

GOVERNANCE**Financial Stability Report: RBI's Warning**

Reserve Bank of India (RBI) released the 22nd issue of its biannual Financial Stability Report outlining the risks to financial stability as well as the resilience of the financial system in the contemporary context.

Key Point**Significance of Financial Stability report**

- The FSR is a hugely useful publication as it receives contributions from all the financial sector regulators in the country.
- As such, it provides a rather comprehensive picture of the so-called macro-financial risks facing the economy.
- The FSR released by the RBI is the biannual alert of such risks in the Indian economy.

An Example of Macro-Economic Risk – High NPAs

- If lots of banks in an economy find that the loans they extended to different businesses are unlikely to be repaid, it is a macro-financial risk.
- Because if banks do not get their money back, they won't be able to fund the next set of investments. Lack of access to credit thus impairs the economic growth as expansion of firms is curtailed.
- Even if the government decides to use the taxpayer's money to bail banks out, it will have to curtail some other expenditure — perhaps on education or healthcare or infrastructure, thus impacting the welfare of citizens
- So, one thing can lead to another and the economic growth of a country can take a massive hit just because too many banks had too many non-performing assets (NPAs or bad loans) all at the same time.

What are the major concerns highlighted by FSR Report of RBI?**High Bank NPAs**

- According to the RBI's analysis, the level of Gross NPA ratio in India's banking system could almost double between September 2020 (7.5% of all loans extended) and September 2021 (13.5% to 14.8% depending on economic deterioration)
- To see these percentages in perspective, one must note that when the economy was growing fast — before the 2008 financial crisis — NPAs hovered around the 2.5% level.
- The banking system is the financier of the whole economy. If its wheels get jammed or malfunction, it can derail the fledgling economic recovery.

Disconnect between certain segments of financial markets and the real economy

- The RBI noted that measures taken to support the economy and safeguard the financial system during the COVID-19 pandemic “may have unintended consequences as reflected, for instance, in the soaring equity valuations disconnected from economic performance”.
- While the country's experienced historic recession (economic output shrank by 7.5% in Q2 and 23.9% in Q1 of FY21) the stock markets have been seemingly disconnected and soaring to record highs. As of the close of trading on January 11 (the day the RBI released its report), the benchmark S&P BSE Sensex had appreciated almost 90% from its closing level on March 23, 2020.
- It is a fact that stock market indices, both in India and elsewhere, have surged even when the real economy — that is the number of cars/TVs/ACs/ phones/ houses/ travel trips etc. — has struggled in contrast.
- RBI warned, “Stretched valuations of financial assets pose risks to financial stability,” adding, “banks and financial intermediaries need to be cognisant of these risks and spillovers in an interconnected financial system.”

How did the above situation arise (stock market rise while economy shrank)?

- Stimulus Packages across world: The onset of the pandemic saw monetary and fiscal authorities worldwide, including in India, introducing a slew of support measures to ensure that the restrictions imposed on economic activity did not completely devastate national economies and household incomes.
- Easy money in Financial System: The stimulus measures, which included interest rate cuts and infusion of liquidity, have driven a substantial surge in funds in the financial system, including

in India's case from overseas investors. Availability of lower-cost borrowings also spur people to borrow money to invest in stocks.

- Resurgence of Foreign Portfolio Investment(FPI) to India: Latest data from the NSDL. show that net FPI into equities in the current fiscal year had surged more than 38-fold to ₹ 2,36,781 crore (as on January 16), from the meagre ₹ 6,153-crore inflow in the preceding year.
- Lack of alternatives for higher returns: Worldwide, easy money conditions have in the past invariably spurred stock market rallies as investors seek higher returns at a time when interest rates on fixed income assets such as deposits and bonds decline.

INDIAN ECONOMY

K-Shaped Economic Recovery

Recently, the latest readings of the Nomura India Normalization Index (NINI) suggested the impact of Covid-19 on Indian Economy and the K-Shaped Recovery through which the Indian Economy is recovering.

- Nomura Services India Private Limited (Nomura Holdings Inc) is a consumer services company.

