VISION IAS
INSPIRING INNOVATION

ECONOMICS

Classroom Study Material

PART-3

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VISION IAS

ECONOMY PART 3

Student Notes:

INDIAN ECONOMY AND ISSUES RELATING TO MOBILIZATION OF RESOURCES

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1. Introduction

Anything that has *utility* or *usability* is a resource. The government requires resources – human, physical and economic - to carry out its functions. In this document, we will deal only with economic resources. Mobilization of resources, in this context, means "**efficient collection and channelizing of resources**" to achieve some goal.

Ways of resource mobilization include direct or indirect taxes, import or export duties or fees for services, or borrowings.

2. Sources of Financial Resources of Government

There are three sources from where the government gets money. The first two are revenue sources, and the last one is borrowings and capital asset sales:

- **Tax Revenue –** This is the tax that the government collects in the form of personal income tax, goods and services tax etc.
- **Non Tax Revenue –** These are things like interests on bonds held, dividends from PSUs, and grants. They are revenue sources meaning they don't have to be repaid and are smaller than tax revenues.
- **Capital Receipts –** These are borrowings of the government like the market loans, short term borrowings, external commercial borrowings etc. The loans received from foreign governments and bodies, disinvestment receipts and recoveries of loans from State and Union Territory Governments and other parties are also part of capital receipts.

Some Estimates of Financial Resources Required

- India will need about **USD 4.5 trillion in the next 25 years** for infrastructure development. (Economic Survey 2018)
- Over the next decade, India requires over **USD 1.5 trillion** to fill up the infrastructure gap.
- Investment on infrastructure needs to increase to **INR 50 lakh crore over the next five fiscals** through 2022. (CRISIL)

3. Transfer of Resources from Center to States

In the federal system of India, state and local bodies depend a lot on Center for meeting their financial requirements. There exist several mechanisms to channel resources from Center to states, such as:

- Finance Commission to lay down principles which shall govern division of sharable pool of taxes of Union of India.
- Goods and Services Tax Council make the recommendation on rate of the GST, surcharges, Exemptions, Model of GST law, Place of Supply rules, and special rate of the GST, Special Provision for North east states or any other matter as decided by the council.
- Grants-in-Aid under Article 275 of the Constitution of India.
- Discretionary grants under Article 282.

Recent Changes Impacting Transfer of Resources

- With the **abolition of Planning Commission,** the model of grants tied to Five Year Plans (FYP) has been done away with (12th FYP which ended in 2017 was the last in series). The grants which were hitherto transferred through Planning Commission are now routed through Finance Ministry.
- **Goods and Services Tax (GST)** has subsumed a number of central and state indirect taxes and provided for a Goods and Services Council. But there has been criticism that it has led to an adverse effect on the fiscal position of the states. Accordingly, it has been provided that the Parliament may by law and with the recommendation of the GST Council, will provide compensation to the State on account of implementation of the GST.
- **Restructuring of Central Sponsored Schemes**: Starting from the FY 2016-17, the schemes of Centrally Sponsored Schemes (CSS) have been reduced drastically. The reduction in the

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number of schemes coupled with the increase in devolution of resources by the 14th Finance Commission reduces the dependency of States on the Centre. It also facilitates the State Governments in designing schemes as per their needs.

4. Issues in Mobilization of Resources

A. There exists **vertical imbalance** (between the Centre and the States) and **horizontal imbalance** (among the states with varying fiscal capacities) in the distribution of financial resources.

B. **Fiscal Consolidation** – against the background of continuing resource asymmetry, most States achieved the statutorily envisaged fiscal consolidation by 2006 itself. They brought down the fiscal deficit to less than 3 per cent of the GDP and wiped out the revenue deficit as mandated. But the Centre did not comply with the FRBM mandate and it has not been able to control its revenue expenditure.

C. **Low Tax-to GDP** ratio:- India's tax-to-GDP ratio for 2017-18 was 11.6% and is well below the emerging market economies and OECD averages of about 21% and 34% respectively. **Key reasons** for India's low tax-GDP ratio are:
- Structural factors such as low per capita income keep tax collections low.
- **Exemptions in the taxable income** have grown at a much faster rate than the income reducing tax buoyancy.
- A lack of policy initiatives has also kept the tax rate low such as *certain tax exemptions* to income generated by small and medium enterprises and agriculture related activities.
- **Widespread income tax evasion as evident by the fact that only 1.7% of the population paid income tax in 2015.-16.**
- **Inefficient tax administrative system, arbitrariness in deciding upon tax quantum of corporate, loopholes in Double Taxation Avoidance Agreement, multiple litigations involving corporate etc. have affected the revenue capacity.**

D. It is widely known that India's **subsidy system** is highly inefficient and millions of needy people do not get their quota of subsidy. Food, fertilizers and fuel (3Fs) are major components of the union's subsidy budget.

E. **Increasing Tax Arrears to the tune of Rs. 5 lakh crores –** the Government should make a determined effort to recover the huge income tax arrears. The total arrears amount to be recovered is stuck because of a variety of reasons like litigation, companies in liquidation, sick companies and untraceable taxpayers.

F. **Corporate Tax Exemptions –** Despite having a scheduled corporate tax rate, which is comparable with developed countries, the effective tax rate for the private corporate sector in India continues to be low due to the myriad exemptions. The various tax exemptions that exist today needs to be rationalized.

NITI Aayog on rationalizing subsidies:
- Social subsidies should be reoriented so that people become economically independent rather than perpetually dependent upon them.
- Within revenue expenditure, subsidies have crowded out more socially relevant expenditures like education and health.
- Better targeting through use of socio-economic and caste census data.
- Doing away with production subsidies like cheap lands and other benefits to companies.
- Use of DBT in all the social welfare distribution schemes.

5. Steps taken by the Government

- Doing away with plan and no-plan expenditure.
- Merger of General and Railways Budget.
- Restructuring of CSS.
- N K Singh panel was formed to review FRBMA for fiscal consolidation.
- Rationalization of subsidies through several initiatives:

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  - Direct Benefit transfer scheme through Jan Dhan-Mobile-Aadhar trinity.
  - Shifting to Nutrient based subsidy scheme for fertilizers.
  - Doing away with fuel subsidies except LPG and Kerosene.
  - Freeing diesel and petrol prices.
  - Give-it-campaign for LPG subsidy and withdrawing LPG subsidy from consumers having taxable income of 10 lakhs or more
- **Levy of Long Term Capital Gains tax** in Budget-2018 announced on profit exceeding Rs. 1 lakh during the sale of shares (equities) & equity mutual funds.
- Review of Public Private Partnership projects (PPPs) through various initiatives:
  - Setting up robust institutional structure for appraising and approving PPP projects.
  - Developing standardised documents such as model concession agreements across infrastructure sectors.
  - Increasing availability of finance by creating dedicated institutions and providing viability gap funding.
  - Abolishing of FPIB as more than 90% of FDI inflows are routed through the automatic route which do not require prior approval of FIPB.
- **India Infrastructure Finance Company Limited** (IIFCL) was incorporated in 2006 for providing long-term loans for financing infrastructure projects that typically involve long gestation periods. IIFCL raises funds from both domestic and overseas markets on the strength of government guarantees. It provides financial assistance both through direct lending to project companies, and by refinancing financial institutions.

5.1. Suggestions to Improve Mobilization of Resources

- The Economic Survey stressed the need to fill the infrastructure investment gap by financing from **private investment**, **institutions** dedicated for infrastructure financing like National Infrastructure Investment Bank (NIIB) and also **global institutions** like Asian Infrastructure Investment Bank (AIIB) and New Development Bank (erstwhile BRICS Bank).
- **Tap Cash Reserves of CPSUs –** there are 50 CPSUs, which collectively have reserves and surpluses of Rs 2,21,157 crore based upon the Public Enterprises Survey, 2003-2004. However, investment by these CPSUs is not more than 30 per cent of total surplus. This disturbing trend towards underinvestment needs to be reversed at once and the CPSUs reinvigorated to undertake massive capital expenditure, diversifying their activities if necessary. Left parties argues that the Government should also seek special dividends from those CPSUs, which are holding very high levels of liquid reserves, in order to finance expenditure in social sectors or infrastructure.
- Effective and efficient shift to **Engineering, Procurement and Construction (EPC) contracts model** where the contractor is responsible for design and construction on a turnkey basis and for a fixed price. It is expected that about 20,000 km of two-lane National Highways would be developed under this model.

6. Panchayat's Finance

In general, Panchayats receive funds in the following ways:

- **Internal Resource** Generation (tax and non-tax).
- **Grants** from the Union Government based on the recommendations of the Central Finance Commission as per **Article 280** of the Constitution.
- **Devolution** from the State Government based on the recommendations of the State Finance Commission as per **Article 243I.**
- **Loans/grants** from the State Government.
- **Programme-specific allocation** under Centrally Sponsored Schemes and Additional Central Assistance.

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Across the country, States have not given adequate attention to fiscal empowerment of the Panchayats. One can draw the following broad conclusions:

- Internal resource generation at the Panchayat level is weak.
- This is partly due to a thin tax domain and partly due to Panchayats' own reluctance in collecting revenue.
- Panchayats are heavily dependent on grants from Union and State Governments.
- A major portion of the grants both from Union as well as the State Governments is scheme specific.
- Panchayats have limited discretion and flexibility in incurring expenditure.
- In view of their own tight fiscal position, State Governments are not keen to devolve funds to Panchayats.
- Overall, a situation has been created where Panchayats have responsibility but grossly inadequate resources.

6.1. Suggestions to Increase Revenue of Panchayats

In order to widen their tax base the PRIs will need to explore additional sources of revenue.

- Sectors like transport, tourism and infrastructure have grown remarkably and a part of this growth has also percolated to the rural sector.
- Among the classical items of tax collection – imposition of profession tax, cattle registration fee and vehicle registration fee are the three notable areas which have not been exploited optimally by the Panchayats. The Panchayats need to be more imaginative and assertive in tapping such resources.
- All common property resources vested in the Village Panchayats should be identified and made productive for revenue generation.
- The local community represented by the local Panchayat should have prime right over the income from royalty accrued to the State Government for mining in that area. State Finance Commissions should bear this in mind while finalizing devolution of grants to the rural local bodies. State Governments should consider empowering the PRIs to collect cess on the royalty from mining activities.
- One of the effective and fair tools to improve revenue collection of the local bodies is to **incentivize** their efforts. Panchayats which have shown positive results must be suitably rewarded. This can be done by linking grants and aids from centre and state to their own revenue generation efforts.

7. Urban Local Bodies' Finances

Receipts in case of an urban local body can be broadly classified as follows:

- Tax Revenue – property tax, advertisement tax etc.
- Non-Tax Revenue – income in terms of rent, royalty, interest, fees and profits/dividends, user charges for public utilities such as water, sewage etc.
- Devolution of funds from the State Government
- Grants from Union and State Governments for development schemes
- Borrowings

7.1. Suggestions to Increase Revenue of Urban Local Bodies

- There is lot of scope for improvement in the area of **Property Tax** which is the most important source of revenue for local governments, such as:-
    - **Widening the tax base –** Only 50-60 per cent property is assessed. There are several reasons for low coverage. With urban sprawls, a large number of properties fall outside the legal jurisdiction of the municipal bodies. State laws often provide for exemption to a number of categories of buildings such as those belonging to religious or charitable

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institutions. A large number of properties belonging to the Union and State Governments are not taxed because of the provisions of **Article 285.** All these properties use services like solid waste management, maintenance of approach roads and general civic amenities. Therefore, Local Governments should be empowered to collect **'service charges'** in respect of these properties.

- **Improving Collection Efficiency –** It has been experienced that the collection efficiency of municipal taxes is in the range of 40 to 46%. Poor data base management, improper upkeep of records, collusion between tax payers and recovery officers and lack of understanding of the tax regime are the main reasons for low recovery rates.
- **Making Property Tax Buoyant –** The tax fixed for a property would remain unchanged till such time an overall revision in the property tax was undertaken in the municipal areas. Such revisions in some places did not take place for several years or even decades. The Unit Area Method overcomes this problem to some extent.

- As per 2nd ARC (Administrative Reforms Commission) suggestions, following principles in administration of taxes should be followed:-
  - Transparent and objective levy of tax
  - The cost of collection (for local body) and compliance (for tax payer) should be reduced to a minimum
  - An independent unit under the Chief Executive to monitor the collection of all taxes
  - Levies should be based on self-declaration accompanied by stringent penalties.
- The levy and collection of **appropriate user charges** for various services provided by municipality must be encouraged.
- State governments should enact fiscal management laws stipulating upper limits for borrowings where municipalities borrow from the market on the basis of their own rating.
- The institutional capability of municipal bodies needs to be enhanced as a necessary pre-condition for successful PPP projects.
- Land held by municipal bodies should be used as a leverage for raising infrastructure investment by leasing of these lands and also borrowing against the value of these lands.

8. Previous Years UPSC Mains Questions

1. Among several factors for India's potential growth, savings rate is the most effective one. Do you agree? What are the other factors available for growth potential?
2. Craze for gold in Indians have led to a surge in import of gold in recent years and put pressure on balance of payments and external value of rupee. In view of this, examine the merits of Gold Monetization Scheme.

9. Previous Years Vision IAS GS Mains Questions

1. Explain the role played by banks for mobilization of resources in India.

Approach:

Straight forward question. Write about how the banks act as an intermediary for mobilization of resources.

Answer:

A well designed financial system promotes growth through effective mobilisation of savings and their allocation to the most productive uses by either following a centralised approach or a decentralised approach or a combination of both. Typically, economies with underdeveloped capital markets adopt a centralised approach, whereby financial intermediaries such as banks mobilise resources from savers and allocate them to borrowers.

Historically, financial intermediation by banks has played a central role in India in supporting the growth process by mobilising savings, particularly after the

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nationalisation of the 14 major private banks in the late 1960s. Banks have been particularly instrumental in mobilising deposits from the household sector, the major surplus sector of the economy, which, in turn, has helped raise the financial savings of the household sector and hence the overall saving rate.

Notwithstanding the liberalisation of the financial sector and increased competition from various other saving instruments, banks continue to play a dominant role in the financial intermediation of the Indian economy. The deregulation of interest rates has opened up new avenues for banks to mobilise funds at competitive rates. Further owing to the robust growth performance, banks need to provide funding on a sustained scale which could be harnessed by unlocking a large part of domestic savings locked up in unproductive physical assets like gold, real estate etc.

The changing demographics and employment patterns also generate demand for a wide range of financial services such as insurance, housing and other financial products with innovative features. In order to reap the benefits of the changing demographics and employment patterns, banks can re-orient their role as financial intermediaries beyond the traditional confines of passive deposit mobilisation and lending by providing a package of financial services as demanded by the customers. The rural sector also throws up vast opportunities for banks to reap the benefits of low cost large deposit base, which may not be available to other financial intermediaries.

The mobilisation of savings from hitherto untapped areas and conversion of physical savings into financial savings would necessitate introduction of appropriate products to suit the demand of savers. Banks are indeed in an ideal position to do so because of certain inherent characteristics of deposits such as safety and liquidity.

2. In recent years, savings rate in the Indian economy has witnessed a consistent decline. What are the factors responsible for this trend? How has the composition of savings changed in the last few years? Suggest measures to improve and better channelize household savings.

***Approach**:*

Gross Domestic Savings, investment, Gross Capital formation are invariably linked with growth. Answer should be structured as follows:

- Introduce by mentioning the peak in savings in 2008 followed by a down turn.
- Enumerate the causes attributed for the declining trend in savings.
- Composition of Savings in terms of the share of Household saving, Public or government savings and Corporate savings should be highlighted
- Measures to better channelize household savings should be in the context of decline in financial savings and a rise in physical savings such as land and gold in recent years.

Answer:

High Saving rates have been linked with high growth. The composition of domestic savings in India includes three sources i.e. households, the private corporate sector, and the public sector. National savings rate in India had hit an all-time high of 36.9 per cent in FY08, but has been consistently declining ever since. According to the Economic Survey 2014-15 the gross domestic saving, has declined from 33.9 per cent of the GDP in 2011-12 to 31.8 per cent in 2012-13 and further to 30.6 per cent in 2013-14. Factors that can be attributed for this trend are:

- Slowdown in overall economic growth
- Diminishing returns on Savings for the Household sector due to factors such as inflation.

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- Decreasing productivity and profit in the Corporate sector.

As far as the changes in the composition of saving in the last few years is concerned the following can be observed:

- Household savings remain the largest contributor but its share has been declining. From 25.9 % of GDP in 2009 to 17.8% in 2013-14.
- The corporate sector as part of the Domestic savings has seen and upward trend and constitutes the second largest share after the household sector.
- The share of Public sector savings has seen a consistent decline over the years From 5% of the GDP in 2008- it came down to 1.6% in 2013-14.

A sharp decline in the household savings and a decline in financial savings (bank deposits insurance, shares etc) vis-à-vis physical savings (Real Estate, Gold etc.) has been identified as key areas of concerns. Following Suggestion can be made to better channelize household savings in India:

- Curbing inflation
- Expanding financial inclusion
- Offering new products such as inflation indexed bonds.
- Improving saver access to financial products.

3. What do you understand by Green Finance? Explain its importance and discuss the issues related to use of Green Finance in the context of India.

Approach:

- Explain the meaning of Green Finance.
- Explain its importance in the context of India.
- Discuss issues related to Green Finance

Answer:

Green Finance refers to financial investments flowing towards sustainable development projects and initiatives. The thematic areas that Green Finance covers are clean energy, energy efficiencies, sustainable transport, water and waste management, biofuels etc.

Importance of Green Finance

Green finance has attained a lot of importance in the past few years due to increased focus of Green development. In 2015, green bonds issued by governments, banks, corporate and individual projects amounted to USD 42 billion.

Green Finance is very relevant in the context of India. The Indian government policies and programs in various sectors require huge funding and most of these are related to sustainable development. Attainment of renewable energy target of 160 GW by 2022, development of smart cities, providing green infrastructure in terms of transport etc. requires Green Finance.

