S.I. 2021	14 सितम्बर	119 (200 में से)

राजस्थान S.I. 2021	15 सितम्बर	126 (200 में से)
RAJASTHAN PATWARI 2021	23 अक्तूबर (1st शिफ्ट)	79 (150 में से)
RAJASTHAN PATWARI 2021	23 अक्तूबर (2nd शिफ्ट)	103 (150 में से)
RAJASTHAN PATWARI 2021	24 अक्तूबर (1st शिफ्ट)	95 (150 में से)
RAJASTHAN PATWARI 2021	24 अक्तूबर (2nd शिफ्ट)	91 (150 में से)
RAJASTHAN VDO 2021	27 दिसंबर (1st शिफ्ट)	59 (100 में से)
RAJASTHAN VDO 2021	27 दिसंबर (2nd शिफ्ट)	61 (100 में से)
RAJASTHAN VDO 2021	28 दिसंबर (1st शिफ्ट)	56 (100 में से)
RAJASTHAN VDO 2021	28 दिसंबर (2nd शिफ्ट)	57 (100 में से)
U.P. SI 2021	14 नवम्बर 2021 1st शिफ्ट	91 (160 में से)
U.P. SI 2021	21नवम्बर2021 (1st शिफ्ट)	89 (160 में से)

& Many More Exams

दोस्तों, इनका proof देखने के लिए नीचे दी गयी लिंक पर क्लिक करें या हमारे youtube चैनल पर देखें –

RAS PRE. – https://www.youtube.com/watch?v=p3_i-3qfDy8&t=136s

VDO PRE. – https://www.youtube.com/watch?v=gXdAk856WI8&t=202s

Patwari – https://www.youtube.com/watch?v=X6mKGdtXyu4&t=103s

अन्य परीक्षाओं में भी इसी तरह प्रश्न आये हैं Proof देखने के लिए हमारे youtube चैनल (Infusion Notes) पर इसकी वीडियो देखें या हमारे नंबरों पर कॉल करें।

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- Special WMA or Special Drawing Facility is provided against the collateral of the government securities held by the state.
- After the state has exhausted the limit of SDF, it gets normal WMA. The interest rate for SDF is one percentage point less than the repo rate.
- The number of loans under normal WMA is based on a three-year average of actual revenue and capital expenditure of the state.
- The RBI has raised the Ways and Means Advances, or WMA, limit by **30%** for all States and UTs to enable them to tide over the crisis caused by **COVID-19 outbreak**.

CHAPTER - 12

BAKING INDIA – PART 2

1. COMMERCIAL BANKS

- Commercial banks may be defined as any banking organization that deals with the deposits and loans of business organizations. Commercial banks issue bank cheques and drafts, as well as accept money on term deposits.
- Commercial banks also act as moneylenders, by way of installment, loans and overdrafts.
- Commercial banks also allow for a variety of deposit accounts, such as current, savings, and time deposit.
- These institutions are run to make a profit and are owned by a group of individuals.
- They lend to all sectors ranging from rural to urban.
- These banks do not charge concessional interest rates unless instructed by the RBI.
- Public deposits are the main source of funds for these banks.
- They have a unified structure and are owned by the government, state, or any private entity.

SCHEDULED COMMERCIAL BANKS (SCB)

- Governed by the Banking Regulation Act-1949.
- Scheduled banks are those mentioned in the 2nd schedule of RBI Act, 1934.
- Scheduled commercial banks (SCBs) account for a major proportion of the business of the scheduled banks.
- Private sector banks include the old private sector banks and the new generation private sector banks– which were incorporated according to the revised

guidelines issued by RBI regarding the entry of private sector banks in 1993.

1. 1 PUBLIC SECTOR BANKS

- These are banks where the majority stake is held by the Government of India. Examples of public sector banks are: SBI, Bank of India, Canara Bank, etc.