Key Points

Effect of Covid-19 on Households:

- Households at the top of the pyramid are likely to have seen their incomes largely protected, and savings rates forced up during the lockdown, increasing 'fuel in the tank' to drive future consumption.
- Households at the bottom are likely to have witnessed permanent hits to jobs and incomes.

Effect of the Current Monetary Policy:

- A long lasting period of ultra-accommodative monetary policy has led to a fall in real lending rates and spreads for corporates and households that should eventually come as lagged relief to the interest-sensitive sectors.
- An economic spread is a measure of a company's ability to make money on its capital investments.

Impact of Vaccination:

- Lagging sectors such as travel, tourism and hospitality will finally emerge out of the effect of Covid-19.

Economic Recovery after Covid-19:

- As the fiscal deficit in FY 2020-21 has widened to roughly 7% of GDP, which is double the pre-pandemic target of 3.5 % of GDP. The government may, therefore, feel encouraged to rely on higher fuel taxes, disinvestment, and sin taxes to bolster coffers.
- India is going through a K-shaped recovery, wherein corporates and households with stronger balance sheets have recovered more robustly, while smaller firms and poorer households probably remain trapped in a vicious cycle of poverty and indebtedness instigated by the pandemic.

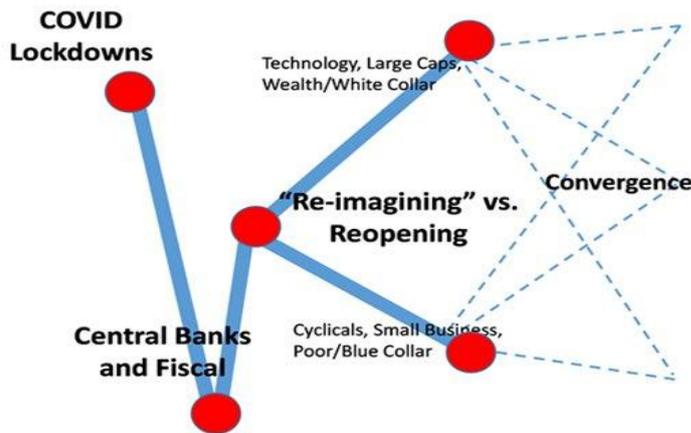
Economic Recovery

Types:

- Economic recovery can take many forms, which is depicted using alphabetic notations. For example, a Z-shaped recovery, V-shaped recovery, U-shaped recovery, elongated U-shaped recovery, W-shaped recovery, L-shaped recovery and K-shaped recovery.

K-Shaped Recovery:

- A K-shaped recovery occurs when, following a recession, different parts of the economy recover at different rates, times, or magnitudes. This is in contrast to an even, uniform recovery across sectors, industries, or groups of people.
- A K-shaped recovery leads to changes in the structure of the economy or the broader society as economic outcomes and relations are fundamentally changed before and after the recession.
- This type of recovery is called K-shaped because the path of different parts of the economy when charted together may diverge, resembling the two arms of the Roman letter "K."



Implications of a K-Shaped Recovery after Covid:

- Households at the bottom have experienced a permanent loss of income in the forms of jobs and wage cuts, this will be a recurring drag on demand, if the labour market does not heal faster.
- To the extent that Covid has triggered an effective income transfer from the poor to the rich, this will be demand-impeding because the poor have a higher marginal propensity to consume (i.e. they tend to spend-instead of saving) a much higher proportion of their income.
- If Covid-19 reduces competition or increases the inequality of incomes and opportunities, it could impinge on trend growth in developing economies by hurting productivity and tightening political economy constraints.

Way Forward

Given the K-shaped recovery and the new “pandemic poor”, the budgets for spending heads such as subsidies, employment generation, rural development and other social sector programmes are likely to remain large. The vaccination costs add to the bill. The government will also have to sharpen its focus on capital spending to contain damage to potential growth.

INTERNATIONAL RELATION

Russia Pulls Out Of Open Skies Treaty

Recently, Russia pulled out of the Open Skies Treaty (OST) citing earlier withdrawal of the USA from the treaty.