The resources of the public sectors are constrained and there is an urgent need for private finances to invest in green projects and infrastructure development. For this, developing countries like India need to develop a robust green bond market through international collaboration in information and knowledge sharing and encouraging private sector to invest

The **major issues** related to Green Finances are:

- **Lack of internationally agreed universal definition** of Green Finance with specific standards in terms of use of proceeds, evaluations, management of proceeds, financial reporting and procedures.

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- Most of Green technology is with developed countries and under protected realm of IPR.
- Green Finance should not only be limited to renewable energy investments but also to greening of coal technologies and poverty programs etc.
- With respect to India, low credit ratings of potential issues of Green Finance and high costs of issuances act as impediments.
- Green Finance should also consider unsustainable pattern of consumptions as parameters in deciding finance, particularly conspicuous consumptions and unsustainable lifestyle in developed countries.

India has started issuing green bonds for renewable energy projects. The government needs to provide specific tax incentives, increase PSL targets for Green Finance and diversify the process of Green Finance to areas not limited to renewable energy to realize the full potential.

4. As the recently released data shows, a narrow tax base remains a major concern in India. What are the possible reasons for such a scenario? In this context, also examine the government efforts to address the issue.

Approach:

- Give a brief picture of the narrow tax base in India.
- Bring out various reasons for the narrow tax base.
- Enumerate and examine various steps taken by government to widen the tax base.

Answer:

The recently released data shows that only 2.9 crores Indian filed personal income tax returns for 2012-13, which is less than 4% of total adult population. More than half of 2.9 crores paid no tax at all. This is too less for effective functioning of any state as tax is the main source of government revenue and determines the capacity of government programmes.

Reasons:

- Low level of incomes so that most of the population remains below the tax net.
- Complex maze of taxes which hinders effective compliance.
- Presence of various exemptions in tax laws, which are utilized by tax payers to lower tax burdens.
- Failure of authorities to check tax evasion.
- Large informal sectors and mostly cash economy which makes it difficult for tax authorities to detect flow of money.
- Flow of black money in the economy.

The government has recognized the need to increase the tax base and has taken the following steps:

- Increasing voluntary compliances and making tax filing user friendly.
- DTC to codify all direct tax laws under one law which would use simple language, provide simplicity and stability in tax structure, consolidate taxing provisions, definitions, exemptions, incentives and procedures to make them uniform.
- The government appointed the Tax Administration and Reforms Commission to recommend ways to enhance tax base.
- Passing of Black Money Act and the Benami Transaction Act to grab tax evaders
- Implement GAAR from April 2017.
- Increased use of technology, e-filling, collecting data from multiple sources and quick disposal of cases to prevent tax evasion.

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- In recent budget, introduction of presumptive taxation regime for small businesses and certain service providers.

These steps are the need of the time. However, measures like Black Money Act have limited effectiveness and need international cooperation as well. Hence, more needs to be done:

- Push for Multilateral agreement to address the issue of tax havens.
- Lower the ceiling of tax imposition.
- Gradual withdrawal on exemptions provided on investment and saving schemes.

GOVERNMENT BUDGETING

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1. Budgeting: Meaning and Importance

Budget is a statement of estimated receipts and expenditures of the government in respect of every financial year. Budgeting is the process of estimating the availability of resources and then allocating them to various activities of an organization according to a pre-determined priority. It is an attempt to balance scarce means with public needs and ends.

Budgets are beyond money; they also represent choices, policies and philosophies. It is about allocating resources to competing priorities and issues of fairness or social justice come into it. They indicate the direction in which a country is headed and the path it has chosen to achieve its objectives.

Apart from its financial roles, the other functions performed by or through budgets are:

- Budgets act as instruments of control. They act as a benchmark to evaluate the progress of various departments. If a department is off-target, w.r.t. its budgetary proposals, it can be informed and corrective actions could be taken.
- Budgetary process involves all the departments of the government. Conflicts among various departments have to be resolved. So, budgetary planning and implementation helps in bringing various departments together and hence achieve co-ordination among them.
- Budgets can also be used as tools of punitive action by reducing the allocation of under-performing departments. So, they are also helpful in maintaining efficiency in working of various departments.
- Budgets can also be helpful in bringing about and institutionalising a change that an administrator wants. For example, if the government wants to improve the productivity of its employees, it can introduce incentives like performance related bonus through budgets.
- Budget also provides a platform for redistribution of resources. This redistribution might be from rich to poor or between regions, between generations, between workers and non-workers.
- It serves the purpose of public accountability of funds.

In sum, it is a planned approach towards increasing government activities that calls for mobilisation of large resources. The criticality of budgets to governance can be well understood by the changes in budgetary process in response to changing public opinion about the functions of government over the years.

Business and government budgeting are more different than alike. The differences between the two is tabulated below:

Student Notes:

Government Budgeting	Business Budgeting
It is legally required for almost all government entities	It is not legally required
It has to stay within the amounts appropriated and any changes need formal approval and difficult to get through the system	It can implement budget as it pleases and may even abandon its budget in midstream
It is formulated with welfare motive	It is mostly profit oriented

2. The Union of India's Budget

Article 112 of the Indian constitution refers to budget as the 'annual financial statement.' The union budget has two purposes:

1. To finance the activities of the union government.
2. To achieve macroeconomic objectives such as employment, sustained economic growth, and price level stability, which forms a part of fiscal policy.

Considering limited resources at its disposal to fulfill multivariate responsibilities, financial planning, and the democratic maxim of 'no taxation without representation', the government has to bring financial statement annually before the Parliament. The Government is not free to tax, borrow and spend money the way it likes. Every item of expenditure has to be well thought out and the total outlay worked out for a specific period. Also, there must be the sanction of the people behind all these financial proposals, expressed clearly through their chosen representatives.

It is in this context that the Budget of the Government of India is presented before both the Houses of Parliament every year. The Budget contains the **financial statements** of the government embodying the **estimated receipts and expenditure** for one financial year, which at present commences on the 1st of April every year. In other words, it is a proposal of how much money is to be spent on what and how much of it will be contributed by whom or raised from where during the coming year.

The Budget gives estimates for the ensuing year and offers an opportunity to the government to review and explain its financial and economic policy and programmes besides enabling the Parliament to discuss and criticize it. Its importance is not limited to finances only as it also reflects government's vision and signals the policies to come in future.

The essential features of the financial procedure followed in India are laid down in the Constitution, which ensures the supremacy of the Lok Sabha, at the Union, and that of Legislative Assembly at state level, in the financial matters. The Constitution provides that no tax shall be levied or collected except by authority of Parliament (Article 265) and that the President shall, in respect of every financial year, cause to be laid before both Houses, the **Annual Financial Statement (Article 112)**.

Article 112 (in case of central government) and Article 202 (in case of state government) of the constitution requires the annual financial statement to be laid before the respective legislatures.

Since 1921, the **union government** has had two budgets – Railway budget and General budget. This separation has been done away with in 2017-2018 budget and the two have been merged into a single document, presented by the Union Finance Minister.

Any budget has the following three types of information:

- Actual figures of receipts and expenditure of the previous year
- Budget and revised figure for the current year

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- Budget estimate for the upcoming year

For example, this year the finance minister presented the budget for the year 2020-21. Then previous year is 2019-20 and current year is 2020-21 at the end of which budget is presented and the coming year is 2021-22.

The receipts and disbursements are shown under the three parts, in which Government Accounts are kept viz. (i) Consolidated Fund (ii) Contingency Fund and (iii) Public Account. The estimated receipts and expenditures are essentially made into and out of these three funds.

(i) Consolidated fund - It is a fund to which all receipts are credited and all payments are debited, that is,

- All revenues received by the Government of India.
- All loans raised by the Government by the issue of treasury bills, loans or ways and means of advances.
- All money received by the government in repayment of loans forms the Consolidated Fund of India.

All the legally authorized payments on behalf of the Government of India are made out of this fund. For example - repayment of debt, giving loans to the state governments etc. No money out of this fund can be appropriated (issued or drawn) except in accordance with a parliamentary law. Money can be withdrawn only under appropriation made by law. Due to constitutional provisions, the expenditures are embodied in the Budget as:

- The sums required to meet the items of expenditure described by the Constitution as those charged on the Consolidated Fund of India.
- The sums required to meet other expenditures proposed to be made from the Consolidated Fund of India.

Expenditures contained in the first category can be discussed in both the Houses but are not submitted to vote of either House. In other words, they constitute the non-votable part of the Budget. The expenditures charged on the Consolidated Fund of India include:

- The emoluments and allowances of the President
- The salaries and allowances of the Chairman, Deputy Chairman of the Rajya Sabha and the Speaker and the Deputy Speaker of the Lok Sabha
- The salary and other allowances payable to the judges of the Supreme Court
- Pensions of the judges of high courts.
- Salary, allowances and pension of the Comptroller and Auditor General of India.
- Salaries, allowances and pension of the chairman and members of the Union Public Service Commission.
- Administrative expenses of the Supreme Court, the office of the Comptroller and Auditor General of India and the Union Public Service Commission including the salaries, allowances and pensions of the persons serving in these offices.
- The debt charges for which the Government of India is liable, including interest, sinking fund charges and redemption charges and other expenditure relating to the raising of loans and the service and redemption of debt.
- Any sum required to satisfy any judgement, decree or award of any court or arbitral tribunal.
- Any other expenditure declared by the Constitution or by Parliament by law to be so charged

The expenditure falling in the second category is presented in the form of Demands for Grants to the Lok Sabha and is voted upon by this House. The Lok Sabha has the right to assent or to refuse any such demand or reduce the demand specified therein. No such demand shall be made except on the recommendation of the President. Since these demands are meant to fulfill

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the programmes and policies of the government, if any demand as a whole is voted down, it tantamounts to a defeat of the government.

(ii) Public accounts of India - All other public money (other than those which are credited to the Consolidated Fund of India) received by or on behalf of the Government of India shall be credited to the Public Account of India.

- This includes Moneys held by Government in Trust as in the case of Provident Funds, Small Savings collections, income of Government set apart for expenditure on specific objects like road development, primary education, Reserve/Special Funds etc.
- This account is operated by **executive action**, that is, the payments from this account can be made without parliamentary appropriation.
- Public Account funds do not belong to Government and have to be finally paid back to the persons and authorities that deposited them. Parliamentary authorization for such payments is, therefore, not required, except where amounts are withdrawn from the Consolidated Fund with the approval of Parliament and kept in the Public Account for expenditure on specific objects, in which case, the actual expenditure on the specific object is again submitted for vote of Parliament for withdrawal from the Public Account for incurring expenditure on the specific object.

(iii) Contingency fund of India – Article 267 of The Constitution authorizes the **Parliament to establish** a 'Contingency Fund of India', into which amounts determined by law are paid from time to time. Accordingly, the Parliament enacted the Contingency Fund of India Act in 1950.

- This fund is placed at the disposal of the President, so that he can make advances out of it to meet unforeseen expenditure pending its authorization by the Parliament. The fund is held by the finance secretary on behalf of the president.
- Like the public account of India, it is also operated by executive action.
- Parliamentary approval for such unforeseen expenditure is obtained, post-facto, and an equivalent amount is drawn from the Consolidated Fund to recoup the Contingency Fund. The corpus of the Contingency Fund as authorized by Parliament presently stands at 500 crore and may be enhanced by the Parliament. Finance Ministry operates this fund on the behalf of the President.

Under the Constitution, Annual Financial Statement distinguishes expenditure on revenue account from other expenditure. Government Budget, therefore, comprises Revenue Budget and Capital Budget. The estimates of receipts and expenditure included in the Annual Financial Statement are for the expenditure net of refunds and recoveries, as will be reflected in the accounts.

2.1. Components of the Government Budget

The Constitution of the country demands that the budget shall distinguish expenditure on revenue account from other expenditure. Therefore, the Budget comprises of the Revenue Budget and the Capital Budget.

Student Notes:

"Components of a Budget"

The Constitution of the country demands that the budget shall distinguish expenditure on revenue account from other expenditure. Therefore, the Budget comprises of the Revenue Budget and the Capital Budget.

Revenue Account

Revenue Account consists of the revenue receipts of Government and the expenditure met from these revenues.

Revenue receipts – These are the receipts which need not to be paid back to the payee by the government, that is, it is non-redeemable. It cannot be reclaimed by the government. Therefore they are one way transaction. It does not create liability for the government. They are divided into tax revenues and non-tax revenues.

- **Tax revenues** – It is the revenue generated by levy and collection of taxes by the central government. It comprises of direct taxes and indirect taxes.
  - Direct taxes – These are the taxes which falls directly on individuals and firms like Income tax (tax on personal income of an individual), corporate tax (tax on a firm), securities transaction tax, commodities transaction tax etc.

    Other direct taxes such as wealth tax (abolished in 2015-16 budget), gift tax and estate duty (now abolished) have never been of much significance in terms of revenue yield and therefore these are known as paper taxes.
  - **Indirect taxes** – These are the taxes which may be levied on one person but ultimately paid by others. For example – excise duty is levied on producer but ultimately is paid by consumer along with the price.

    It includes Goods and Services tax, comprising of the Central, Integrated and State components.
- **Non-Tax revenues** – It mainly consists of

Capital Account

Capital Account is an account of the assets as well as liabilities of the central government, which takes into consideration changes in capital. It consists of the capital receipts and capital expenditure of the government

Capital receipts - All those receipts of the government which create liability or reduce financial assets are termed as capital receipts. It can be classified into two categories –

- **Debt capital receipts** – It mainly includes borrowings and other liabilities.
  - **Borrowings or public debt** – Money raised on the security of consolidated fund of India and repayable out of it. It includes:
    - Borrowing within the country, that is, loans raised from the public (market borrowings), borrowings from RBI and other financial institutions through sale of treasury bills.
    - Borrowing outside the country , that is loans received from foreign governments and international organisations.
  - **Other liabilities** – These are money not directly borrowed from people but is available for the government's expenditure purpose which government is liable to pay back. It includes money kept in public account of India which includes small savings (Post-Office Savings Accounts, National Savings Certificates, etc), provident funds.
- **Non-debt capital receipts** – It includes recoveries of loans granted by the central government and net receipts obtained from the sale of shares in Public Sector Undertakings (PSUs) (This is referred to as PSU disinvestment).

1/2

Student Notes:

- **Interest receipts** – It is the interest income from the loan given by the central government to state government and other government bodies. This constitutes the single largest item of non-tax revenue
- **Dividends and profits** on the investment made by the government. Dividends are income from the shares held by government in private enterprises and semi government enterprises. Profits are dividend income from the fully government owned enterprises
- **Fees and other receipts** for the services rendered by the government
- **Cash grants-in-aid** from foreign countries and international organizations.

The estimates of revenue receipts shown in the Annual Financial Statement take into account the effect of various taxation proposals made in the Finance Bill.)

Revenue expenditure – It consists of all those expenditures of the government, which do not result in creation of physical or financial assets. It relates to those expenses incurred for the normal functioning of the government departments and various services, i.e., day to day and regular needs expenditure that will not yield any revenue in future. It is a one way payment which mean if government spends money it cannot recover it. Till 2017-2018 budget, it included two components:

- **Plan Revenue expenditure** – It used to be related to Central Plans (the Five-Year Plans) and central assistance for State and Union Territory Plans.
- **Non-plan revenue expenditure** – It included:
  - **Interest payments** on debt incurred by the government through market loans or external loans or from various other reserve funds
  - **Grants** given to state governments and other parties (even though some of the grants may be meant for creation of assets).
  - **Others** - defense services, subsidies, salaries and pensions and various social services (non-capital expenditure towards health, education etc.).

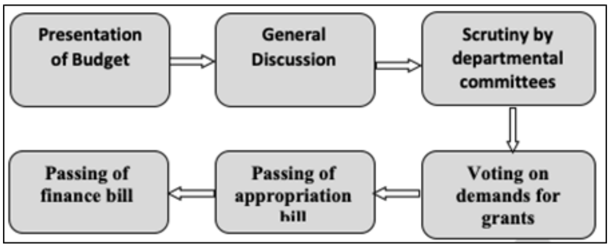
This categorization stands abolished by the 2017-2018 budget, based on the recommendation of Rangarajan Committee. This would be further discussed later in this document.

Capital Expenditure: It includes expenditures that create permanent assets and yield periodical income. This includes expenditure on the acquisition of land, building, machinery, equipment, investment in shares, and loans and advances by the central government to State and Union Territory governments, PSUs and other parties. Capital expenditure was also categorised as plan and non-plan in the budget documents. Plan capital expenditure, like its revenue counterpart related to central plan and central assistance for state and union territory plans. Non-plan capital expenditure covered various general, social and economic services provided by the government.

2/2

2.2. Stages in Enactment

The procedure adopted in the Parliament while dealing with financial matters, specifically the Budget, involves many stages (refer to the infographic):



2.2.1. Presentation of Budget

From fiscal year 2017-2018, the consolidated budget would be presented whereby the hitherto existing Railway Budget would be merged in the General Budget. This consolidated budget would be presented by the Union Finance Minister. The rationale behind this move would be discussed later in this document.

The Budget is presented with a 'Budget Speech', which is in two parts: Part A contains 'a general economic survey' of the country and Part B 'the taxation proposals' for the ensuing financial year.

Student Notes:

The Rules of Procedure and Conduct of Business in the **Lok Sabha** for Financial Legislation are as follows:

- The **Annual Financial Statement** or the **Statement of the Estimated Receipts and Expenditure** of the Government of India in respect of each financial year (also called **'the Budget'**) is presented to the House on such day as the President may direct.
- The Budget is presented to the House in such form as the Finance Minister may, after considering the suggestions, if any, of the Estimates Committee, settle.
- There shall be no discussion of the Budget on the day on which it is presented to the House.

2.2.2. General Discussion on Budget

- Subsequently, on a day appointed by the Speaker, the House is at liberty to discuss the **Budget as a whole** or any **question of principle** involved therein, but no cut motion is moved nor is the Budget submitted to the vote of the House.
- It takes place in both the Houses of Parliament and lasts usually for three to four days.
- The Finance Minister has a general right of reply at the end of the discussion.
- The Speaker may, if he thinks fit, prescribe a time limit for speeches.