EMERGENCE OF STATE BANK OF INDIA (SBI) GROUP

- State bank group implies, State bank of India and its associates.
- Prior 1955, SBI was known as "Imperial Bank of India".
- Imperial Bank of India created in 1921 by amalgamating 3 Presidency banks of – Bengal, Bombay and Madras.
- Post – independence, the economic model of Five-year plan necessitated a reorganisation of banking. Following this, on July 1, 1955 as per the SBI act 1955, the SBI constituted and it took over the business and undertaking of Imperial Bank.

- By enacting SBI Act, 1955 the government partially nationalized Imperial Bank of India and renamed it as SBI.
- In 1959, by enacting SBI (Associates) Act, 1959 the government brought 8 banks of former princely states under SBI as its associates. They were –
  - State bank of Bikaner
  - State bank of Jaipur
  - State bank of Hyderabad o State bank of Indore
  - State bank of Mysore
  - State bank of Saurashtra
  - State bank of Patiala
  - State bank of Travancore
- State bank of Bikaner and Jaipur were merged and known as SBBJ (State Bank of Bikaner and Jaipur)
- 2008 – State bank of Saurashtra was merged with state bank of India.
- Now the number of associate banks is 5.
- SBI associates and Bharatiya Mahila Bank was merged with SBI w.e.f. April 1, 2017.
- SBI is the largest public sector bank in India.
- To unload RBI from its administrative work and to endow it with only regulatory functions, RBI's shareholding was transferred to the government of India.

<u>2019: Global top banks</u> – 100 banks ????
China (18 banks), USA (12 Banks), Japan > France >.....India (only 1 bank: SBI at Rank 55).
The Union Cabinet in 2017, had approved the merger of five associate banks along with Bharatiya Mahila Bank with SBI. The five banks were State Bank of Bikaner and Jaipur, State Bank of Hyderabad, State Bank of Travancore, State Bank of Mysore and State Bank of Patiala. At present, there are 12 Public Sector Banks in India including SBI.

1. 2 NATIONALIZATION OF THE BANKS

- In India, the banks which were previously functioning under the private sector were transferred to the public sector by the act of nationalization and thus the nationalized banks came into existence.

- Post-independence, the GOI adopted a planned economic development model for the country. Nationalisation was in accordance with the national policy of adopting the socialistic pattern of society.

- The first major step was Nationalization of the Imperial Bank of India in 1955 via the State Bank of India Act.

- *Two successive years of drought had led to severe food shortages and also compromised national security (PL 480 program).*
- *Resultant three-year plan holiday affected aggregate demand as public investment was reduced.*
- *India's economic growth barely outpaced population growth in 1960-70s and average incomes stagnated.*
- *Share of the industrial sector in credit disbursement by commercial banks almost doubled between 1951 and 1968, from 34% to 68% whereas agriculture received less than 2% of total credit, though more than 70 percent of the population was dependent upon it.*
- *Priority Sector Lending – the agriculture sector and its allied activities were the largest contributors to the national income.*
- *Nationalisation aimed at mobilizing the savings of the people to the largest possible extent and to utilize them for productive purposes.*
- *Reducing inter and intra-regional imbalance to curb the urban-rural divide*
- *Controlling private monopolies over financial sectors.*
- *Ensuring Socio-economic welfare as enshrined in preamble of the Indian constitution.*
- *Expansion of banking to rural pockets to ensure financial inclusion.*
- *To shift from 'class banking' to 'mass banking' (social banking)*

1.2.2 OBJECTIVE OF NATIONALISATION

- *To Induce Confidence of Public in Banking Sector*
- *To provide social orientation like loan to weaker sections of society*
- *Expansion of banking, Opening accounts in rural areas – financial inclusion*
- *To reduce inequalities in society.*
- *Controlling private monopolies*
- *Reducing regional imbalances*
- *Developing banking habits*
- *Priority sector lending to weaker sections – inclusive growth*