- According to Russia, provisions of the pact that allows unarmed surveillance flights over member countries had been seriously compromised by the withdrawal of the United States.
- This move was made after the USA pulled out of the Open Skies Treaty in November 2020, arguing that Russian violations made it untenable for the United States to remain a party.

Key Points

Reasons for USA Withdrawal:

- Russia’s continuous non compliance: The USA had for over a decade accused Russia of non-compliance with OST protocols, blaming Moscow of obstructing surveillance flights on its territory, while misusing its own missions for gathering key tactical data.
- OST misused to claim Ukrainian region: The USA also accused Russia of designating an airfield in the annexed Crimean Peninsula as an Open Skies refueling base as an illegal attempt by Russia to cement its claim to the Ukrainian region.
- Risk to critical infrastructures: Russia misused its flights over the USA and Europe to identify critical infrastructure for potential attack in a time of war.

Reasons for Russia Withdrawal:

- USA limiting OST: Russia defends its non compliance with the OST to allow flights over Kaliningrad (Russian exclave in Eastern Europe that lies between NATO allies Lithuania and Poland) citing the example of the US imposing similar limits on flights over Alaska.
- No assurance from NATO members: After USA withdrawal from OST, Russia did not get the sought assurance from North Atlantic Treaty Organization (NATO) allies who continued to remain on the treaty that they would not transfer data collected by their flights over Russia to Washington (USA).
- Significance:

For European NATO members:

- Russia's departure could adversely impact Washington's European allies, which rely on OST data to track Russian troop movements in the Baltic region.
- Departure from Arms control treaties:
- The failure of the Open Skies Treaty follows the demise of another significant arms control accord, the Intermediate-Range Nuclear Forces (INF) Treaty, after both the US and Russia left it in 2019. This treaty aimed at eliminating their stocks of intermediate-range and shorter-range (or "medium-range") land-based missiles which could carry nuclear warheads.
- Withdrawal of the USA and Russia from OST has further deepened doubts on extension of the New START treaty, which expires in February, 2021.

For India:

- Growing mistrust between global powers could make it difficult for India to maintain good mutual relationships with both the countries if the hostility escalates in future.

Open Skies Treaty (OST)**Background:**

- It was first proposed by USA in 1955 to deescalate tensions during the Cold War.
- This treaty was eventually signed in 1992 between NATO members and former Warsaw Pact countries following the demise of the Soviet Union. It finally came into effect in 2002.
- The Warsaw Pact (1955) was signed between Russia and her satellite states shortly after West Germany was admitted to NATO.
- The Pact was a mutual defense agreement, which the Western countries perceived as a reaction against West Germany's membership of NATO.

Aim:

- Building confidence: The OST aims at building confidence among its 34 signatories countries through mutual openness, thus reducing the chances of accidental war.

Terms:

- Open surveillance: Under the treaty, a member State can undertake surveillance on any part of the host nation, with the latter's consent.
- Only approved imaging equipment is permitted on the surveillance flights.
- Officials from the host state can also stay on board throughout the planned journey.
- Sharing strategic information: The information gathered, such as on troop movements, military exercises and missile deployments, has to be shared with all member States.
- Both US and Russia were signatories of the treaty.
- India is not a member of this treaty. the Duqm Port industrial city.

INFRASTRUCTURE DEVELOPMENT DIVERSITY**Iron-Ore Policy 2021**

The Ministry of Railways has approved a new iron-ore policy governing the allocation of rakes and transportation of iron-ore.

Key Points

- This new policy has been named as Iron-ore Policy 2021 and shall come into effect from February 10, 2021.
- The provisions of the new policy will be updated in the rake allotment system module by the Centre for Railway Information Systems (CRIS).
- Scrutiny of documentation by Railways has been removed.
- Executive Director Rake Movement of Railway Board (EDRM) office, Kolkata which has been sanctioning programmes for movement of iron-ore traffic will have no regulatory role in the new policy.
- Customers now desirous of moving their traffic under any priority will have to give (an) undertaking that they have procured, transported and utilized materials as per rules and regulations of Central and State Governments.
- Higher priority will be given to the movement of iron-ore traffic for domestic manufacturing activity.
- Old and new plants will be treated similarly as far as allotment and loading of rakes is concerned.