2.2.3. Scrutiny by Departmental Committees

After the general discussion on the budget is over, the Houses are adjourned for about three to four weeks. During this gap period, the 24 departmental standing committees of Parliament examine and discuss in detail the demands for grants of the concerned ministries and prepare reports on them. These reports are submitted to both the Houses of Parliament for consideration. The standing committee system established in 1993 (and expanded in 2004) makes parliamentary financial control over ministries much more detailed, close, in-depth and comprehensive.

2.2.4. Demand for Grants

Demand for grants is a statement of estimated expenditure to be made out of consolidated fund of India**. Article 113** of the Constitution mandates that the estimates of expenditure from the Consolidated Fund of India included in the Annual Financial Statement and **required to be voted by the Lok Sabha** are submitted in the form of Demands for Grants. The Demands for Grants are presented to the Lok Sabha along with the Annual Financial Statement.

- Generally, **separate demands** are made for the grants proposed for each Ministry.
- Each demand contains first a statement of the **total grant proposed** and then a statement of the **detailed estimate** under each grant divided into items. A demand becomes a grant after it has been duly voted.
- Two points should be noted in this context.
  - **One**, the voting of demands for grants is the exclusive privilege of the Lok Sabha, that is, the Rajya Sabha has no power of voting the demands.
  - **Second**, the voting is confined to the votable part of the budget—the expenditure charged on the Consolidated Fund of India is not submitted to the vote (it can only be discussed).
- Demands are required to be made in the form of a **motion** but in practice, they are assumed to have been moved and are proposed by the Chair to save the time of the House.
- During this stage, the members of Parliament can discuss the details of the budget. They can also move motions to reduce any demand for grant. Such motions are called as 'cut motion'

A motion may be moved to reduce the amount of a demand in any of the following ways:

- **'that the amount of the demand be reduced to Re.1/-'** representing disapproval of the policy underlying the demand. Such a motion shall be known as **'Disapproval of Policy Cut'**.

Student Notes:

A member giving notice of such a motion has to indicate in precise terms the particulars of the policy which he proposes to discuss. The discussion is confined to the specific point or points mentioned in the notice and it is open to members to advocate an alternative policy;

- **'that the amount of the demand be reduced by a specified amount**' representing the economy that can be affected. Such specified amount may be either a lump sum reduction in the demand or omission or reduction of an item in the demand. The motion shall be known as **'Economy Cut'**. The notice has to indicate briefly and precisely the particular matter on which discussion is sought to be raised and speeches shall be confined to the discussion as to how economy can be affected;
- **'that the amount of the demand be reduced by Rs.100/-'** in order to ventilate a specific grievance which is within the sphere of the responsibility of the Government of India. Such a motion shall be known as **'Token Cut'** and the discussion thereon is confined to the particular grievance specified in the motion.

For the sake of convenience, usually the main motion for demand and the Cut Motion relating to it are put and discussed together in the House. Cut Motion thus is a device to initiate the discussion on demand for grants and to uphold the principle of responsible government by probing the activities of the government. After discussion, first the cut motions are disposed off and thereafter, the demands for grants are put to vote of the House. Cut Motions are generally moved by members from the opposition, and if carried, amount to a vote of censure against the government.

In total, 26 days are allotted for the voting of demands. On the last day the Speaker puts all the remaining demands to vote and disposes them whether they have been discussed by the members or not. This is known as 'guillotine'.

Other grants - In addition to the budget that contains the ordinary estimates of income and expenditure for one financial year, various other grants are made by the Parliament under extraordinary or special circumstances:

- **Vote on Account-** Only after enactment of Appropriation Act after it is assented to by the President, the payments can be made from the Consolidated Fund of India. Before 2017-18, this used to go on till the end of April. But the government needed money to carry on its normal activities after 31 March (the end of the financial year). To overcome this functional difficulty, the Constitution has authorized the Lok Sabha to make any grant in advance in respect to the estimated expenditure for a part of the financial year, pending the completion of the voting of the demands for grants and the enactment of the appropriation bill. This provision is known as the 'vote on account'.
- **Supplementary grants, Votes of Credit etc.**
    - Supplementary, additional, excess and exceptional grants and votes of credit are regulated by the same procedure as is applicable in the case of demands for grants.
    - Supplementary grant is granted when the amount authorized by the Parliament through the appropriation act for a particular service for the current financial year is found to be insufficient for that year.
    - Additional Grant is granted when a need has arisen during the current financial year for additional expenditure upon some new service not contemplated in the budget for that year.
    - Excess Grant is granted when money has been spent on any service during a financial year in excess of the amount granted for that service in the budget for that year. It is voted by the Lok Sabha after the financial year.
    - Vote of Credit is granted for meeting an unexpected demand upon the resources of India, when on account of the magnitude or the indefinite character of the service, the demand cannot be stated with the details ordinarily given in a budget. Hence, it is like a blank cheque given to the Executive by the Lok Sabha.

Student Notes:

- Exceptional Grant is granted for a special purpose and forms no part of the current service of any financial year.

- **Token grant**
  - When funds to meet proposed expenditure on a new service can be made available by reappropriation, a demand for the grant of a token sum may be submitted to the vote of the House. If the House assents to the demand, funds may be made available.

2.2.5. Appropriation Bill

Under the Constitution, no money can be withdrawn from the Consolidated Fund of India without enactment of law by the Parliament. In pursuance of this, a Bill incorporating all the demands for Grants voted by the Lok Sabha, along with the expenditure charged on the Consolidated Fund, is introduced in the Lok Sabha. This Bill is known as the Appropriation Bill. The Bill, as the name suggests, intends to give legal authority to the government to appropriate the expenditure from and out of the Consolidated Fund.

Procedure regarding Appropriation Bill

- The procedure in regard to the passage of an Appropriation Bill is the same as for any other Bill, generally with only those modifications that the Speaker may consider necessary.
- The debate on an Appropriation Bill, however, is restricted to those matters, which have not already been raised while the relevant demands for grants were under consideration.
- No amendments can be proposed.

After the Bill is passed by the Lok Sabha, the Speaker certifies it as a Money Bill and transmits it to the Rajya Sabha. The latter House has no power to amend or reject the Bill, but has to give its concurrence, and if Rajya Sabha doesn't take any action on it within 14 days even then it is considered as passed by the Rajya Sabha. The bill, thereafter, is presented to the President for his assent.

2.2.6. Finance Bill

At the time of presentation of the Annual Financial Statement before Parliament, a Finance Bill is also presented in fulfillment of the requirement of Article 110 (1)(a) of the Constitution, detailing the imposition, abolition, remission, alteration or regulation of taxes proposed in the Budget. A Finance Bill is a Money Bill as defined in Article 110 of the Constitution. It is accompanied by a Memorandum explaining the provisions included in it.

3. Weaknesses in the Budgetary Process

3.1. Weaknesses in Resource Allocation and Use

Many of the weaknesses in budgeting reflect the failure to address linkages between the various functions of budgeting. The following factors contribute to budget systems and processes that create a disabling environment for performance in the public sector, both by commission and by omission:

- Almost exclusive focus on inputs, with performance **judged largely in terms of spending** no more, or less, than appropriated in the budget;
- Input focus takes a **short-term approach** to budget decision making; failure to adequately take account of longer-term costs (potential and real), and biases in the choice of policy instruments (e.g., between capital and current spending and between spending, doing, and regulation) because of the short-term horizon;
- A bottom-up approach to budgeting that means that even if the ultimate stance of fiscal policy was appropriate (and increasingly after 1973 it was not) game playing by both line and central agencies led to high transaction costs to squeeze the bottom-up bids into the appropriate fiscal policy box;

Student Notes:

- A tendency to budget in real terms, leading either to pressure on aggregate spending where inflation is significant (which was often validated through supplementary appropriations) or arbitrary cuts during budget execution with adverse consequences at the agency level;
- Cabinet decision making focused on **distributing the gains from fiscal drag** across new spending proposals;
- Cabinet and/or central agencies **extensively involved in micro-decision making** on all aspects of funding for ongoing policy;
- Weak decision making and last-minute cuts cause unpredictability of funding for existing government policy; this is highlighted to the centre by central budget agencies on the alert to identify and rake back "fortuitous savings;"
- Strong incentives to spend everything in the budget early in the year and as quickly as possible, since the current year's spending is the starting point for the annual budget haggle and the fear of across-the-board cuts during execution;
- Existing policy itself (as opposed to its funding) subject to very little scrutiny from one year to the next. (This and previous point epitomize the worst dimension of incremental budgeting);
- **Poor linkages between policy and resources** at the centre, between the center and line agencies, and within line agencies because of incremental budgeting;
- A **lack of clarity as to purpose and task** and therefore poor information on the performance of policies, programmes and services, and their cost because of poor linkages;
- The linking together (in association with the point above) within government departments of policy advising, regulation, service delivery and funding and an aversion to user charging. Overall, few incentives to improve the performance of resources provided.
- **Weak parliamentary control** over finances, as the accountability is number driven. Therefore, the ruling party, having the majority in Lok Sabha, has its say in budget making.
- The goals in the budget are **very difficult to quantify and measure**. As a result, the accountability of the executive to the legislature remains weak.

3.2. Weaknesses in the Indian Budgetary System and Implementation

- Unrealistic budget estimates
- Delay in implementation of projects
- Skewed expenditure pattern with a major portion getting spent in the last quarter of the financial year, especially in the last month.
- Inadequate adherence to the multi-year perspective and missing 'line of sight' between plan and budget
- No correlation between expenditure and actual implementation
- Ad hoc project announcements
- Emphasis on compliance with procedures rather than on outcomes.

4. Budgetary Reforms

Attempts are continuously being made to overcome as many of the shortcomings as possible. A good example is the trend in OECD countries. The common elements of the budgetary reforms in OECD member countries are:

4.1. Medium Term Budget Frameworks

Medium-term budget frameworks form the basis for achieving fiscal consolidation. They need to clearly state the government's medium term fiscal objectives in terms of high-level targets such as the level of aggregate revenue, expenditure, deficit/surplus, and debt. They then need to operationalize these high-level targets by establishing hard budget constraints for individual ministries and programmes over a number of years.

Student Notes:

4.2. Prudent Economic Assumptions

Deviations from the forecast of the key economic assumption underlying the budget are the government's key fiscal risk. There is no single factor more responsible for "derailing" fiscal consolidation programmes than the use of incorrect economic assumptions. Great care must be taken in making them and all key economic assumptions should be disclosed explicitly. The establishment of an independent body to recommend the economic assumptions to be used in the budget may be considered as well. All this serves to place safeguards against the use of unrealistic, or "optimistic," economic assumptions.

4.3. Top-Down Budgeting Techniques

Budgeting has traditionally operated on a bottom-up principle. This means that all agencies and all ministries send requests for funding to the finance ministry. These requests greatly exceed what they realistically believe they will get. Budgeting then consists of the Finance Ministry negotiating with these ministries and agencies until some common point is found. This bottom-up system has several disadvantages to it.

First, it is very time consuming and it is essentially a game; all participants know that the initial requests are not realistic. Second, this process has an inherent bias for increasing expenditures; all new programmes, or expansion of existing programs, are financed by new requests; there was no system for reallocation within spending ministries and there were no pre-set spending limits. Third, it was difficult to reflect political priorities in this system as it was a bottom-up exercise with the budget "emerging" at the end of this process. This manner of budgeting is now being abandoned and replaced with a new top-down approach to budget formulation. This has been of great assistance in achieving fiscal consolidation.

The starting point for the new system is for the government to make a binding political decision as to the total level of expenditures and to divide them among individual spending ministries. This decision is made possible by the medium-term expenditure frameworks which contain baseline expenditure information, i.e. what the budget would look like if no new policy decisions were made. The political decision is whether to increase expenditures for a high-priority area, for example education, and to reduce expenditures, for example defence programs. Only the largest and most significant programmes reach this level of political reallocation. The key point is that each ministry has a pre-set limit on how much it can spend.

4.4. Relaxing Central Input Controls

This is based on the simple premise that the heads of individual agencies are in the best position to choose the most efficient mix of inputs to carry out the agency's activities. The end-result is that an agency can produce the same services at less cost, or more services at the same cost. This greatly facilitates fiscal consolidation strategies by mitigating their effects on services.

Relaxing central input controls operates at three levels. First, the consolidation of various budget lines into a single appropriation for all operating costs (salaries, travel, supplies, etc.). Second, the decentralization of the personnel management function. Third, the decentralization of other common service provisions, notably accommodations (buildings). This can be seen as the public sector's version of "deregulation."

4.5. An Increased Focus on Results

An increased focus on results is a direct quid pro quo for relaxing input controls as described above. Accountability in the public sector has traditionally been based on compliance with rules and procedures. It didn't matter what you did as long as you observed the rules. Now, when the public sector is deregulated, a new results-based system is needed to hold managers accountable. This is a fundamental change: holding managers accountable for what they do, not how they do it.

Student Notes:

4.6. Budget Transparency

The budget is the principal policy document of government, where the government's policy objectives are reconciled and implemented in concrete terms. Budget transparency – openness about policy intentions, formulation and implementation – is therefore at the core of good governance agenda. The extent to which budget achieves any or all of its purposes is dependent on its transparency. If we take a look at fiscal transparency in concrete terms, we can say that it has three essential elements:

- The first is the release of budget data. The systematic and timely release of all relevant fiscal information provided for analysis and conclusions by decision makers is what we typically associate with budget transparency. It is an absolute pre-requisite, but it is not enough.
- The second element is an effective role for the legislature. It must be able to scrutinize the budget reports and independently review them. It must be able to debate and influence budget policy and be in a position to effectively hold the government to account. This is both in terms of the constitutional role of the legislature and the level of resources that the legislature has at its disposal.
- The third element is an effective role for civil society, through the media and nongovernmental organisations. Citizens, directly or through these vehicles, must be in a position to influence budget policy and must be in a position to hold the government to account. In many ways, it is a similar role to that of the legislature albeit only indirectly.

4.7. Modern Financial Management Practices

The modernisation of financial management within governments made great advances during the past ten years. The sheer scale of government means that such improvements had a material effect on fiscal outcomes. These include the introduction of accruals, capital charges, carry-overs of unused appropriations, and interest-bearing accounts.

The **Fiscal Responsibility and Budget Management Act** (FRBMA) 2003 has been enacted by the Parliament to institutionalize **fiscal discipline** at both the centre and state level by setting targets including reduction of fiscal deficits and elimination of revenue deficit. It is a legal step to ensure fiscal discipline and fiscal consolidation in India.

(Kindly refer the document of Fiscal Policy for more details on FRBMA.)

5. Recent Changes in Union Budgeting

5.1. Rationalization of Centrally Sponsored Schemes (CSS) and expenditure Thereon

Budget 2016-17 introduced a new classification system for the Centre's spending, based on the categorization of CSS, pruning the existing 66 CSSs to 28, and then further divided them into three categories—six 'core of the core' schemes, 20 core schemes, and two optional schemes. The classification is discussed as under:

1. ***Core of the Core:*** Those schemes which are for social protection and social inclusion should form the core of core and be the first charge on available funds for the National Development Agenda. Under the new classification, six schemes are classified as Core of the Core, including MGNREGA and all the umbrella schemes for the upliftment of minorities, Scheduled Castes, and Scheduled Tribes.

   As per the new system, the Core of the Core schemes are of highest priority, and thereby will retain their expenditure allocation framework. For example, MGNREGA had 75 per cent of the material expenditure from the Centre and 25 per cent from the states.

Student Notes:

2. ***Core:*** Focus of CSSs should be on schemes that comprise the National Development Agenda where the Centre and States will work together in the spirit of Team India. The Core schemes, 20 in number, include schemes as far-ranging as the Krishi Unnati Yojana, the Smart Cities programme, and the modernisation of the police force. These are second in priority and will have a 60:40 formula of expenditure.
3. ***Optional Schemes:*** It includes all those schemes, presently two in number, which a particular state feels necessary considering its level of socio-economic development. These will have a 50:50 formula, with the states having the flexibility to decide whether to invest in these or not.

This system was put in place on the recommendations of a sub-committee of Chief Ministers formed by Niti Aayog for the rationalisation of the CSS.

5.2. Scrapping of Plan and Non-Plan Classification

The previously exiting Plan and non-plan classification of expenditure has been done away with from FY 2017-2018 and their place has been now taken by capital and revenue spending classifications. In 2011, an experts' committee headed by C. Rangarajan had proposed that this distinction should be abolished.

Under the previous classification, all expenditures which were done in the name of planning were called plan expenditures while all other expenditures were placed under non-plan expenditures. Further, generally (not always), the plan expenditure produced some tangible assets related to economic development. This was the reason that plan expenditures were also called "development expenditures".

Rationale behind this move

1. This move is in line with the scrapping of Planning Commission and thereby development based on hitherto existing planning.
2. This classification has led to an increasing tendency to start new schemes/projects neglecting maintenance of existing capacity and service levels.
3. It has also led to the misperception that non-plan expenditure is inherently wasteful, adversely affecting resource allocation to social sectors like education and health where salary comprises an important element.
4. It prevented any meaningful 'outcome based budgeting' because only plan expenditure is considered for looking at outcomes while practice should be to look at total expenditure.
5. Growing complexity in nature of government and expenditure on varied heads ensure that segregating a head under plan or non-plan items is not done on rational grounds and hence the distinction is not logical.
6. The distinction meant that infrastructure like schools come under planned expenditure while expenditure on teachers come under non-planned expenditure likewise hospitals under planned and salaries etc. of doctors under non-planned. This mismatch leads to mismanagement and ineffective resource utilization.

5.3. Merging of Railway and General Budget

The 92 years old practice of presenting separate budgets- Railway Budget and General Budget has been abolished. It was recommended by Bibek Debroy Committee on restructuring and reforming railways. This move is being lauded for it will be beneficial for the economy at large and there will be positive influence in the development in railways.