1.2.3 IMPACT OF NATIONALIZATION OF BANKS

- *Nationalization of the Banks brought the public confidence in the banking system of India.*
- *After the two major phases of nationalization in India, 80% of the banking sector came under government ownership.*
- *After the nationalization of banks, the branches of the public sector banks in India rose to approximately 800 per cent in deposits, and advances took a huge jump by 11,000 per cent.*
- *Government ownership gave the public implicit faith and immense confidence in the sustainability of public sector banks.*
- *Indian banking system has reached even to the remote corners of the country.*
- *More equitable and prioritized disbursement of credit to different sectors of economy.*
- *Nationalization of banks led to a smooth and streamlined Indian growth process, particularly in the Green revolution.*
- *Aim of nationalization is to promote rapid growth in agriculture, small industries and export, to encourage new entrepreneurs and to develop all backward areas.*

ECONOMIC SURVEY 2020 *– After the 1980 nationalization, PSBs had a 91% share in the national banking market which has reduced to 70% in recent times. Reduced stake has been absorbed by New Private Banks (NPBs) which came up in early 1990s after liberalization.*

ECONOMIC SURVEY 2020 *– Allow campus recruitment, lateral entry in higher management positions, make employees 'part owners' through Employee Stock Ownership Plan (ESOP). Use Artificial Intelligence (AI),*

- RRBs are at par with commercial banks as far as compliance requirements to CRR and SLR is concerned.
- The RRBs combine the characteristics of a cooperative in terms of the familiarity of the rural problems and a commercial bank in terms of its professionalism and ability to mobilise financial resources.
- Each RRB is owned by three entities with their respective shares as follows:
  - Central Government → 50%
  - State government → 15%
  - Sponsor bank→ 35%
- However, the PSL target of RRBs is 75% of total outstanding advances (PSL norm is 40% for a commercial bank).

1. 50% Centre
2. 35% Sponsor bank
3. 15% state government

RRB Viz-a-viz COMMERCIAL BANKS

- **Ownership** – they are owned by three different entities – Central govt, state govt and sponsor bank.
- **Regulation** – They are regulated by NABARD
- **Statutory Background** – RRBs have a separate law behind them viz. RRB Act, 1976.
- **Statutory pre-emptions** – RRBs don't need to maintain CRR and SLR like other banks.

2.1.1 Objectives of the RRB

To develop the rural economy by providing, for the purpose of development of agriculture, trade, commerce, industry and other productive activities in the rural areas, credit and other facilities, particularly to small and marginal farmers, agricultural labourers, artisans and small entrepreneurs, and for matters connected therewith and incidental thereto.

POLICY OF CURRENT GOVERNMENT ON RRB

- The Modi Government has put hold on further amalgamation of the Regional Rural Banks.
- The focus of the new government is to improve their performance and explore new avenues of investments in the same.
- Currently, there is a bill pending to amend the RRB Act which aims at increasing the pool of investors to tap capital for RRBs.

2.1.2 NEED FOR RRBS

- To ensure adequate credit in rural areas during the lockdown due to the COVID-19
- RRB helps to bring the financial inclusion in the primary level of the nation
- To provide banking services to rural and semi-urban areas.
- Locker, debit and credit card facilities to the countryside
- To enhance employment opportunities by promoting trade and commerce in rural areas.
- To support entrepreneurship in rural areas.
- Pension and MGNREGA wages distribution.

2.1.3 ISSUES WITH RRBS

- Organisational problem – multi agency control of RRBs led to a lack of uniformity in their performance.
- Recruitment process as well as training of staff of RRB hasn't received sufficient attention
- Problems of loan recovery
- Mounting losses resulting into non-viability
- Management Problems pertain to involvement of three agencies.

2.5 LOCAL AREA BANK

- Introduced in India in the year 1996 based on Budget-1996 by the then Finance Minister, Dr. Manmohan Singh.
- Unlike RRBs, they're not set up by Union or State governments or by any special act of the parliament, but by private entities, simply applying to RBI under Banking Regulation Act.
- Each Local Area bank is registered as a public limited company under the Companies Act, 1956. However, they are licensed under the Banking Regulation Act, 1949.
- Earning profit is the main objective of Local Area Banks
- They are Non-Sch. Banks – CRR, SLR, PSL applicable.
- Only RBI regulates
- Present in Maximum 3 geographically contiguous districts. only 1 urban centre per district.