NATIONAL DEVELOPMENT**Government's Disinvestment Plans**

Recently, the Ministry of Finance has extended the bidding deadlines for the strategic disinvestment of Pawan Hans by a month, citing logistical challenges faced by interested bidders due to the Covid-19 pandemic.

- Pawan Hans Limited is a helicopter service company based in New Delhi. It is a Mini Ratna-I category Public Sector Undertaking.

Key Points**Background:**

Government's Disinvestment Target for 2020-2021: Government plans to raise Rs. 2.1 lakh crore through disinvestment in 2020-21, with just about Rs. 14,000 crore raised so far through minority stake sales.

New Public Sector Policy: As part of the 'Aatmanirbhar Bharat Abhiyan' package, the government in May 2020 had announced that there will be a maximum of four public sector companies in the strategic sectors, and state-owned firms in other segments will eventually be privatised.

- Under the policy, a list of strategic sectors will be notified where there will be at least one and a maximum of four public sector enterprises, apart from private sector companies.
- In other sectors, central public sector enterprises (CPSEs) will be privatised, depending on the feasibility.

Current Situation:

The Bidding deadline for the disinvestment of Pawan Hans has been extended by a month.

Strategic sales of public sector firms like Air India and Bharat Petroleum Corporation Limited (BPCL) are unlikely to conclude this year.

Further amendments are needed to the LIC Act of 1986 to list the Life Insurance Corporation of India on the markets.

Disinvestment

- Disinvestment means sale or liquidation of assets by the government, usually Central and state public sector enterprises, projects, or other fixed assets.
- The government undertakes disinvestment to reduce the fiscal burden on the exchequer, or to raise money for meeting specific needs, such as to bridge the revenue shortfall from other regular sources.
- Strategic disinvestment is the transfer of the ownership and control of a public sector entity to some other entity (mostly to a private sector entity).

Unlike the simple disinvestment, strategic sale implies a kind of privatization.

- The disinvestment commission defines strategic sale as the sale of a substantial portion of the Government shareholding of a central public sector enterprises (CPSE) of upto 50%, or such higher percentage as the competent authority may determine, along with transfer of management control.

The Department of Investment and Public Asset Management (DIPAM) under the Ministry of Finance is the nodal department for the strategic stake sale in the Public Sector Undertakings (PSUs).

SCIENCE AND TECHNOLOGY/DIVERSITY**5G Technology**

Recently, the Department of Telecommunications (DoT) has sought inputs from telecom companies and other industry experts on the sale and use of radio frequency spectrum over the next 10 years, including the 5G (Fifth Generation) bands.

Key Points**Features of 5G Technology:**

Millimeter wave spectrum: The 5G networks will operate in the millimeter wave spectrum (30-300 GHz) which have the advantage of sending large amounts of data at very high speeds because the frequency is so high, it experiences little interference from surrounding signals.

Upgraded LTE: 5G is the latest upgrade in the long-term evolution (LTE) mobile broadband networks.

Internet speed: In the high-band spectrum of 5G, internet speeds have been tested to be as high as 20 Gbps (gigabits per second) as compared to the maximum internet data speed in 4G recorded at 1 Gbps.

5G network speeds should have a peak data rate of 20 Gb/s for the downlink and 10 Gb/s for the uplink.

Bands in 5G: 5G mainly work in 3 bands, namely low, mid and high frequency spectrum — all of which have their own uses as well as limitations.

Low band spectrum: It has shown great promise in terms of coverage and speed of internet and data exchange however the maximum speed is limited to 100 Mbps (Megabits per second).

Mid-band spectrum: It offers higher speeds compared to the low band, but has limitations in terms of coverage area and penetration of signals.

High-band spectrum: It has the highest speed of all the three bands, but has extremely limited coverage and signal penetration strength.