Rationale for introducing separate budgets in 1921

The separation was introduced in 1921 based on the recommendation of Acworth Committee report. The reason was that a larger part of the country's GDP depended on railway revenue, therefore, railway demanded separate budgetary focus. Independent India also continued this practice and over the period of time it became accepted practice with following advantages:

Student Notes:

1. ***Accountability:*** Separate budget used to give sufficient media attention to the budgetary proposals, thereby enforcing accountability of the government.
2. ***Public transport:*** Railways has been the public transportation system, therefore it was desirable that railways should be given special attention by separate budget.
3. ***Autonomy:*** It was expected that separate budgetary process would ensure requisite autonomy to the railways to function as independent commercial entity.

However, over a period of time, the railway budget became a tool for populism and led to populist waste and inefficiency. Hence, there was a strong demand for corporatization of the Railways. Not having a separate budget for it prepares the ground for such a change.

Rationale for Merger

1. During the British rule Railways took up to 85% of the yearly budget while now it has gone down to about 15% only.
2. Now that the Railway Budget will be introduced along with the Union Budget, there will be less wastage of time when a new policy is to be initiated and implemented.
3. Separate Railway Budget became a tool for corruption, inefficiency, and populist measures. As a result, the successive Railway Minister used to find it hard to increase fairs in line with the increasing operational costs. This was the primary reason for cross subsidization (where the passenger traffic is subsidized by the freight traffic).
4. The Railways would not need to pay Rs 10,000 crore annual dividend to the union government. This annual dividend can now be used for development of Indian Railways.
5. Synergetic transportation policies would henceforth be possible because the Finance Ministry would be responsible for allocation of resources to all kinds of transportation system.

Apprehensions against this move

1. The resource allocation to Railways would henceforth be dependent on Finance Ministry. Therefore, there may be rise or fall in resource allocation to Railways depending on the size of the budget. This may hamper the independent development of Railways.
2. Merger may result in reduced accountability, as the media attention given to separate budget would no longer be there. This would make easy for the government to sweep the losses in railways under the carpet.
3. Some experts feel that merger would throw railways open to privatization and crony capitalism.

There have been mismanagement of the highest order in Indian railways and if there are chances of seeing it improve, merging it with the Union budget is just the solution that could help. The falling revenue and more projects for new trains and stoppages have been a difficult project for the railway ministry which took the right step by merging the two budgets.

5.4. Budget Advancement

The Budget was present 27 days before the earlier practice of presenting the budget on last day of February. The objective behind this move is to have the Budget constitutionally approved by Parliament and assented to by the President, and all allocations at different tiers disseminated to budget-holders, before the financial year begins on April 1.

Rationale of this move

1. The Finance Bill, incorporating the budget proposals, could be passed well before the starting of fiscal year. Therefore, the government departments, agencies would know their allocation right from April 1, the onset of financial year.
2. It would also help the private sector to anticipate government procurement trends and evolve their business plans.

Student Notes:

3. In the earlier scheme of things, the Lok Sabha passed Vote on Account for April-June quarter, under which departments are provided with a sixth of their total allocation for the year. Advancing the budget enables the government to do away with this practice.
4. The investment in infrastructural projects largely takes place in later part of the year, because budget gets passed only by June, but by then monsoon sets in making it difficult to start infrastructural project. As a result, the effective investment period is quite short, thereby ending in 'March Rush'. This causes inefficiency in resource utilization and delays in project implementation.

Apprehensions against this move

1. One big disadvantage of advancing the Budget was lack of comprehensive revenue and expenditure data. Previously, work on the Budget began in earnest by December. By the time it was finalized in mid-February, data on revenue collections and expenditure trends was available for the first nine months of the financial year, i.e. April-December, based on which, projections for the full year would be made.
2. Advancing the Budget dates is fraught with practical difficulties. Effective Budget planning also depends on the monsoon forecasts for the coming year, making advancing the whole exercise even more difficult.

Despite the apprehensions, all the above discussed budget reforms are a welcome move, but these reforms have to go further, as has been suggested by C. Rangarajan Committee in 2011.

6. Evolution of Budgeting

When governments had to prove to their tax-payers that they could be trusted with their money, the budget emphasized controlling costs, accounting for finances, and improving efficiency. Later, during the depression, people wanted the government to proactively solve problems for which the private sector was largely blamed, the effectiveness of public programs came into greater budgetary focus. In recent years, both of these missions have been reflected in the budgets.

6.1. The Line Item Budget

- In the early nineteenth century, government budgeting in most countries was characterized by weak accounting procedures, adhocism, little central control and poor monitoring and evaluation.
- In the late nineteenth century, line-item budgeting was introduced in some countries. The line item budget is defined as *"the budget in which the individual financial statement items are grouped by cost centers or departments .It shows the comparison between the financial data for the past accounting or budgeting periods and estimated figures for the current or a future period"*
- In a line-item system, expenditures for the budgeted period are listed according to objects of expenditure, or "line-items." These line items include detailed ceilings on the amount a unit would spend on salaries, travelling allowances, office expenses, etc. The focus is on ensuring that the agencies or units do not exceed the ceilings prescribed which is monitored by a central authority or the Ministry of Finance

Advantages

- The line item budget approach is easy to understand and implement.
- It also facilitates centralized control and fixing of authority and responsibility of the spending units.

Disadvantages

- Its major disadvantage is that it does not provide enough information to the top levels about the activities and achievements of individual units.

- The weaknesses of the line item budgeting were sought to be remedied by introducing certain reforms. Performance budgeting was the first such reform.

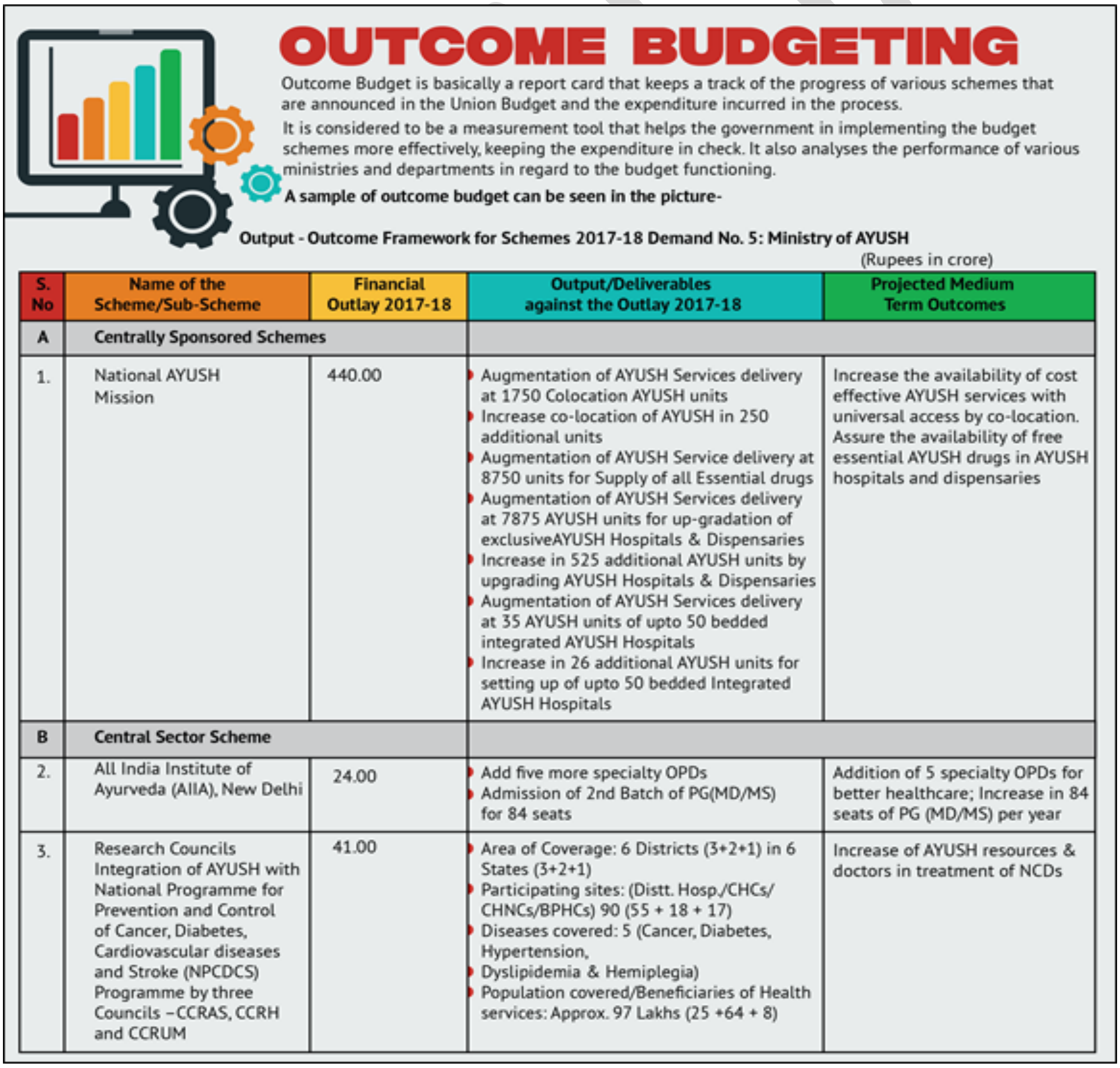
6.2. Performance Budgeting

Unlike the traditional line item budget, a performance budget reflects the goal/objectives of the organization and spells out performance targets. These targets are sought to be achieved through a strategy. Unit costs are associated with the strategy and allocations are accordingly made for achievement of the objectives. A Performance Budget gives an indication of how the funds spent are expected to give outputs. However, performance budgeting has a limitation - it is not easy to arrive at standard unit costs especially in social programmes, which require a multi-pronged approach.

6.3. Outcome budgeting

It is a budgeting scheme that gives project-wise outlays for all central ministries, departments and organisations listed against corresponding outcomes (measurable physical targets) to be achieved during the year. It measures the development outcomes of all government programmes.

Outcome based performance budgeting symbolizes a shift from traditional budgeting in the sense that it goes beyond budgeting by inputs (how much can we spend) towards budgeting by measurable outcomes (what can we achieve with what we spend). It is expected to sharpen the budgetary projections by listing the projected outcomes under various schemes.



OUTCOME BUDGETING

Outcome Budget is basically a report card that keeps a track of the progress of various schemes that are announced in the Union Budget and the expenditure incurred in the process.

It is considered to be a measurement tool that helps the government in implementing the budget schemes more effectively, keeping the expenditure in check. It also analyses the performance of various ministries and departments in regard to the budget functioning.

A sample of outcome budget can be seen in the picture-

Output - Outcome Framework for Schemes 2017-18 Demand No. 5: Ministry of AYUSH

(Rupees in crore)

S. No	Name of the Scheme/Sub-Scheme	Financial Outlay 2017-18	Output/Deliverables against the Outlay 2017-18	Projected Medium Term Outcomes
A	Centrally Sponsored Schemes			
1.	National AYUSH Mission	440.00	Augmentation of AYUSH Services delivery at 1750 Colocation AYUSH units Increase co-location of AYUSH in 250 additional units Augmentation of AYUSH Service delivery at 8750 units for Supply of all Essential drugs Augmentation of AYUSH Services delivery at 7875 AYUSH units for up-gradation of exclusiveAYUSH Hospitals & Dispensaries Increase in 525 additional AYUSH units by upgrading AYUSH Hospitals & Dispensaries Augmentation of AYUSH Services delivery at 35 AYUSH units of upto 50 bedded integrated AYUSH Hospitals Increase in 26 additional AYUSH units for setting up of upto 50 bedded Integrated AYUSH Hospitals	Increase the availability of cost effective AYUSH services with universal access by co-location. Assure the availability of free essential AYUSH drugs in AYUSH hospitals and dispensaries
B	Central Sector Scheme			
2.	All India Institute of Ayurveda (AIIA), New Delhi	24.00	Add five more specialty OPDs Admission of 2nd Batch of PG(MD/MS) for 84 seats	Addition of 5 specialty OPDs for better healthcare; Increase in 84 seats of PG (MD/MS) per year
3.	Research Councils Integration of AYUSH with National Programme for Prevention and Control of Cancer, Diabetes, Cardiovascular diseases and Stroke (NPCDCS) Programme by three Councils –CCRAS, CCRH and CCRUM	41.00	Area of Coverage: 6 Districts (3+2+1) in 6 States (3+2+1) Participating sites: (Distt. Hosp./CHCs/ CHNCs/BPHCs) 90 (55 + 18 + 17) Diseases covered: 5 (Cancer, Diabetes, Hypertension, Dyslipidemia & Hemiplegia) Population covered/Beneficiaries of Health services: Approx. 97 Lakhs (25 +64 + 8)	Increase of AYUSH resources & doctors in treatment of NCDs

Student Notes:

Student Notes:

The outcomes are expected results not only in terms of monetary units or physical infrastructure but also in terms of qualitative targets and achievements. The first step is defining the desired outcomes (mostly long term) for the concerned ministry, department or function. This is followed by the process of identifying the interventions required for achieving target outcomes. Finally, the expenditure required for implementing the identified interventions is estimated, which forms a line item in the budget for that particular year.

Background

Since 1968, Government departments had been preparing performance budgets trying to link financial aspects to physical results. However, this remained a supplementary device without any perceptible impact on resource allocation. Later, a revised version of Outcome Budget was introduced in India in 2005-06, for the first time, as the focus needed to be shifted from outcomes towards outlays. However, limited progress has been made in this area since then. India today follows a performance budgeting framework which tracks outcomes at the level of individual programmes. It misses the link to overall development indicators for that sector.

Significance of Outcome Budgeting

- **Accountability of the Executives**: The information on services to be provided to the people and the linking of funds to the results is a powerful innovation that defines accountability of the executive. It arms citizens with data to hold governments accountable, and in turn empowers the governments to better orient the bureaucracy towards results
- **Outcome based information**: The performance-oriented budgets provide information on the use of public resources, as against the conventional budgeting practice of highlighting only allocations under different programmes. An outcomes-based approach shifts the perspective to the short and long-term outcomes of governance.

Challenges to Outcome Budgeting

The outcome budget is yet to emerge as a robust fiscal instrument to influence the decisions over public finances and provide a framework to judge the performance of the government.

- **Incompatible administrative structure**: Much of the development interventions in India are routed through the state governments. But key line departments in most states are yet to adopt planning and service delivery processes which are oriented around outcomes.
- **Lack of debate**: Outcome budgets are separately placed by the departments later in the Budget session. They do not receive the needed debate and scrutiny and thus remain unseen in the public arena. Lack of Knowledge: There also exists limited knowledge and understanding on the linkage between specific Government interventions and the outcomes they are likely to impact. This makes the whole exercise of OB futile in the long run.
- **Underdeveloped Components**: The building blocks of the outcome budget — measurement of performance indicators, specification of standards, costing of programmes, and a monitoring and evaluation system — are still evolving in India
- **Lack of clarity about the link between two kinds of budgeting**: Performance information contained in the individual outcome budgets should play an active role in programme formulation and resource allocation. However, due to the separate presentation of the two types of budgets there is no clarity on the same.

Way Forward

- India needs effective programmes to eradicate poverty and to meet the needs of primary health and education. Resources committed without precise outcomes, and without accountability might get deflected and wasted.
- The outcome budget in India provides an opportunity, which needs to be strengthened and taken forward. The important factors in this context are the ability to prepare measures

under different government programmes to evaluate results, and utilise this performance information in shaping the Budget decisions, both in programme formulation and resource allocation

Student Notes:

6.4. Gender Budgeting

Gender budgeting is a strategy for ensuring gender sensitive resource allocation and a tool for engendering macro-economic policy, not a separate budget for women.

Requirement of Gender Budgeting

- To ensure men's and women's needs and priorities are considered equally.
- To encourage the incorporation of gender analysis in preparation, implementation, audit and evaluation of government budgets at all the levels and evaluating the impact of the budget on the gender equality objective.
- To enhance the linkages between economic and social policy outcomes.

The Framework adopted for gender analysis of expenditures is often broken down in three categories:

- **Gender-specific allocations** are allocations specifically targeting women and girls or men and boys. For example, school bursaries for girls or domestic violence counselling for men. Many governments have allocated special funds for women's programmes and it is important to analyse their impact on women's lives and ensure that such programmes give value for money.
- **Mainstream allocations** need to be examined for their gendered impacts. Most expenditures fall in this category and the real challenge of gender analysis of budgets is to examine whether such allocations address the needs of women and men, girls and boys of different social and economic backgrounds equitably.
- **Equal opportunity employment allocations** are allocations intended to promote gender equality in the public service. For example, day-care facilities for employees' children, paid parental leave, or special training for women middle-level managers.

Evolution of Gender Budgeting in India

In **2001,** the Finance Minister of India made a special reference to gender budgeting in his Budget speech. In **2003**, the Cabinet Secretary Government of India, recommended the suggestion that Ministries/Departments should have a chapter on Gender issues in their Annual Reports. Since **2005-06**, the Expenditure Division of the Ministry of Finance has been issuing a note on Gender Budgeting as a part of the Budget Circular every year. In **2007,** the scheme on Gender Budgeting with a view to building capacity and encouraging research was introduced. Its purpose was that a gender perspective was retained at all levels of the planning.

Current Status of Gender Budgeting in India

- **Union Government- Gender Budgeting Cell** (GBCs) have been constituted to serve as focal points for coordinating gender budgeting initiatives within their Ministries and across Departments. So far 56 Ministries/Department have confirmed setting up of a cell/ nominating a nodal person.
- **State Governments-** Many State Governments like Rajasthan, Gujarat, Madhya Pradesh, Karnataka, Orissa, Kerala, Assam, Bihar, Chhattisgarh, Tripura, Nagaland, Uttar Pradesh and Uttarakhand have adopted Gender Budgeting.
- **Capacity Building-** The Ministry of Women and Child Development (MWCD) has been engaged in conducting a number of trainings, workshops, one to one interactions/ discussions and development of resource material.
- **Resource Material Development-** MWCD, in collaboration with UN Women, has also developed a Manual and Handbook for Gender Budgeting for Gender Budget Cells for Central Ministries and Departments.