2.6 LEAD BANK SCHEME

- The Lead Bank Scheme was introduced in 1969 in which aims at providing adequate banking and credit in rural areas through an 'service area approach', with assignment of lead roles to individual banks (both in public sector and private sector) – one bank assigned for one area
- A bank having a relatively large network of branches in the rural areas of a given district and endowed with adequate financial and manpower resources has generally been entrusted with the lead responsibility for that district.
- On the recommendation of the Gadgil Study Group and Banker's Committee, the Scheme was introduced by RBI. The commercial banks did not have adequate presence in rural areas and also lacked the required rural orientation which was hindering the growth of rural areas.

OBJECTIVES OF LEAD BANK SCHEME

- to identify those regions which unbanked and underbanked in districts and to extend banking facilities to such areas
- to help in removing regional imbalances through appropriate credit deployment.
- It was observed in the studies by the committee that there are certain credit gaps in various sectors which need to be addressed and a credit plan is needed.
- to identify economically viable and technically feasible schemes.
- The structural and procedural changes in the banking sector were needed.
- Development of co-operation amongst financial and non-financial institutions.

Govt. constituted Usha Thorat committee which highly favoured the further continuance and revitalization of the scheme for the sake of the financial inclusion in the country.

3. CO – OPERATIVE BANKS

- In India, the history of Cooperatives begins with the Cooperative Credit Societies Act, 1904 which led to the formation of Cooperative Credit Societies in both rural and urban areas.
- In independent India, with the onset of planning, the cooperative organizations gained more leverage and role with the continued governmental support.
- Co-operative bank is a financial entity which belongs to its members, who are at the same time the owners and the customers of their bank. Co-operative banks are often created by persons belonging to the same local or professional community or sharing a common interest.
- Co-operative banks played an important role in national development. Initially set up to supplant indigenous sources of rural credit, particularly money lenders, today they mostly serve the needs of agriculture and allied activities, rural-based industries and to

- In comparison to branch banking, the size of unit banks is very small.
- Due to small size and due to unit structure; the decision making in unit banks is very fast.
- The management in unit banks enjoy more autonomy and more discretionary powers.
- However, due to single units, the risk is not distributed or diversified.

MIXED BANKING

- Mixed Banking is the system in which banks undertake activities of commercial and investment banking together.
- These banks give short-term and long-term loans to industrial concerns.
- They thus promote rapid industrialization. They may however pose a grave threat to liquidity of a bank and lead to bad debts.

CHAIN BANKING

- Chain banking system refers to the type of banking when a group of persons come together to own and control three or more independently chartered banks.
- Each of these banks could maintain their independent existence despite common control and ownership.
- The banks in the chains were assigned specific functions so there was no loss of profits and overlapping of interests.

RETAIL BANKING

- Retail banking means banking where transactions are held directly with customers and there are no transactions with other banks or corporations.
- The banks provide all kinds of personal banking services to customers like saving accounts, transactional accounts, mortgages, personal loans, debit and credit cards etc.
- However, due to increasing use of new technology, the operational costs for banks have gone up.

RELATIONSHIP BANKING

- Relationship banking is a banking system in which banks make deliberate efforts to understand customer needs and offer him products
- It helps banks to gather critical soft information about the borrowers, which helps them to determine creditworthiness of such clients.
- Clients can often renegotiate their loan terms and hence result in inefficient investments for banks.

CORRESPONDENT BANKING

- Correspondent banking prevalent in over 200 countries is a profitable way of doing business by banks in foreign countries in which they don't have physical presence or limited operational permissions.
- Correspondent banks thus act as banking agents for a home bank and provide various banking services to customers where otherwise the home bank does not operate.
- It helps customers to perform banking operations at ease even in places where their banks don't have physical presence.