Hurdles in Rolling Out 5G Technology:

- Enabling critical infrastructures
- Financial liability on consumers
- Capital Inadequacy

Utility of 5G Applications: Combined with IoT, cloud, big data, AI, and edge computing, 5G could be a critical enabler of the fourth industrial revolution.

Global Progress on 5G:

- Global telecom companies have already started building 5G networks and rolling it out to their customers in many countries:
- 5G had been deployed in 50 cities in the United States.
- South Korea has rolled out 5G to 85 cities.
- Japan and China have too started 5G mobile service on a trial basis.

BIODIVERSITY & ENVIRONMENT

India home to both species of red panda: ZSI

Scientists from the Zoological Survey of India have concluded that India is home to both the (sub) species — Himalayan red panda (*Ailurus fulgens*) and the Chinese red panda (*Ailurus styani*).

Key Points

- The Siang river in Arunachal Pradesh splits the red panda into these two phylogenetic species.
- The red panda was considered a monotypic species till 2020 until the scientists studied its genetic make-up with respect to the geographical distribution and described the occurrence of the two species.
- The reason for the reduction in the population size of the Himalayan red panda is due to the geological and climatic oscillations as the landscape was exposed to heavier topographic and geological changes through repeated cycles of the wet and dry periods during the last glacial maxima and Pleistocene Era.
- It is considered an indicator species for ecological change, the red panda is shy, solitary and arboreal animal. It primarily feeds on bamboo and avoids human presence.
- Director of the ZSI, said the overall conservation of this ecologically sensitive species required an effort from both the national and international stakeholders and adequate awareness among the local communities.

Important value additions

- The red panda (*Ailurus fulgens*) is a mammal species native to the eastern Himalayas and southwestern China.
- It is listed as Endangered on the IUCN Red List
- Threats: Habitat loss and fragmentation, poaching, and inbreeding depression.
- Despite its name, it is not closely related to the giant panda



IMPORTANT FACTS FOR PRELIM

Western Disturbance

According to the India Meteorological Department (IMD), a western disturbance is likely to affect the Himalayan region soon.

- The disturbances will result in fairly widespread light to moderate snowfall and rains in the plains of Jammu.

Key Points

- Western Disturbance (WD), labelled as an extra-tropical storm originating in the Mediterranean, is an area of low pressure that brings sudden showers, snow and fog in northwest India.

- The disturbance travels from the “western” to the eastern direction.
- These travel eastwards on high-altitude westerly jet streams - massive ribbons of fast winds traversing the earth from west to east.
- Disturbance means an area of “disturbed” or reduced air pressure.
- Equilibrium exists in nature due to which the air in a region tries to normalise its pressure.
- A WD is associated with rainfall, snowfall and fog in northern India. It arrives with rain and snow in Pakistan and northern India. The moisture which WDs carry with them comes from the Mediterranean Sea and/or from the Atlantic Ocean.
- WD brings winter and pre-monsoon rain and is important for the development of the Rabi crop in the Northern subcontinent.

DAILY ANSWER WRITING PRACTICE

Qns. “Institutional quality is a crucial driver of economic performance”. In this context suggest reforms in the Civil Service for strengthening democracy. (UPSC GS-2 Mains 2020).

Ans:

Institutional quality in a democracy determines how successful the government machinery adheres to the principles of public service, rule of law, and social justice. One such institution is the Civil Services, which acts as a link between the Government & Citizenry and strengthens democracy.

However, there are many challenges faced by civil services, which act as a roadblock in the path of democracy.