Student Notes:

In the recent Budget 2020-21, the finance minister while re-iterating the slogan of, **'Naari tu Narayani',** called for need for their socio-economic growth on all levels. A shift from women centric policy making to a **women led policy making**, a committee has been proposed with Government and private stakeholder for moving forward on Gender Budgeting.

Challenges in Gender Budgeting

Various challenges remain in implementing gender budgeting and accepting the analysis generated by these processes:

- **Collection of sex-disaggregated data:** There is some sex-disaggregated data available but there is a need to generate more information in order to shed more light on the differences between women and men, girls and boys, particularly in access to resources, opportunities and security without which it is not possible to integrate a gender perspective in the budget process.
- **Limited evidence connecting analysis with policy & budget changes** as most of the gender budgeting initiatives worldwide are at the stage of analysis.
- **Limitation of parliamentary intervention:** Legislatures, in partnership with gender experts and civil society groups, have sometimes played an important advocacy role in various countries but the role of legislatures in the budget process is often confined to budgetary approval and oversight and not involved in formulation and execution
- **Political will to institutionalise gender budgeting:** Gender budgeting requires political will, adequate resources and capacity to support a process of transforming the traditional budget-making and policy processes by removing long-standing, in-built biases which disadvantage women and girls.

However, more efforts are required in this regard to achieve the objectives of gender budgeting:

- Create a **ranking for state level gender budgeting** to incentivise the states in taking further steps to improve the efficacy of these measures.
- The **capacity building and technical support** should be provided to state level Gender Budgeting Cells.
- **Gender audits** of centrally sponsored schemes and flagship programs should be undertaken to measure impacts. This also necessitates increased efforts for the collection of gender disaggregated data at national, state and district levels.
- Segregation of the provisions for women in the composite programmes under education, health and rural development sectors which target girls/ women as the principal beneficiaries so that restrictions could be placed on reappropriation for other purposes.
- **Deviation between budgetary allocation and actual spending** needs to be addressed through proper monitoring of outcome.

Given the significant gender gap in the country, there is a strong need to prioritise policies to reduce bias against women. Further, intersectional policy research should be undertaken to aid evidence-based gender policy formulation for it to curb gender inequalities and contribute to overall development.

6.5. Participatory Budgeting

According to the International Budget Project, participatory budgeting is the process by which **citizens deliberate and negotiate over the distribution of public resources** for the final budget. It contrasts with standard public budget-making, in which bureaucrats or elected politicians decide the allocation of public resources.

It addresses two distinct but interconnected needs: **improving state performance and enhancing the quality of democracy.** Participatory budgeting programs also serve as "citizenship schools," as engagement empowers citizens to better understand their rights and duties as citizens as well as the responsibilities of government.

Participatory budgeting is highly adaptable. But following factors need to be kept in mind for better adoption of the idea of participatory budgeting programs:

- a civil society willing and able to contribute to ongoing policy debates
- a generally supportive political environment that insulates participatory budgeting from legislators' attacks and
- financial resources to fund the projects selected by citizens.

Significance of participatory budgeting for India:

- The process of participatory budgeting empowers citizens and enables inclusive policy formulation and budgetary allocation as marginalized section of the society will also have a say in the process.

Student Notes:

Student Notes:

- It can lead to greater accountability and transparency as citizens leave the process with more knowledge and experience in governing and holding officials accountable.
- It has the capacity to address the basic needs of people like access to water for households, electricity, education, health more adequately.
- It gives citizens the opportunity to learn about government practices and to come together to deliberate, discuss, and substantively affect budget allocations.
- As highlighted by World Bank, it has the potential to limit government inefficiency and curb clientelism, patronage, and corruption.

Challenges in main streaming of participatory budgeting in India:

- **Lack of education and awareness** among the people especially about various concepts of budget and key terminology is hampering their effective participation.
- **Infrastructural difficulties** like digital divide may seclude some regions and sections of the society from taking participation.
- **Lower tax base and lower source of revenue** may become a problem as demand of general public may not be fulfilled making the budgeting more or less discretionary process of government.
- **Lack of Capacity**: Many public institutions lack resources and capacity to engage citizens.
- **Fear of Failure**: The participatory nature itself makes it vulnerable to criticism due to diversity of opinions and unnecessary delays in budgetary process.

However, in this context, India can look into Brazilian experience of participatory budgeting and look forward to implementing the process and deal with the challenges by providing a robust participatory platform. It has enhanced the quality of democracy in Brazil, improving governance and empowering citizens.

These challenges underscore the necessity of tapping into existing civic networks to organize and mobilize. As a result, NGOs like DISHA Foundation should be encouraged more as they are working on budget analysis with perspective of marginalized section of people. Further, awareness creation and knowledge about budget needs to reach hinterland regions as well.

6.6. Zero-based Budgeting

The concept of zero-based budgeting (ZBB) was introduced in the 1970s. As the name suggests, every budgeting cycle starts from scratch. Unlike the earlier systems where only incremental changes were made in the allocation, under zero-based budgeting every activity is evaluated each time a budget is made and only if it is established that the activity is necessary, are funds allocated to it. The basic purpose of ZBB is phasing out of programmes/activities, which do not have relevance anymore. However, because of the efforts involved in preparing a zero-based budget and institutional resistance related to personnel issues, no government ever implemented a full zero-based budget, but in modified forms the basic principles of ZBB are often used.

6.7. E-Budgeting

E-budgeting may be defined as electronic or enterprise-wide budgeting. It presents a strategic advantage with help of the capability of internet to let various establishments execute an enterprise wide budgeting system, which can be reached from any location.

Advantages

- Extremely efficient as it brings efficiency with supervision and control and elimination of cumbersome accounting tasks
- convenient and adaptable as the technology is being used for anywhere and anytime budgeting.
- enables planning to keep pace with e-business

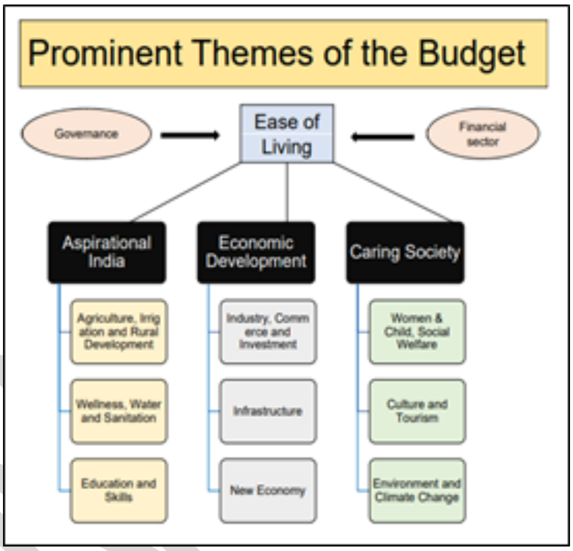
Student Notes:

- ability to collaborate with managers, administrators, ministers in the same platform
- worldwide communication and collaboration
- easy assessment through automatization of calculations and other processes

E-budgeting is rapidly becoming the norm all over the world due to its ability to allocate resources efficiently and assisting governments in competing successfully in an ever changing economic environment

7. Key Highlights from the Union Budget 2020-21

The Union Budget 2020-21 with the central tenet of **"Ease of Living" for all citizens**, is woven around three prominent themes:



- **Aspirational India**: All sections of the society to have better standards of living, with access to **health, education,** and **better jobs**.
- **Economic Development for all**: This would entail **economic reforms**, yielding more space for the private sector to ensure higher productivity and greater efficiency.
- **A Caring Society**: based on **Antyodaya**, which is both humane and compassionate.

These three broad themes are held together by a corruption free, policy-driven good governance and a clean and sound financial sector.

I. Aspirational India -

1. **Agriculture, Irrigation, and Rural Development: 16-action points** which cover almost all aspects of the agriculture and allied activities sector and **address supply bottlenecks**. This includes focus on **Blue Economy**, Jaivik Kheti Portal, Zero-Budget Natural Farming, Deen Dayal Antyodaya Yojana, along with
   a. **Kisan Rail**, **Krishi Udaan** for a seamless national cold supply chain for perishables,
   b. **OneProduct One-District** for better marketing and export in the Horticulture sector,
   c. **PM-KUSUM** for 20 lakh farmers for setting up standalone solar pumps, another 15 lakhs for grid-connected pump sets,
   d. **Village storage Scheme** to be run by the SHGs to provide farmers a good holding capacity and to reduce logistics cost.
2. **Wellness, Water and Sanitation:** More than 20,000 empanelled hospitals under PM Jan Arogya Yojana, FIT India movement launched to fight NCDs, "TB Harega Desh Jeetega" campaign launched to end TB by 2025, viability gap funding proposed for setting up hospitals in the PPP mode, Expansion of Jan Aushadhi Kendra Scheme to all districts by 2024, ODF Plus to sustain ODF behaviour, liquid and grey water management along with waste management.
3. **Education and Skills:** About 150 higher educational institutions will start apprenticeship embedded courses, enabling sourcing of ECBs and FDIs for education, special bridge courses to improve skill sets of those seeking employment abroad.

II. Economic Development for all -

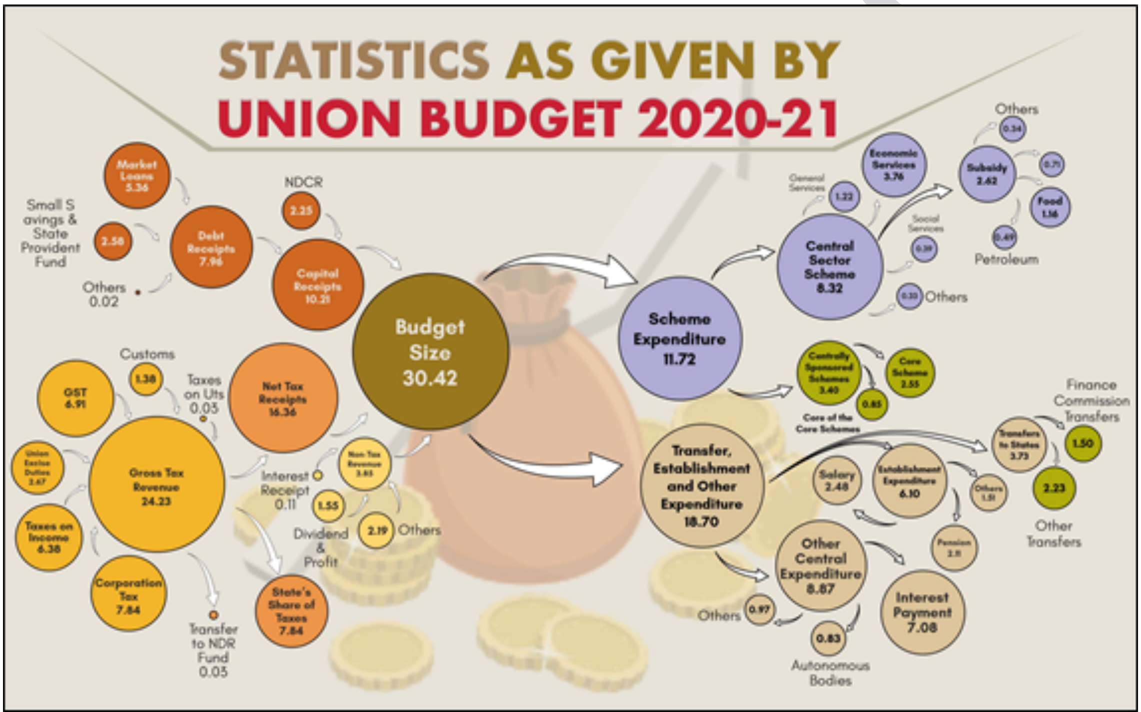
1. **Industry, Commerce, and Investment:**
   a. Focus on encouraging manufacturing of mobile phones, electronic equipment, and semiconductor packaging,
   b. **National Technical Textiles Mission** to be implemented from 2020-21 to 2023-24,

c. **Investment Clearance Cell** to be set up to provide ”end to end” facilitation,
d. Extension of invoice financing to **MSMEs** through **TReDs**.

2. **Infrastructure: National Logistics Policy** and single window e-logistics market, 6500 projects under **National Infrastructure Pipeline** including housing, safe drinking water, and healthcare, smart cities developed in PPP mode, expanding **National Gas Grid**, corporatizing at least one major port.

III. **Caring Society -**

1. **Women and Child, Social Welfare:** Focus on MMR, anganwadi workers, no manual scavenging.
2. **Culture and Tourism:** Indian Institute of Heritage and Conservation proposed, selected archaeological sites to be developed as iconic sites, development of Maritime and Numismatics and Trade museums.
3. **Environment and Climate Change**: Enactment of Coalition for Disaster Resilient Infrastructure and plans for pollution redressal.



This budget has been presented in the backdrop of two cross-cutting developments namely, proliferation of technologies like Machine Learning, Robotics, AI, Bioinformatics, etc., and India’s demographic dividend. It is a step forward towards meeting the aspirations of New India, however one of the most critical parts will be the implementation of the measures to support growth along with proper fiscal consolidation.

8. Previous Years UPSC Mains Questions

1. One of the intended objectives of Union Budget 2017-18 is to ‘transform, energize and clean India’. Analyse the measures proposed in the Budget 2017-18 to achieve the objective.
2. Women empowerment in India needs gender budgeting. What are the requirements and status of gender budgeting in the Indian context?
3. In what way could replacement of price subsidy with Direct Benefit Transfer (DBT) change the scenario of subsidies in India? Discuss.
4. What are the reasons for introduction of Fiscal responsibility and Budget Management (FRBM) act, 2003? Discuss critically its salient features and their effectiveness.
5. What is meaning of the term tax-expenditure? Taking housing sector as an example, discuss how it influences budgetary policies of the government.

Student Notes:

Student Notes:

6. Discussion the rationale for introducing Good and services tax in India. Bring out critically the reasons for delay in roll out for its regime.
7. Comment on the important changes introduced in respect of the Long-term Capital Gains Tax (LCGT) and Dividend Distribution Tax (DDT) in the Union Budget for 2018-2019.

9. Vision IAS GS Mains Test Series Questions

1. Explain, in brief, the various components of budget receipts and expenditure.

Approach:

- Introduce with the definition of budget and its constitutional provisions in India.
- Elaborate the different components of budget receipts as well as budget expenditure.
- Write brief conclusion.

Answer:

A government budget is an annual financial statement showing item wise estimates of expected revenue and anticipated expenditure during a fiscal year. There is a constitutional requirement in India U/A 112 to present before the Parliament an 'Annual Financial Statement', which constitutes the main budget document of the government.

Various components of a government Budget is shown below:

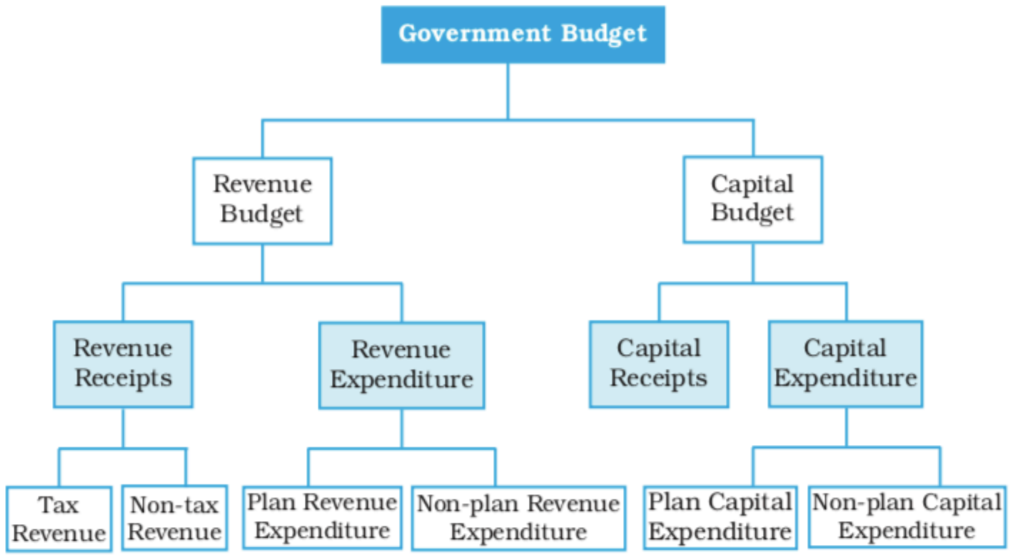


Chart 1: The Components of the Government Budget

Components of Budget Receipts

1. **Revenue Receipts**: Revenue receipts are those receipts that neither create asset nor reduce any liability on the government. They are divided into tax and non-tax revenues.
   - **Tax revenues** includes receipts in the form of **direct taxes** such as personal income tax, corporation tax, wealth tax, gift tax etc. and indirect taxes such as GST, custom duties (taxes imposed on goods imported into and exported out of India).
   - **Non-tax revenue** of the central government mainly consists of interest receipts on account of loans by the central government, dividends and profits on investments made by the government, fees and other receipts for services

Student Notes:

rendered by the government. Cash grants-in-aid from foreign countries and international organisations are also included.

2. **Capital Receipts**: All those receipts of the government which create liability or reduce financial assets are termed as capital receipts. These include recovery of loans, disinvestment, borrowings etc. These receipts can be debt creating or non-debt creating.

Components of Budget Expenditure

1. **Revenue Expenditure:** It is expenditure incurred for purposes other than the creation of physical or financial assets of the central government. It relates to those expenses incurred for the normal functioning of the government departments and various services, interest payments on debt incurred by the government, and grants given to state governments and other parties (even though some of the grants may be meant for creation of assets).
2. **Capital Expenditure:** There are expenditures of the government which result in creation of physical or financial assets or reduction in financial liabilities. This includes expenditure on the acquisition of land, building, machinery, equipment, investment in shares, and loans and advances by the central government to state and union territory governments, PSUs and other parties.

In 2017-18, the Union government has done away with the division of expenditure in Indian budget into plan and non-plan. Also, Rail Budget was merged with the Union Budget from budget year 2017-18.

2. "Good economics and bad politics can not coexist in a sound budgetary process" Discuss.