SOCIAL BANKING

- Social banking is a concept where banking services are oriented towards mass welfare and financial inclusion of the poor and vulnerable segments of society.
- RBI has taken some praiseworthy initiatives to make financial inclusion a reality for the remotest segments of Indian population. Some of these are:-
- It is mandatory for banks to open 25% of new branches in rural areas which don't have access to formal banking, Basic Savings Bank Deposit Account has been introduced for all, KYC documentations have been considerably relaxed and simplified for small accounts.

- The BBB will advise on appointments to the board, banks' chairman and other executive directors.

IMPORTANCE OF YEAR 1991 IN BANKING OF INDIA

- The public sector was born out of a planned economy model, which was underpinned by a Nehruvian-Fabian socialist philosophy.
- Prior to 1991, India was more or less an isolated economy, loosely integrated with the economy of the rest of the world.
- In 1991, India embarked on the path of liberalization, privatization and globalization (LPG). This injected new energy into the slow growing Indian Economy.
- With reference to the Banking sector, it was in this year that the Narasimham Committee I (1991) gave a blueprint of banking sector reforms.
- Accordingly, the government launched a comprehensive financial sector liberalization programme which included interest rates liberalization, reduction of reserved rations, reduced government control in banking operations and establishment of a market regulatory framework.
- Another outcome of liberalization was the dismantling of prohibitions against foreign direct investment.

OUTCOMES OF REFORMS THAT IMPACTED THE BANKING SECTOR

- Steps were taken to move to a market determined exchange rate system, and a unified exchange rate was achieved in the 1990s itself.
- The government also released a slew of norms pertaining to asset classification, income recognitions, capital adequacy which the banks had to comply with.
- Current account convertibility (Tarapore committee – 2006) was allowed for the Rupee in accordance with IMF conditions.
- Nationalized banks were allowed to raise funds from the capital markets to strengthen their capital base.
- The lending rates for commercial banks was deregulated, thereby freeing them to lend more or as they saw fit.
- Banks were allowed to fix their own interest rates on domestic term deposits that matured within two years.
- Customers were encouraged to move away from physical cash, as RBI issued guidelines to the banks pertaining to the issuance of debit cards and smart cards
- The process of introducing computerization in all branches of banks began in 1993 in line with the Committee on Computerization in Banks' recommendations.
- FII (Foreign Institutional Investors) were allowed to invest in dated G-Securities
- The Foreign Exchange Management Act (FEMA) was enacted in 1999 and eliminated the Foreign Exchange Regulation Act (FERA) of 1973. FEMA enabled the development and maintenance of the Indian foreign exchange markets and facilitated external trade and payments
- The National Stock Exchange (NSE) began its operations in 1994.
- RBI began the practice of auctioning Treasury Bills spanning 14 days and 28 days
- Capital index bonds were introduced in India for the first time.

The RBI provided licenses to conduct banking operations to some private banks such as ICICI Bank, HDFC Bank etc.

- New technology and customer-friendly measures were adopted by bankers to attract and retain customers.
- The Banking Ombudsman was established.

CHAPTER - 24

FINANCIAL INCLUSION

MEANING OF FINANCIAL INCLUSION

- According to the World Bank -Financial inclusion means that individuals and businesses have access to useful and affordable financial products and services that meet their needs – transactions, payments, savings, credit and insurance – delivered in a responsible and sustainable way.
- Financial inclusion ensures financial literacy and Financial democracy for the people.
- This ensures social, economic and transaction security, improves social harmony, women empowerment, helps reaping the benefit of "Less Cash Economy"
- Financial inclusion or taking banking services to the common man was the main driver of bank nationalization in 1969 and 1980 powered by **three priority** areas –
    - Access to banking
    - Access to affordable credit
    - Access to free face-to-face money advice.