Challenges Faced By Civil Services in India

- **Status Quoist:** As instruments of public service, civil servants have to be ready for change. The common experience, however, is that they resist changes as they are wedded to their privileges and prospects and thereby, have become ends in themselves.
- For example, the 73rd and 74th Amendments to the Constitution have envisaged democratic decentralization.
- However, due to the reluctance on the part of the civil servants to accept the changes in control and accountability, the intended vision has not been achieved.
- **Rule-Book Bureaucracy:** By the rule book bureaucracy, it meant mainly following the rules and laws of the book without taking care of the actual needs of the people.
- Due to rule book bureaucracy, some civil servants have developed the attitude of ‘bureaucratic behavior’, which evokes issues like red-tapism, the complication of procedures, and the maladapted responses of ‘bureaucratic’ organizations to the needs of the people.
- **Political Interference:** The political representative for the sake of fulfilling the populist demand, influences the functioning of administrative officials. Hence, an administrative official has to adhere to the will of the political master.
- This interference sometimes leads to issues like corruption, arbitrary transfers of honest civil servants.
- Also, this led to substantial inefficiency where the vital positions are not held by the best officers and ultimately this can lead to institutional decline.

Civil Services Reforms

- **Prompt Delivery Of Services:** Every department should seek to simplify their processes to cut administrative delays and ensure participatory feedback mechanisms for efficient service delivery.
- **Reducing Discretion & Enhancing Accountability Mechanism:** There is an inherent need to set key responsibility/focus areas and progressively reduce discretionary aspects to evaluate civil servants.
- **Online Smart Performance Appraisal Report Recording Online Window (SPARROW)** should be instituted in all central and state cadres.
- Also, as suggested by many committees, there is a need to develop benchmarks to assess the performance of officers and compulsorily retire those deemed unable to meet the benchmarks.
- **Incorporation of Code of Ethics:** As suggested by 2nd ARC, along with streamlining of code of conduct rules, there is a need to inculcate ethical underpinning in the civil servants by implementing Code of Ethics.
- This will sensitize civil servants to problems of people and help in the resolution of ethical dilemmas, which tend to emerge frequently in the public sphere.

Conclusion

Sardar Patel considered the civil service “the steel frame of government machinery”. However, without adequate reforms, this steel frame may start to get corrosion and may collapse. Therefore, in order to deal with present-day challenges and strengthen democracy, there is a need to carry out Civil services reforms in a holistic way.

DAILY QUIZ

1. With reference to Mitochondria, which of the following statements are correct?
1. Mitochondrial DNA is the small circular chromosome.
 2. The mitochondria produce cellular energy in the form of adenosine triphosphate (ATP).
 3. Mitochondrial DNA is inherited from the mother, while nuclear DNA is inherited from both parents.

Select the correct answer using the code given below:

- a) 1 and 3 only
 - b) 2 and 3 only
 - c) 1 and 2 only
 - d) 1, 2 and 3**
2. Consider the following statements:
- a) The Open Skies Treaty between two countries provides rights for airlines to offer international passenger and cargo services.
 - b) Open Sky agreement allows a member State to undertake surveillance on any part of the host nation.

Which of the statements given above is/are correct?

- a) 1 only
 - b) 2 only
 - c) Both 1 and 2
 - d) Neither 1 nor 2**
3. Which of the following statements is not correct regarding the different shapes of economic recovery?:
- a) In Z-shaped the economic disruption lasts for a small period wherein more than people's incomes, it is their ability to spend is restricted.
 - b) In V-shaped the incomes and jobs are permanently lost, and the economic growth recovers gradually.**
 - c) In U-shaped the economy after falling, struggles around a low growth rate for some time, before rising gradually to usual levels.
 - d) In K-Shaped after a recession, different parts of the economy recover at different rates, times, or magnitudes.

4. Consider the following statements regarding Semeru volcano:

1. It is a part of the Island arcs formed by the subduction of the Indo-Australian plate below Sunda Plate.
2. It is prone to seismic upheaval due to its location on the Pacific's Ring of Fire.

Which of the statements given above is/are correct?

- a) 1 only
 - b) 2 only
 - c) Both 1 and 2**
 - d) Neither 1 nor 2
5. Which of the following statements is not correct regarding the 'Western disturbances'?
- a) It is an extra-tropical storm originating in the Mediterranean region.
 - b) It is associated with rainfall, snowfall and fog in northern India.
 - c) It is important for the development of the Kharif crop in the Northern subcontinent.**
 - d) It travels from the western to the eastern direction on high-altitude westerly jet streams.