Approach:

The question needs to cover the following issues:

- The importance of a sound budgetary process in a developing country like India
- First define briefly what you mean by 'Good Economics' and 'bad politics'
  - Does demand politics play a role in the government budgeting process?
- Conclusion, on a positive note, with suggestions for reforms

Answer:

The government budgeting process, in most countries of the world, is influenced by the exigencies of popular politics. However, the extent to which political exigencies and economic decision-making are interlinked differ from one country to another. In a country like ours, where the Indian State is envisaged as a developmentalist State, politics and economics are intricately intertwined. Our demand politics is oriented towards short term goals, competitive processes for determining policies, public interest and the provision of private goods. It is constrained and directed by the imperatives of electoral victory and pluralist and class bargaining. This is essentially 'bad politics'.

A sound budgetary process, on the other hand, requires resources allocation, efficiency, achieving macroeconomic objectives like employment, sustained economic growth, and price level stability, capital formation, controlling deficits, curtailing wasteful expenditure, efficient management of BoP etc. This is essentially 'Good Economics'.

A necessary condition to achieve these economic goals is the state's ability to free itself through leadership or repression from the constraints of societal demand. It requires sacrificing short run for long run benefits, while demand politics do the reverse. The

Student Notes:

preference of political leaders and bureaucrats largely determine budgetary decisions and policy choice in our country. They favour, repress, license, or co-opt economic classes, organized interests, and elites. Thus we can say, in Indian scenario, that 'good economics' and 'bad politics' are not compatible in a sound budgetary process. For instance, 'good economics' says that fuel subsidies should be removed as they are harmful for financial health of nation. But due to 'bad politics' these subsidies are still continuing to some extent.

However seeing 'bad politics' as populist measures – they need not be always incompatible with the 'good economics'. Adopting budgetary reforms like adopting medium-term budget frameworks, prudent economic assumptions, top-down budgeting techniques, relaxing central input controls, focussing on results, budget transparency and modern financial management practices, along with performance budgeting, outcome budgeting and zero budgeting can bring an end to the contradiction between bad politics and good economics.

3. "Unspent provisions in a grant or appropriation indicate either poor budgeting or shortfall in performance or both". Elaborate this statement in the context of budgeting in India. Also suggest few remedies to overcome it.

Approach:

The lack of efficiency in programme management at the departmental level in an annual budget cycle should be stressed.

Answer:

Despite having an elaborate and time consuming system of making budgetary estimates, large amounts of unspent money is surrendered every year at the lapse of the financial year. Large-scale unspent provisions are indicative of lack of efficiency in programme management at the departmental level in an annual budget cycle and undermine efficient use of public money which is one of the major objectives of any budgeting system. Excessive provision under various sub-heads during the budget preparation stage due to lack of a realistic assessment of departmental requirements is the major reason for this. It also shows that proper forecasting methods are not used to estimate expenditure on account of various items.

Following steps can be taken to solve this problem.

- Ministry of Finance advised the Ministries/Departments to gear up the 'existing mechanism of review, monitoring and control' as to make a careful formulation of plan/schemes having regard to 'ground realities and achievable targets' and also to make 'realistic assessment of funds.'
- The assumptions made while formulating estimates must be realistic. At the end of each year the reasons for the gap between the 'estimates' and 'actuals' must be ascertained and efforts made to minimize them. These assumptions should also be subject to audit.
- The method of formulation of the annual budget by getting details from different organizations/ units/ agencies and fitting them into a predetermined aggregate amount leads to unrealistic budget estimates. This method should be given up along with the method of budgeting on the basis of 'analysis of trends'. This should be replaced by a 'top-down' method by indicating aggregate limits to expenditure to each organization/agency.
- Internal capacity for making realistic estimates needs to be developed.

Student Notes:

4. *What is an Interim Budget? Why did all the state governments present interim budgets in 2014?*

Approach:

Straight forward question. Define interim budget and then mention due to impending elections, as central government presented interim budget, therefore state governments also had to.

Answer:

An interim budget is the budget presented by the government when it is in the last year of its tenure. It differs from the normal budget as it does not have any major provisions in it which can jeopardise the functioning of the next government by putting excessive financial burden on the government. The successive government lays down its own budget which reflects its manifesto and goals. The interim budget helps span the transition time between the two governments so that administration can continue to function.

The state governments are financially dependent on the center for most of their financial needs and hence whenever the central government presents an interim budget, the states also have to present an interim budget as they cannot prepare their full budget without the union government's support.

For instance the 80th amendment has introduced the Alternative Scheme of Devolution as per which a certain percentage of the income from the central taxes and duties should go to the states. Unless the states know this amount how can they plan their expenditure?

5. *What is gender budgeting? Give an account of the issues due to which gender budgeting has not been a fruitful exercise in India. Also, suggest measures required to address these issues.*

Approach:

- Explaining the concept of gender budgeting, give the rationale behind its introduction.
- Then bring out the issues that continue to pose concerns for gender budgeting in India.
- Bring out the measures required to address these concerns.

Answer:

Gender Budgeting means gender based assessment of budgets incorporating a gender perspective at all levels of the budgetary process and restructuring revenues and expenditures in order to promote gender equality. It entails dissection of the Government budget to establish its gender differentiated impacts and to ensure that gender commitments are translated into budgetary commitments.

Women constitute 48 percent of India's population but they lag behind men on many social indicators like health, education, economic opportunities etc. India adopted gender budgeting in 2004-05, however this exercise has not been fruitful.

Issues due to which gender budgeting has not been a fruitful exercise in India:

- **Insufficient resources:** The overall quantum of the gender budget is still less than 1% of the GDP (0.63% in 2019-20). Further, there is lack of utilization of existing funds also, such as 89% of the Nirbhaya Fund (a fund allocated for women's safety) have remained unutilized by the states.

Student Notes:

- **Concentrated in a few sectors:** Over the last decade, four ministries – Rural Development, Education, Health and Women & Child Development have received between 85-90% of the Gender Budget expenditure. This limits adoption of a more holistic approach.
- **Lack of impact assessment:** Though it is mandatory to release the Gender Budget Statement (GBS), there are no accountability mechanisms mandating impact assessment of allocations for women beneficiaries. Further, lack of data hampers policy making as well as impedes impact study for analysis of outcomes.
- **Inconsistent state-specific approach:** About 16 states in India currently undertake gender budgeting, however, the quality of statements produced, and allocation undertaken vary significantly among states, owing to inadequate training of government officials.

Various steps have been taken in this regard like **Gender Budgeting Cells** in the Union government to serve as focal points for coordination with Ministries and departments, training, workshops for capacity buildings etc.

However, more efforts are required in this regard to achieve the objectives of gender budgeting:

- Create a ranking for state level gender budgeting to incentivise the states in taking further steps to improve the efficacy of these measures.
- The capacity building and technical support should be provided to state level Gender Budgeting Cells.
- Gender audits of centrally sponsored schemes and flagship programs should be undertaken to measure impacts. This also necessitates increased efforts for the collection of gender disaggregated data at national, state and district levels.
- Segregation of the provisions for women in the composite programmes under education, health and rural development sectors which target girls/ women as the principal beneficiaries so that restrictions could be placed on reappropriation for other purposes.
- Deviation between budgetary allocation and actual spending needs to be addressed through proper monitoring of outcome.

Given the significant gender gap in the country, there is a strong need to prioritise policies to reduce bias against women. Further, intersectional policy research should be undertaken to aid evidence-based gender policy formulation for it to curb gender inequalities and contribute to overall development.

6. Do you think that multi-year budgeting is the need of the hour in India?

Approach:

- Introduce by highlighting limitations of an annual budget.
- Mention the advantages of adopting a multi-year budget.
- Conclude briefly.

Answer:

Multi-year budgeting is defined as the development and formal adoption of expenditure and revenue document that spans two or more years.

Currently, annual budgets present the revenue and expenditure projections for twelve months, which are inherently limited as they cannot link long term planning and budgeting. A piecemeal approach to sanctioning funds and schemes leads to loss of considerable time and delays in the realisation of objectives. Also, linking financial outlays to outcomes becomes difficult in an annual budgeting exercise.

Student Notes:

The benefits of adopting a multi-year budget are:

- **Efficiency in public resource allocation**- A multiyear budget allows long term interlinking of current year budgets with future expenditure requirements. It would provide a platform whereby perennial fiscal problems could be resolved by matching the government's expenditure commitments to the resources available.
- **Fiscal sustainability**- Improves financial management by addressing the issue of annual imbalances between revenues and expenditure. Further, by providing estimates for certain forthcoming years, it could help generate fiscal outcomes in different economic conditions.
- **Greater emphasis on program evaluation and monitoring**- A long term financial budget helps to provide a comprehensive analysis of schemes and programmes. It acts as a tool for reinforcing the fiscal discipline in public sectors.
- **Improved long-term planning**- It helps to provide a long term vision along with projected expenditure and revenue to match them. It leaves little scope for short term populist policies which may impose high economic cost in the long run.

However, there are various challenges associated with adopting a multi-year budget such as the difficulty in forecasting revenue and expenditure for multiple years, administrative capacity to monitor and implement, lack of flexibility for unseen expenditures due to certain emergencies etc.

Therefore, it is important to address these challenges before multi-year budgeting is implemented. Also, it can be adopted on a gradual basis starting with a single ministry/department to analyze the changes better.

7. It is imperative that the present system is re-engineered and a transition towards Outcome Budgeting is made for effective Public Finance Management in India. Discuss.

Approach:

- Explain what you understand by Outcome Budgeting.
- Briefly state its benefits.
- Highlight the challenges associated with transition towards Outcome Budgeting.
- Conclude with a brief way forward.

Answer:

Outcome Budgeting is a budgeting technique that **links budgetary outlays to specific outputs.** Under Outcome Budgeting, each government ministry and department carries out a comprehensive exercise wherein all major programmes and schemes are mapped against outputs, benefits accruing to people and qualitative targets. These outputs are measured not just in monetary terms but also in terms of the quality delivered.

It was first introduced in India in 2005-06 as a revised version of the Performance Budget, wherein certain ministries of the government were required to produce an outcome budget.

Outcome budgeting is essential for sound public finance management because it **arms citizens with data to hold governments accountable**, and in turn empowers the governments to better orient the bureaucracy towards results. Further, programmes and schemes are linked to a comprehensive set of indicators with targets, thus ensuring that r**esults are more tangible** and **costs are reduced** by identifying areas where investment can be more effective.

However, in India, there have been several issues with regard to transition towards Outcome Budgeting. These include:

Student Notes:

- **Difficulties in measuring outcomes** as compared to outputs and ensuring managerial accountability to link funds to outcomes for public programmes. For instance, for the schemes for cooperation education and cooperative training, no quantifiable deliverables and outcomes have been given. Thus, many Outcome Budgets produced by ministries are in effect are 'outlay budgets'.
- Scrutiny of the Outcome Budgets for the years 2013-14 to 2016-17 by the CAG revealed **inconsistency in depicting scheme-wise achievements** (outcomes) against targets already set in previous years. Audit noted that the Outcome Budget 2013-14 indicated unquantifiable targets like improvement of roads, bridges, drains, construction of market complexes, flyovers etc. but achievements or outcomes were not included in the Outcome Budget of the following year i.e. 2014-15.
- While formulating the Outcome Budgets, the principles and the intent of outcome budgeting are often overlooked as programmes are implemented without a comprehensive risk management framework.
- The internal audit system in the ministries is weak in terms of professional expertise and inadequate manpower. Thus, there is lack of independent, objective opinion to add value and improve the operation of schemes.
- The regular budget presented in the Parliament is a separate process from the ministry-wise outcome budgets tabled later in the budget session. Thus, there is increased scope of dissonance between the two.

Outcome Budgets should be adequately utilised both in programme formulation and resource allocation. Further, programmes should be taken up only when outcomes can be spelt out and implemented when an effective and timely feedback system is in place. It also requires a two-way relationship between the government and citizens to make it work. The government should formulate outcomes valued by the public while the public needs to assess the results and provide feedback on the utility of the outcome based budgeting.

8. ***The "Outcome Budget" reflects the endeavour of the Government to convert "Outlays" into "Outcomes". Explain. Also, discuss why the potential of outcome budgeting remains untapped in the Indian context.***

***Approach**:*

- Explain Outcome budgeting in the context of changing outlays to outcomes.
- Highlight its benefits.
- Discuss challenges faced by India while using the practice of outcome budgeting

***Answer**:*

Budgeting is an annual government exercise of estimating receipts and expenditures for the coming year. Accordingly, outlays are assigned to various ministries and government schemes on the basis of estimated output or outcome.

Under 'Outcome-based Budgeting', outcomes of each programme or scheme designed by the government is estimated. These Outcomes are the end results or impact of initiatives and interventions. Here Output must be differentiated from Outcome, as the former deals with quantitative result while the latter also includes qualitative aspect.

For instance, if outlay of 100 Crore is assigned for construction of hospital, then the 'output' would be measured in terms of physical infrastructure, whereas 'outcome' will also include the impact of the initiative, like percentage reduction in death rate, maternal mortality rate in that area among other parameters.

Student Notes:

Benefits of Outcome based Budgeting

- Outcome Budgeting shifts the perspective from "doing the job" to "doing it well".
- It leads to efficient service delivery, transparency, and accountability.
- The outcome budget indicates actual performance which helps people scrutinising the government and educates them about policies.

Outcome Budgeting in India:

The Outcome Budget was first introduced in India in 2005-06, with an understanding that "the people of the country are concerned with outcomes, not outlays". However, limited progress has been made in this front, primarily due to three key reasons:

- Much of the development interventions are routed through the state governments. Only a few states have adopted planning outcome budgeting.
- Limited understanding exists on the linkage between specific Government interventions and their outcomes. Ministries face difficulties in spelling out the outcomes on ex-ante basis.
- The principles and intent of outcome budgeting are often overlooked. There is lack of programme formulation, programme implementation and programme monitoring capabilities in the ministries.

Way Forward

- Appropriate Centre-State institutional framework should be created to standardize set of output indicators and processes for collecting and collating outcome related information.
- Effective feedback system such as social audit is required in implementation of every programme.
- The country needs to evolve ways and means to strengthen its institutions, without undermining them. Following steps have to be undertaken in this regard:
    - strengthening the Public Accounts Committee
    - professionalising the internal audit and vigilance organisation in the ministries
    - building capacities for risk management techniques in the programme divisions
    - making budget division and budget formulation activities independent of the executive to improve the outcome of programmes.
    - as the outcome may not be co-terminus with the period of the budget. There needs to be defined intermediate outcomes as well.

9. *Discuss the need for adhering to the road map for fiscal consolidation by fixing the fiscal deficit. Has the Fiscal Responsibility and Budget Management (FRBM) Act, 2003 served the purpose for which it was envisaged?*

Approach:

- The question is focused on the recent controversy surrounding the desirability of achieving fiscal deficit without any regard for monetary scenario. Therefore, the answer should start by briefly explaining the context of enacting the FRBM Act and its need.
- In the next part discuss whether the FRBM Act has fulfilled its stated objectives.

Answer:

The FRBM Act was introduced to check the deteriorating fiscal situation prevailing in 1990s. It intends to ensure prudent fiscal management. It specifies the annual reduction targets for fiscal and revenue deficits. The amended Act stipulates the reduction of fiscal deficit to 3% of the GDP by 2017-18. The Act binds the Government

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to adhere to the path of fiscal consolidation (although exceptional situations like the 2008 crises allow the government to take exceptional measures).

Achievements of the Act

- Brought centrality to the issues relating to fiscal consolidation as the government has to mandatorily present medium-term and strategy statements annually.
- Sustained high FDs raise the debt-GDP ratio and increase interest payments as proportion of revenue.
- It improved the fiscal performance of both centre and states, which has contributed to their economic stability, as reflected in controlled inflation in the past year.
- Performance on controlling fiscal deficit has been an important factor deciding sovereign debt ratings. Adherence to consolidation has helped us from being downgraded.
- Strict adherence to the path of fiscal consolidation during pre-crisis period created enough fiscal space for pursuing counter cyclical fiscal policy.

However, fixing a blanket target for fiscal deficit has been debatable. It is argued that, if the bank credit to the economy does not adequately grow, economic growth will suffer for want of money. Government expenditure must fill the gap in such situation, the consequence of which is rise in fiscal deficit. The economic slowdown since 2012 can partly be attributed to reduced money supply since. Further, the restrictions placed by the FRBMA have constrained the ability of the state to fill the expenditure gap.

The Finance Minister has recently suggested that fiscal expansion or contraction should be aligned with credit (money supply) contraction or expansion respectively. That is, if credit growth falls, fiscal deficit may needs to rise and vice-versa to ensure adequate money supply to the economy. FRBMA in its current form ignores this possibility and therefore, it is appropriate to get it reviewed.

10. It is important for India to return to the path of fiscal consolidation while also increasing public investment. Explain why achieving both these objectives are important to revive the present economic environment in the country.

Approach:

- Defining fiscal consolidation, discuss its significance for economic stability.
- Discuss the significance of public investment.
- Discuss the underlying challenges in balancing the two and suggest measures for the same.

Answer:

Fiscal consolidation (FC) means reducing fiscal deficit (FD) by reducing public expenditure and/or increasing the revenue. The aim is to discipline the public finances and is enjoined by the FRBM Act, 2003 (which intends to cap the Fiscal deficit to 3% of GDP). Public investment means committing public money to various socio-economic objectives. It is often seen that public investment is curtailed to cater the needs of fiscal consolidation. Both these objectives have been contested, with arguments on both the sides.

Fiscal Consolidation (FC)

A. Significance

- Large FD means government as the major borrower leaving private sector short of credit for investment.

Student Notes:

- High FD adds to interest burden on the government, thereby diverting the money from productive sectors. At present, interest payments at the Union level, account for almost 50% of their net tax revenues.
- High FD increases the interest rates in the economy, thereby fuels inflation.

Therefore, the importance of FC can't be overstated. Hence, the credit rating agencies consider FD as an important variable to assess the credit worthiness of an economy.