OBJECTIVES OF FINANCIAL INCLUSION

- **Bank accounts:** Ensuring universal access to bank accounts, which are a gateway to all financial services.
- **Digital payment services:** Providing access to digital payment services and increasing its penetration.
- **Insurance:** Ensuring universal coverage of insurance for life, accidents, etc.
- **Asset diversification:** Allowing diversification of asset portfolio of households through increased participation in capital markets.
- **Social Security:** a system of payments / assistance by the government to citizens who are ill, handicapped, poor, aged or unemployed.
- Better access to credit at a reasonable cost for those presently excluded
- **Social Justice:** distribution of wealth, opportunities, and privileges within a society- through reservation in jobs, admissions and election and through legal safeguards for protection of civil rights, prevention of atrocity and personnel laws.

Article 41 (DPSP)– State to provide public assistance to its citizens in case of unemployment, old age, sickness and disablement;

Article 42 (DPSP)– The State shall make provision for securing just and humane conditions of work and for maternity relief.

NEED FOR FINANCIAL INCLUSION

- Financial inclusion is a key enabler to reduce extreme poverty and boost shared prosperity,
- An ambitious global goal (World Bank) to reach Universal Financial Access (UFA) by 2020.
- Financial inclusion has been identified as an enabler for 7 of the 17 Sustainable Development Goals (SDG)
- **Development** – financial inclusion would result into higher savings, decrease in income inequality and poverty, increase in employment opportunities.
- **Growth** – greater access to formal credit would promote entrepreneurship in country

can be extortionate and arbitrary – vicious cycle of perpetual indebtedness sets in.

- People who save informally (that is not in a bank account) do not benefit from the interest rates and tax advantages that people with savings accounts enjoy. Savings kept in cash at home are vulnerable to theft.
- If the SMEs sector, are affected by financial exclusion then their potential contribution to the overall economic growth is severely hampered. Further, given the fact that about two-third of the units in this sector are owned by the disadvantaged section, such an exclusion results into a form of social injustice.
- Financial inclusion broadens the resource base of the financial system by developing a culture of savings among large segment of rural population and plays its own role in the process of economic development.
- Financial inclusion also mitigates the exploitation of vulnerable sections by the usurious money lenders by facilitating easy access to formal credit.

Know Your Customer (KYC)

KYC is the due diligence and bank regulation that financial institutions and other regulated companies must perform to identify their clients and ascertain relevant information pertinent to doing financial business with them.

BANKING SECTOR AND FINANCIAL INCLUSION

YEAR	DEVELOPMENT
1955, 1969, 1980	Nationalization of Banks to improve its customer base, reach in various parts and financial inclusion.
1961	DICGCI Act – formation of corporation to insure customers deposits in bank.
1966	Cooperative Banks under RBI's Ambit
1969	Lead Bank Scheme (State Cooperative Banks – Pvt or Public) given lead role in district. They prepared credit plan with 'Service Area Approach', and coordinate with the efforts of Government, banks and NBFCs.
1971	State level Bankers' Committee to monitor progress of financial inclusion
1972	Differential rate of interest was introduced to provide bank finance at a concessional rate of interest of 4% per annum to the weaker sections of the community for engaging in productive and gainful activities so that they could improve their economic conditions.
	Regional Rural Bank (RRB) setup through Act – expanded banking in rural pockets. Further, RBI requires commercial banks to setup atleast 25% of their branches in unbanked rural areas. Similar norms for White label ATM Companiesed
1992	The Self-Help Group-Bank Linkage Programme (SBLP) started as a pilot

नोट – प्रिय IAS उम्मीदवारों, यहाँ हमने इस टॉपिक का मात्र SAMPLE ही दिया है, पूरा टॉपिक नही दिया है / यदि आपको हमारे नोट्स के सैंपल अच्छे लगे हों तो कम्पलीट नोट्स खरीदने के लिए नीचे दिए गये हमारे संपर्क नंबर पर कॉल कीजिए या लिंक पर क्लिक करें / दोस्तों, हमें पूर्ण विश्वास है कि ये नोट्स आपकी "UPSC IAS (PRE. & MAINS)" की परीक्षा में पूर्ण संभव मदद करेंगे और आप "INFUSION NOTES" के साथ IAS की परीक्षा में जरूर सफल होंगे, धन्यवाद /