B. Argument against

During economic slowdown, the government has to incur deficit to boost the economy. When the aggregate demand is already low, adhering to the path of FC is counter-productive. For example, during 2008 crisis we have to abandon the targets under FRBM Act. To look into this issue further, NK Singh Committee has been set up by Finance Ministry.

Public Investment

A. Significance

- Public investment in productive sectors acts as the stimulator, fueling demand and hence growth in the economy. It is particularly important in current scenario of sluggish growth.
- At present, capital expenditures is merely 1.7% of GDP which means lesser future growth. Public investment in infrastructure would boost future growth and consumption in the present.
- It has domino effect as it crowds in the private investment, which, at present, is significantly depressed.
- Private investment is volatile and it being majorly in form of FDI and FII is prone to global risks and hence more volatile.
- Private investment in India has been in capital intensive sectors like services. Hence, to boost employment growth public investment is needed.
- Public investment is necessary to bridge the sectoral and regional inequalities.

B. Challenges

- Increased public investment may crowd out private investment.
- It is difficult to mobilize resources for investment in current slowdown.

Way forward

We have to find balance between these apparently conflicting objectives as under:

- Reprioritize expenditure, with greater focus on the productive capital expenditure and reducing revenue expenditure.
- Rationalize subsidies to increase fiscal space.
- Divest government's stakes held in specified PSUs and utilize these resources for capital investment.
- In line with Vijay Kelkar Committee's report on PPP, we should resolve the stuck investment projects and revive the PPPs.
- As suggested by FFC, there should be an independent Fiscal Council to monitor the implementation of fiscal rules by the government.
- The implementation of a well-designed Goods and Services Tax (GST) and other tax reforms would also play the crucial role in enhancing revenues.
- Exploring feasibility of having a 'fiscal deficit range' as the target in place of the existing fixed numbers(percentage of GDP) as fiscal deficit target.

Student Notes:

11. Parliamentary scrutiny over public finance is an important aspect of governmental accountability. In this context, discuss the role, importance and challenges in establishing a Parliamentary Budget Office (PBO) for effective oversight of budgetary process.

Approach:

- Briefly discuss the role of parliament in scrutiny over public finance and its effectiveness.
- Mention the role and significance of a Parliamentary Budget Office (PBO) in effective oversight of budgetary process.
- Discuss the challenges to be faced in establishing a PBO.

Answer:

In a parliamentary democracy, legislature plays a crucial role in scrutiny of public finance. MPs, through debates, discussions and voting on motions, hold the government accountable for the money that it spends from the public exchequer. Constitutional bodies like CAG and parliamentary committees like the PAC maintain a close oversight on manner of government spending.

However, due to lack of resources such as time, detailed information and expertise on financial/economic matters with individual members, it becomes difficult to hold the government accountable to higher standards. As such, many times it has been felt that spending by the government has been inefficient and ineffective, if not profligate or politically expedient. In this light, a need has been felt for an independent and impartial body that provides technical and objective analysis of Budgets and public finance to the House and its committees.

Role:

Specifically, the functions of PBOs can be different in different countries. Generally, the following features are found:

- Independent and objective economic forecasts;
- Baseline estimate survey;
- Analyzing the executive's Budget proposals and their costs-benefits; and
- Providing medium- to long-term analysis.

Costing is a standard practice for many PBOs. Budgets generally start with an economic forecast. A PBO can present either its own independent forecast or it can validate the government's, providing an objective analysis on the official forecast. A PBO is very different from research wings or Finance Committees or Public Accounts Committee (PAC). It is comprised of independent and specialized staff such as Budget analysts, economists, public finance experts.

Also, it must be non-partisan, independent and mandated to serve all parliamentarians including treasury bench and opposition.

Significance:

PBOs provide legislators with high-quality analysis that is independent of the executive. They specialize in objective and policy neutral analysis on the full budget cycle, the broad fiscal challenges facing the government, budgetary trade-offs and the financial implications of legislative proposals. Such research can raise the quality of debate and scrutiny in Parliament as well as enhance fiscal discipline. Most importantly, it strengthens the role of Parliament in financial oversight.

Student Notes:

Challenges:

The key challenges faced by any country that establishes a PBO are threefold— Guaranteeing independence and viability of the office in the long-run, ability to carry out truly independent analysis and demonstrating impact. However, political will and public support would help overcome these challenges.

Going forward, it will be important to understand that a PBO can only provide independent research; it cannot prevent executives from taking bad fiscal decisions.

12. The need to overhaul the current budget making process can be gauged from the fact that it neither undertakes broad-based consultations, nor is adequately transparent nor effective in estimating and allocating the demands of various stakeholders. Examine.

Approach:

- Explain the issues with the current budget making process. Try to substantiate your arguments with relevant facts.
- Give relevant solutions so as to make the current budgeting process more transparent and accountable at the same time.

Answer:

Recently, India scored 48 out of 100 in the *Open Budget Survey of 2017* reflecting low levels of transparency in the annual budget process. Similarly, ***Transparency International India (TII)*** reported that India's budgeting process is less transparent than her neighbours like Bangladesh.

Before budget formulation, the finance ministry does take into account views of experts and different stakeholders. There are regular meetings with expert bodies as well representatives of various organisations such as farmers, industry, academia, etc. However, the views of the common people often go unheard of and the general citizenry is only a recipient of what has been prepared by the ministry or demanded by various vested interests. Recognizing this facet of budgetary process, the Prime Minister asked for a need to change this structure of engagement to make the Budget-making exercise more "social friendly" by taking the views of the common people.

Another aspect is the demands by the ministries and final allocation by the finance ministry. In view of scarcity of resources and competing demands, every ministry tries to inflate its estimates so as to get more resources. Finance ministry also recognizes this tactic and thus, in the ensuing negotiations, many a times, legitimate demands may be sidelined or allocation may not be done according to actual requirements. Hence, the process of estimation and allocation also suffers from drawbacks.

Other issues with the current budget making process in India are:

- **Lack of transparency**: Currently, the process of budget preparation by the government is carried out behind closed doors. Even, the mid year reviews have not been compiled with much discipline. For e.g. no mid year review was published in 2016.
- **State budgets**: The state budget in India remains highly incomprehensible, , making it difficult for the citizenry to participate in shaping public policy.
- **Top down approach**: None of the stages involve the third tier of governance i.e. the local governments of Panchayats and Municipalities.
- **Duration**: While the budget process is an excessively lengthy exercise, the time spent discussing the budget has reduced from an average of 123 hours in the 1950's to 41 hours in the last decade.

Student Notes:

- **Gender budgeting:** Although India has adopted the practice of Gender Responsive Budgeting (2005),it has been merely in financial terms with inadequate focus on gender related data collection and outcomes-achieved.
- **Non participative**: There is a lack of participation and consultations with the common public & other stakeholders during enactment of the budget process.
- **Frequent practice of Guillotine:** The budgetary practice of "Guillotine" is often misused to avoid discussions on matters of public importance.
- **Role of Opposition parties**: Generally, the motions are passed in accordance with the majority government. The amendments by the opposition parties are usually neglected.
- **Role of Rajya Sabha**: The Rajya Sabha has no active role in the passing of budget. Its advices are seldom accepted by the Lower House as well.
- **Lack of Cooperative federalism**: State governments are not taken into consideration while framing the Union Budget policies.

Thus, budget making process can be made more participatory and transparent by inculcating the following points:

- **Use of technology**: Technology can be leveraged to shorten the duration of budget process as well as to enhance citizen participation & transparency in the budgeting process.
- **Bottom up approach**: Incorporation of District and State plans in central budgetary allocation.
- **True outcome based budgeting**: Outcome based budgeting needs to include the citizen's feedback on effectiveness of schemes. The details of the budget in the formulation phase should be put in public domain for public scrutiny.
- **Public access to thematic reports:** reports tracking revenue and expenditure can provide regular information to policy makers, media, and the public.
- **Setting minimum working hours**: As during the budget session, frequent adjournment of lower house prevents discussion on important demand for grants.
- **Simplified language**: Budget document may be simplified and made available in all the official languages.
- **Cooperative federalism**: Rajya Sabha should be given more powers than merely discussing the budget and their recommendations should be given more importance.

13. What do you understand by the term 'Environmental Accounting'? Discussing the rationale behind introducing environ accounting, highlight its status in India.

Approach:

- Explain the term Environmental Accounting.
- Highlight the rationale behind Environmental Accounting.
- Discuss its status in India.

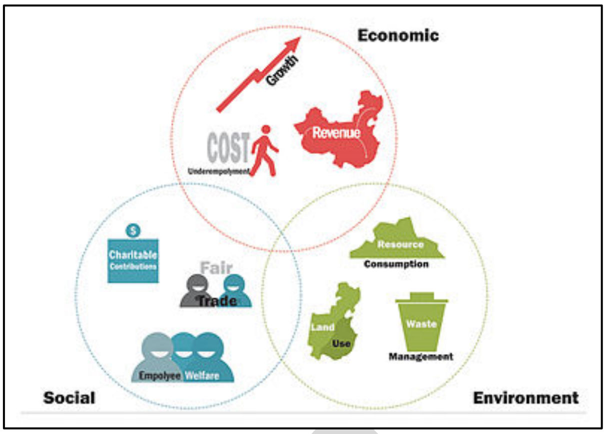
Answer:

Environmental accounting refers to the practice of incorporating principles of environmental management and conservation into reporting practices. It attempts to make the best possible quantitative assessment of the costs and benefits to an enterprise for activities specifically directed to environmental preservation.

It allows an organization to see the impact of ecologically sustainable practices at every stage right from their supply chain to facility expansion. An actionable example of environmental accounting is the Kyoto Protocol that quantifies carbon emissions.

Student Notes:

Rationale and Significance:



- It differs from traditional accounting practices which are usually unidimensional in their approach and only measure the tangible impacts an organization makes through accounting methods of profit and loss.
- Measures the effects of the natural environment on a company in monetary terms, unlike ecological accounting which measures the influence on the environment in physical measurements.
- It ascertains the costs to clean up or remediate contaminated sites, environmental fines, penalties and taxes, purchase of pollution prevention technologies and waste management costs.
- It is crucial in preventing serious environmental displacements and consequences translating into environmental related hazards.
- Helps in fulfilling an organizations accountability to stakeholders, such as consumers, business partners, investors and employees, when utilizing environmental resources.
- Encourages consumers and helps them purchase 'green products', thus both consumers and corporate benefit.

Indian Scenario

- Legal Framework for Environmental Accounting in India emanates from Article 51A of the Indian Constitution, which impose a fundamental duty on every citizen to protect and improve the natural environment.
- Further, various laws and legislations like the Environment Protection Act require industrial units to disclose environment related information. For instance, Maruti Udyog Limited shares data on non–methane hydrocarbons in Paint Shop and Engine Testing shop with monitoring agencies.
- EIA has now been made mandatory under the Environmental (Protection) Act, 1986 for certain categories of developmental activities.
- India is working towards SDG# 13 and SDG # 15 that relate directly to preserving and supporting ecosystems and mitigating climate change.

Although the concept of environmental accounting suffers from certain problems like no standard accounting methods, poor valuation techniques, long term process and lack of reliable industry data, nonetheless it has emerged as a crucial tool to arrive at a fair assessment of "development" and bring environmental transparency.

Student Notes:

ECONOMIC REFORMS

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1. Introduction

The economy of contemporary India is a great paradox. It is a strange combination of outstanding achievements as well as grave failures. Since Independence, India has achieved remarkable progress in overcoming its economic backwardness. From being a very poor country in the 1950s and a 'basket case' in the mid-1960s, it has emerged as the third largest economy (in terms of **purchasing power parity**). Our economy has become one of the fastest growing economies in the world. Now the country is one of the leading players in the world knowledge economy with vast intellectual capital and booming software and information technology services. These factors together have made India one of the greatest destinations for foreign investment.

However, in spite of these historic achievements, the country has pervasive poverty, malnutrition, illiteracy, and a huge unemployment problem. Although we are the world's largest democracy, our country has an overwhelming majority of poor voters. While the country is celebrating its growth rate and technological wonders, it is witnessing social contradictions and the paradoxes and ironies of development. Thus, there is the India of burgeoning growth coexisting with the India of widespread want and misery. This gives rise to several questions: Where have we gone wrong? Was the development strategy adopted after Independence right? Were the economic reforms of 1991 done right? Could the reforms have been done better?

2. Development Planning

Economic policies adopted in India after 1947 were conditioned by the colonial legacy and the prevailing international situation. The strategic design of these policies was tremendously influenced by the dominant ideology of the Indian national movement and the ideas of nationalist leaders, especially Nehru. At the time of Independence, India was in the stranglehold of stagnating per capita national income, static and semi-feudal agriculture, poorly developed industry and inadequate infrastructure, mass poverty, extreme unemployment and underemployment, massive illiteracy, high birth and death rates and deplorable health conditions. Independent India faced the gigantic task of undoing the damage caused by British Rule. There was a need to put in huge and organized effort on a national scale to achieve substantial progress on the socio-economic front. Towards this end, planning was accepted as the key strategy of India's developmental efforts.

Planning was considered a superior way of developing the Indian economy than the market mechanism. While the market gives priority to high-profit activities, planning makes a systematic utilization of the available resources at a progressive rate to ensure quick building of the productive capacity of the country. Planning was looked upon as an instrument that could enable the state to undertake several massive development projects and unemployment and poverty alleviation programmes. Furthermore, planning was essential to deal with difficulties caused by the partition of the country in 1947, that is, huge influx of refugees from East and West Pakistan and the loss of raw material-producing areas.

Several international developments in the early decades of the 20th century revealed the limitations of market mechanism with respect to both efficiency and equity. After the 1917 revolution, the Soviet Union became the first socialist state and adopted a planned economy model. Its remarkable achievements on the socioeconomic front greatly inspired the nationalist youth in India. Around the same time, the Great Depression of 1929-33 exposed the problems of a free market economy. Keynesianism, a product of the Depression, strongly advocated the case of economic management by the state through taxation and spending policies.

In fact, the economic critique of colonialism by the national movement and its explicitly articulated set of economic objectives provided the foundation to the strategy of development planning in India after Independence. While criticizing colonial underdevelopment and the

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dependent character of the Indian economy, Indian nationalists put forward the idea of a self-reliant independent economic development in which state planning would play the key role. In the 1930s, ideas on development planning were crystallized due to the influence of the Russian experiment, Keynesian economic ideas and the New Deal programme in the US seeking state intervention in the economic forces. The need for planning was so strongly felt that the Indian National Congress set up the National Planning Committee (NPC) in 1938 under the chairmanship of Jawaharlal Nehru. This plan was to have great implications on the post-Independence economic strategy in India. In addition to this plan, several plan documents were prepared along different ideological lines in the 1940s: the Bombay Plan was authored by India's eight leading capitalists, the People's Plan prepared by M. N. Roy took a left position, and the Gandhian Plan formulated by Shriman Narain pleaded for a self-sufficient village economy. However, there was a broad consensus among the Gandhians, the capitalists, the socialists and the communists on the necessity of planning as well as the nature and path of development to be followed after Independence.

Jawaharlal Nehru, the chief architect of planning in India and the country's first prime minister, was greatly influenced by democratic, socialist and Gandhian values. He believed that socialism and democracy were inseparable. Hence, he described democratic socialism as the vision of independent India that would seek to make democratic social transformation an integral part of the country's economic strategy. Nehru spoke of his approach as a third way that takes the best from all existing systems—the Russian, the American and others—and seeks to create something suited to one's own history and philosophy. He thought that planning introduced in a democratic manner could become the instrument for growth and reduction of inequalities while ensuring individual freedom and avoiding the violence of revolutionary change. He hoped for a society organized on a planned basis for raising humankind to higher material and cultural levels, to cultivation of values, of cooperation and ultimately a world order. He also considered planning a positive instrument for resolving conflict in a large and heterogeneous country.

2.1. Nature and Objectives of Planning

After Independence, India adopted a democratic ideology—representative form of government based on universal adult suffrage with rights and liberties for the masses. Democracy became central to the Indian model of development. There was unanimity among the leaders on the unique approach of India to planning within a democratic and civil-libertarian framework. It was believed that planning would create a democratic economy in the country by bringing the economy under public control. At the same time, in India's development strategy market and economic planning were regarded as complementary to each other. Development plans were to be formulated and carried out within the framework of a mixed economy that included the merits of both socialism and capitalism. A mixed economy was marked by the coexistence of private and public sectors, the latter remaining confined to infrastructure and basic and heavy industries.

The basic objectives of planning were derived from the Directive Principles of State Policy enshrined in the Constitution. These basic objectives provided the guiding principles of planning in India. These spelt out as: (i) economic growth— accelerating the growth to achieve higher level of national and per capita income; (ii) modernization—implementing structural and institutional changes to make the economy progressive and independent; (iii) self-reliance—eliminating dependence on foreign aid and India's vulnerability to external pressures and disturbances; and (iv) social justice—improving the living standards of the masses, especially the underprivileged through deduction in income inequalities, removal of unemployment, elimination of poverty, land reforms and social programmes on health and education. Overall, growth and social justice formed the economic and social framework of planning. With this perspective, the Planning Commission was set up in 1950 by a government resolution to formulate a plan for economic and social development and to act as an advisory body to the

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Union government in its behalf. The National Development Council was formed later as an adjunct to the Planning Commission to associate the states in the formulation of plans.

2.2. The Nehru-Mahalanobis Development Strategy

The era of planned development was ushered in with the launch of the First Five-Year Plan in April 1951 (the Harrod-Domar model with some modifications was the underlying model for the First Plan). It addressed the problems arising from massive influx of refugees, acute food shortage and mounting inflation. The highest priority was given to overcoming the food crisis by raising foodgrain output, curbing inflation and the development of infrastructure.