संपर्क करें – 9887809083, 8233195718, 9694804063, 8504091672

प्रिय दोस्तों, अब तक हमारे विभिन्न नोट्स में से विभिन्न परीक्षाओं में आये हुए प्रश्नों के परिणाम –

EXAM (परीक्षा)	EXAM DATE	हमारे नोट्स में से आये हुए प्रश्न
RAS PRE. 2021	27 अक्तूबर 2021	74 प्रश्न (150 में से) CUT OFF – 64
UPSC – IAS PRE. (2022)	05 JUNE 2022	69 (100 में से)
SSC GD 2021	16 नवम्बर	68 (100 में से)
SSC GD 2021	01 दिसम्बर	65 (100 में से)
SSC GD 2021	08 दिसम्बर	67 (100 में से)
राजस्थान S.I. 2021	13 सितम्बर	113 (200 में से)
राजस्थान S.I. 2021	14 सितम्बर	119 (200 में से)

राजस्थान S.I. 2021	15 सितम्बर	126 (200 में से)
RAJASTHAN PATWARI 2021	23 अक्तूबर (1st शिफ्ट)	79 (150 में से)
RAJASTHAN PATWARI 2021	23 अक्तूबर (2nd शिफ्ट)	103 (150 में से)
RAJASTHAN PATWARI 2021	24 अक्तूबर (1st शिफ्ट)	95 (150 में से)
RAJASTHAN PATWARI 2021	24 अक्तूबर (2nd शिफ्ट)	91 (150 में से)
RAJASTHAN VDO 2021	27 दिसंबर (1st शिफ्ट)	59 (100 में से)
RAJASTHAN VDO 2021	27 दिसंबर (2nd शिफ्ट)	61 (100 में से)
RAJASTHAN VDO 2021	28 दिसंबर (1st शिफ्ट)	56 (100 में से)
RAJASTHAN VDO 2021	28 दिसंबर (2nd शिफ्ट)	57 (100 में से)
U.P. SI 2021	14 नवम्बर 2021 1st शिफ्ट	91 (160 में से)
U.P. SI 2021	21नवम्बर2021 (1st शिफ्ट)	89 (160 में से)

& Many More Exams

दोस्तों, इनका proof देखने के लिए नीचे दी गयी लिंक पर क्लिक करें या हमारे youtube चैनल पर देखें –

RAS PRE. – https://www.youtube.com/watch?v=p3_i-3qfDy8&t=136s

VDO PRE. – https://www.youtube.com/watch?v=gXdAk8S6W18&t=202s

Patwari – https://www.youtube.com/watch?v=X6mKGdtXyu4&t=103s

अन्य परीक्षाओं में भी इसी तरह प्रश्न आये हैं Proof देखने के लिए हमारे youtube चैनल (Infusion Notes) पर इसकी वीडियो देखें या हमारे नंबरों पर कॉल करें ।

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Part - 2 Ancient and Medieval History of India

Part - 3 Modern History of India

Part - 4 Art and Culture

Part - 5 Society, World History and Post-Independence India

GENERAL STUDY PAPER – 2

Part -1 Polity, Constitution and Governance

Part - 2 International Relations

Part - 3 Social Justice and Welfare Schemes

GENERAL STUDY PAPER – 3

Part - 1 Economics Part – 1

Part - 2 Economics Part – 2

Part - 3 Science and Technology

Part - 4 Environment, Ecology and Biodiversity

Part - 5 Disaster Management and Internal Security

GENERAL STUDY PAPER – 4

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Paper – 1 Essay Writing + Current Events & Govt. Schemes

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