The Second Five-Year Plan is regarded as the milestone in the trajectory of planning since it was based on the Nehru-Mahalanobis strategy of development, which guided the planning practice for more than three decades until the end of the Seventh Five-Year Plan. The draft outline of this plan was framed by P C. Mahalanobis. This development strategy was based on several assumptions regarding the causes of structural backwardness of the Indian economy. First, severe deficiency of material capital was seen as the basic constraint of development since it prevented the introduction of more productive technologies. Second, the low capacity to save was considered as the limitation on the speed of capital formation. Third, it was believed that through industrialization the surplus labour underemployed in agriculture could be productively employed in industries. Fourth, it was presumed that if the market mechanism were given primacy, this would lead to excessive consumption by higher-income groups, along with relative underinvestment in the sectors essential to the accelerated development of the economy.

Given these assumptions, the basic questions before the planners were: How to increase capital stock rapidly? How to invest wisely? How to increase savings? How to regulate the market? The Nehru-Mahalanobis development strategy found the answer to these questions in rapid capital formation through the development of capital goods industries with direct intervention of the state in the economy. As such, it was based on the principle—higher the allocation of investments to the heavy or capital goods industries, lower will be the rate of growth of income in the short run, but higher will it be in the end. Thus, industrialization with preference to capital goods industries over consumer goods industries became the core of this development strategy. The basic elements of this strategy can be summed up as:

- Raising the rate of investment since the rate of development is dependent on the rate of investment. It involved stepping up domestic and foreign savings also.
- Rapid growth of the productive capacity of the economy by directing public investment towards development of industries, especially capital goods industries. Simultaneously, promotion of labour-intensive small and cottage industries for the production of consumer goods and expansion of employment opportunities.
- Import substitution for self-reliance and reduction of external dependence.
- Setting up of an elaborate system of controls and industrial licensing to allocate resources among industries as per the Plan requirements and distribute consumption goods equitably among the consumers. This was done through the Industries Development and Regulation Act (IDRA) of 1951.
- Enhancing the scope and importance of the public sector so that this sector comes to predominate capital goods industries, and controls the commanding height of Indian economy.

In this way, the Second Five-Year Plan sought to promote a pattern of development that would ultimately lead to the establishment of a socialistic pattern of society in India. The development strategy of the Third Plan was basically the same as that of the Second Plan but the highest priority in this Plan was accorded to agriculture.

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2.3. Agrarian Reconstruction

While formulating national plans and policies, the planners also tried to address the fundamental social and economic problems of the agrarian structure. The Gandhian idea of gram swaraj was a great influence in this regard. Two significant steps were taken in the 1950s to bring about major changes in the agrarian structure. These were the Community Development Programme and land reforms.

2.4. Role of the State

Given the nature of problems in India at the time of Independence, development became the core of the state's agenda. Development was comprehensively defined to encompass not only an industrial economy, but also simultaneously a programme of social transformation and political democratization. The state tried to achieve economic development as well as an egalitarian social order within the confines of democracy. The Constitution in 1950, having universal adult franchise and an extensive list of Fundamental Rights, officially declared India a democracy. The Directive Principles of the Constitution with the goals of social justice and preventing concentration of wealth shaped the scope and nature of state intervention.

For the attainment of economic as well as social transformation in the society, the Indian state took up the role of a developmental state. It became the central instrument in the development course through the process of planning, which involved state control over the production, distribution and exchange of goods and services. The state itself entered the fields of production and distribution to meet the developmental objectives. The Nehru-Mahalanobis strategy found the state as the most suitable agency to achieve its objectives. The state was required to intervene in the economy, promote public sector in heavy industries and guide the growth of the economy. The state launched big dams, large industrial and mining projects and institutions of higher learning as 'temples of modern India' for infrastructure development. To improve village life, the state undertook institutional reforms or land reforms. It took the primary responsibility for providing elementary education, basic healthcare, safe drinking water and employment programmes. Such a large expansion of the economic and social responsibilities of the state was consistent with the objective of the socialist pattern of society. However, this did not mean complete elimination of private enterprise. In fact, the state was pledged to maintain a mixed economy in the society based on its commitment to democracy and socialism.

2.5. Analysis

The Nehru-Mahalanobis strategy of development faced considerable criticism from several quarters. Since it put greater emphasis on industrialization compared to agriculture, the latter suffered. The allocation of higher priority to heavy industries compared to labour-intensive industries resulted in heavy concentration of wealth and large-scale unemployment. The IDRA (Industrial Development Regulation Act) of 1951 did not serve its purpose fully. It created a *license raj* in the country favouring the large industrial houses, which became an impediment to industrial development. Land reforms could not be implemented properly owing to the defects in legislations, lack of political will and bureaucratic apathy. Because of the same reasons, the CDP (Community Development Programme) did not achieve considerable success.

Nevertheless, the first phase of the development effort witnessed several significant achievements. This phase created the basic physical and human infrastructure for comprehensive development in the society. The overall economic performance was far better compared to the colonial period. The rate of growth was quite impressive. Both the savings and investment rates rose substantially. Growth in agricultural production occurred because of land reforms, CDP and large investment in irrigation, power and agricultural research. Industry grew more rapidly than agriculture. The country developed a heavy industry complex with considerable diversification within the industrial structure. Furthermore, progress was made in the sphere of human capital due to the setting up of institutions of higher learning, especially in the scientific field.

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3. Economic Crisis – 1960s

Despite these significant achievements, India faced a **macroeconomic** crisis in the mid-1960s, due to the slow growth of agriculture and exports, two successive droughts of 1965 and 1966 and the Indo-Pak War of 1965, followed by a suspension of US aid. This situation delayed the Fourth Plan and three annual plans were adopted between 1966 and 1969. The response of the state to the crisis included:

- The adoption of restrictive **fiscal policies** by cutting down on expenditure
- The devaluation of the rupee; and
- Launching of the Green Revolution

3.1. Shifts from Early Development Strategy

The Nehru-Mahalanobis strategy of development came under severe attack due to the poor performance of the economy and the economic crisis of the mid-1960. Although the basic framework of the Mahalanobis strategy was retained until the end of the Seventh Plan, shifts from this strategy became visible from the Fourth Plan onwards. In the Fourth Plan, the objective of self-reliance was not discarded, but the main emphasis was shifted to rapid economic growth. Consequently, preference was given to quick-yielding projects as well as to light industry at the expense of heavy industry. The state went for an elaborate system of controls in the economy such as nationalization of banks in 1969, the Monopolies and Restrictive Trade Practices (MRTP) Act in 1969, nationalization of the insurance sector in 1972 and the coal industry in 1973, and the Foreign Exchange Regulation Act (FERA) in 1973.

A major criticism of the Mahalanobis development strategy came from the World Bank economists in the early 1970s. Challenging this growth-oriented strategy, they argued that the objective of removal of poverty could not be achieved by growth itself. Several studies concluded that the benefit of growth had failed to reach the poor. Hence, the Fifth Plan allocated highest priority to the elimination of poverty and it adopted various area development programmes. The Sixth Five-Year Plan adopted various redistributive measures such as the Integrated Rural Development Programme (IRDP). The Seventh Plan adopted a new long-term development strategy focusing on growth in foodgrain production, employment opportunities and productivity.

4. Economic Crisis – Early 1990s

India faced a full-scale macroeconomic crisis in the early 1990s that reached its climax in 1991. The crisis was marked by high inflation, rising food prices, large current account deficit, huge domestic and foreign debt, a sharp fall in the foreign exchange reserves, a steep decline in India's credit rating, and a cut off of commercial loans accompanied by a net outflow of NRI (Non-Resident Indian) deposits.

The long-term constraints of the preceding decades, especially the 1980s, combined with certain immediate factors gave rise to this economic crisis. The Nehru-Mahalanobis strategy of import substitution-industrialization made the Indian industry inefficient and technologically backward due to the absence of competition. Due to the discouragement of foreign capital, India could not get the benefits of technology and competition. Heavy regulation of private sector through the system of licenses and permits caused a great damage to entrepreneurship and innovation. The public sector that dominated this strategy became highly inefficient and even sick due to excessive political interference. The preoccupation of the strategy with self-sufficiency caused export pessimism. This heavy industry strategy required huge imports of capital goods. Due to large imports of capital goods and foodgrain combined with little exports,

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the trade deficit increased. Instead of making necessary modifications according to the changing world situation, the government itself caused fiscal deterioration in the 1980s through: (a) populist policies, (b) rapid growth of state controls over the economy, and (c) reservation of certain areas for small-scale industries. The Gulf Crisis of 1990 came as an external shock to the Indian economy, which was in a highly vulnerable state.

5. Need for Economic Reforms

In this context, there arose a need for economic reforms arose due to the following underlying factors.

5.1. Weaknesses of the Pre-1991 Policies

One of the important factors which led to economic reforms was the weakness of pre-1991 economic policies such as low rate of economic growth, rising unemployment, stagnation in the rate of domestic savings and investment, poor performance of the public sector industries, inadequate infrastructural facilities, industrial licensing policy, growth of monopolies, etc.

Apart from these, there also prevailed other crisis-like conditions in 1990 and 1991, which pushed India towards liberalisation and globalisation.

5.2. Major Foreign Exchange Crisis

In the year 1991, Indian economy faced an acute shortage of foreign exchange. Several factors were responsible for this crisis.

First, the immediate cause for the foreign exchange crisis was the war between the Gulf countries of Iraq and Kuwait. This pushed oil prices and the oil import bill went up substantially.

Second, India's external debt had increased over time. The burden of interest and repayment of old debts was very large. Fresh debts were being denied by the international institutions such as International Monetary Fund (IMF) and the World Bank as well as other commercial lenders.

Third, foreign exchange in the form of NRI deposits was being withdrawn very rapidly because of the political instability and uncertainty at home.

Finally, the growth in imports had always been far more than the growth in exports. India had to, therefore, depend on foreign loans. Hence, foreign debt was always on the rise. Very soon, the foreign exchange crisis took a serious turn. Between January 1991 and June 1991, India faced a situation in which it had foreign exchange just enough to meet the import needs of only about three weeks. India was almost on the edge of defaulting on its foreign lenders' claims. As a result, the foreign exchange reserves with the Reserve Bank of India almost dried up.

5.3. Conditionalities Imposed by IMF and World Bank

In view of the foreign exchange crisis, the Government of India was pushed to the wall. Therefore, it had to approach the IMF and the World Bank to tide over the crisis. These institutes provided the much-needed foreign exchange, but on their own terms and conditions.

As a part of these conditions, India was required to cut down fiscal deficit and the rate of growth of money supply so as to liberalise the domestic economy and to relax restrictions on international flow of goods, services, capital and technology. Therefore, under pressure from the IMF-World Bank, the Indian policy-makers were almost pressurised to make several changes in the policy before they could obtain fresh credit from the IMF and the World Bank to tide over the crisis.

5.4. Fall of USSR (Union of Soviet Socialist Republics)

The USSR and the East European countries had over time become the major markets for Indian consumer goods exports. At the end of 1990, political system of these countries collapsed. Most

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of these countries became market economies. India had to open up trade with these countries on the basis of its ability to compete. It had to compete in the global market to retain its share of exports. India had, therefore, to reorganise its own policies to find a share in the world market.

6. Economic Reforms

In response to the internal economic crisis of 1990-91 and the changing international situation, the Narasimha Rao government decided to introduce economic reforms or the New Economic Policy (NEP). The NEP clearly reflected certain global trends, namely, the collapse of the socialist economy and growing acceptance of economic globalization across the world.

Although the reforms as a part of the process of liberalization and globalization were revolutionary in nature, these were launced within the democratic framework of the country. They marked a shift from the Nehruvian consensus of the 1950s to a new consensus around reforms. While the national goals set out at Independence remained unaltered, the change came only in the strategy to achieve these goals – from Nehru-Mahalanobis development strategy to the new development strategy of liberalization and economic reforms.

a) Macroeconomic stabilization measures

Macroeconomic stabilization was a short-term programme adopted to overcome the macroeconomic crisis by regulating the total demand in the economy

To correct the ***twin deficit*** i.e. the BOP problem & fiscal deficit, the reform package was announced in 1991 as a ***short term measure***, which had the following three components:

- **Fiscal stabilization measures**: To check the growing fiscal deficit, it proposed to step up the investment by the State in areas of social sector (school, hospitals etc) & infrastructure (roads, power etc) without creating inflationary pressures on the economy to generate demand.
- **Internal sector Liberalization**: Selectively control & permit the private sector to make their production and investment decisions as per the market conditions of demand & supply & allow them to invest liberally.
- **External sector Liberalization:** Integration of Indian economy with the Global economy to benefit from the resource inflows & competition, by removing controls on foreign trade & exchange rates & a policy to attract FDI etc.

It was believed that these measures would generate investment & high productivity in the economy, creating more employment opportunities & boost **demand**. This demand would lead the economy to a high growth path. This was however a **short-term** strategy, a package that was intended to correct the economic lapses in the system that existed that time.

The result was that India was able to pay its dues to IMF in time. Not only this, the Indian economy was back on track & achieved an average annual growth rate of 6.5% against a targeted 5.6% during 8th FYP. But India launched another set of medium to long term measures as well, termed as Structural reforms.

b) Structural Reform Measures

It was strongly believed that the stabilization that will be achieved by the package in the short term will not be sustainable if India's economy doesn't undergo structural reforms. Structural reform was a medium- and long-term programme, which dealt with sectoral adjustments and the problems on the supply side of the economy by bringing in dynamism and competitiveness to the economy. These included liberalized trade and investment policies with emphasis on exports, industrial deregulation, disinvestment and public sector reforms, and reform of the capital markets and the financial sector.

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Crisis management measures included use of gold to acquire foreign currency to meet payment obligations, devaluation of the rupee, compression of imports and seeking finances from multilateral financial institutions and bilateral donors. In this way, an attempt was made to achieve a progressive economy by removing the internal controls and further to equip it to take advantage of the opportunities provided by the worldwide globalization process. Accordingly, a new trade policy and a new industrial policy were introduced. In the face of these changes, the Eighth, Ninth and Tenth Plans were launched.

6.1. Redefining the Role of the State

The adoption of the NEP based on liberalization and privatization has given rise to a debate on the nature of the link between state and market. The NEP does not imply a retreat of the state. It is based on a few propositions.

First, the state and the market are not substitutes for one another but they complement each other. Second, these two actors provide mutual checks and balances in such a way that one can correct the failures of the other. Third, through proper intervention the state has to make the market people-friendly because governments are accountable to people, while markets are not. It calls for a reorientation in the role of the state that tended to take too many responsibilities in the past. It underlines a change in the nature of the state from a producer, investor and regulator to a facilitating agency.

The state has to maintain general law and order and provide an appropriate policy framework in the areas where the private sector can play a large role. The state needs to formulate policies to bring about improved transparency and greater accountability, which form the basic pillars of good governance.

The new development strategy urges the state to play an important role in creating economic and social infrastructure that is unlikely to attract private investment, such as rural infrastructure and the development of roads and railways. It also justifies state intervention in those areas where the markets either do not exist or where market activity can lead to undesirable outcomes – providing public goods such as healthcare, education, and safe drinking water, and generating measures for eradication of poverty, creation of employment opportunities, empowerment of the disadvantaged and elimination of regional imbalances.

7. Liberalisation, Privatisation and Globalisation

The New Economic Policy was based on three major policy measures, namely, (a) liberalisation, (b) privatisation, and (c) globalisation. Liberalisation policy was characterised by liberalisation of the Indian economy from various types of controls, licensing and permits, which regulated the non-agricultural sector before 1991. The policy of privatisation basically implied expansion of the private sector and limiting the role of the public sector. Globalisation was the policy of opening up the Indian economy to other economies of the world.

Now, let us look at the economic reforms in detail under each of these three heads.

7.1. Policy of Liberalisation of Indian Economy

The policy of liberalisation forms an important part of the economic reforms characterising the new economic policy.

7.1.1. Meaning of Liberalisation

Economic liberalisation is the policy of deregulation of different segments of economy. It is the policy of doing away or reducing the government's controls over industry and other activites, which existed before 1991. The objective of introducing the liberalisation policy in 1991 was to move from a regulated system to a new system where regulations were to be reduced and ultimately minimised. Different sectors of the economy were to be made free from controls,

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licenses and permits. The Indian policy-makers were not thinking of a policy of *laissez-faire*, i.e. completely unregulated economy, but of reduced regulation.

7.1.2. Features of Liberalisation Policy

The main features of the policy of liberalisation are as follows:

Delicensing: Before 1991, there existed a regulatory system of licensing and controls. Industries which were covered under this system were required to be registered and were granted licenses by the government. The regulatory system of licensing and controls became a hurdle in the industrial growth. It caused delays and was breeding corrupt practices. The industrial licensing policy led to unnecessary government interferences, delays in investment decisions, bureaucratic red-tapism, etc. The regulatory measures also created an inefficient, high-cost and weak industrial sector. Therefore, there was a need to review these measures.

The thrust of the policy of liberalisation was on abolishing the requirement of licensing of industries. In most cases, the industrial policy of 1991 has made the licensing policy very liberal. The requirement of licensing has been abolished for most of the industries. Entrepreneurs are now free to enter any industry, trade or business.

Relaxation in Controlling Monopolies: Under the Monopolies and Restrictive Trade Practices (MRTP) Act, all the firms with assets above a certain amount (Rs. 100 crore since 1985) were permitted to enter select industries only, and they were required to take the approval of the government for any investment proposals. In order to make deregulation more effective, restrictions on functioning of monopolies have been relaxed. Monopoly houses are no longer required to seek prior government approval for expansion and establishment of new industries. The emphasis has shifted now to controlling and regulating the monopolistic and restrictive unfair trade practices by taking action against the offenders so as to safeguard the interest of consumers.

Industrial Location Policy Liberalised: In a departure from the earlier industrial location policy, freedom has been given to industries to be located at any location, with some exceptions. Also there is no need for obtaining the approval of the government, except for industries subject to compulsory licensing.

Removal of Restrictions: Restrictions on mergers, takeovers, separation of industrial units etc. have been largely removed.

Liberalisation of Capital Markets: Capital market has been made free. A new company can be floated now with the issuance of new shares and debentures without seeking the permission of the government. However, Securities and Exchange Board of India (SEBI) has been set up as a watchdog for regulating the functioning of the capital market.

Foreign Exchange Market: Reforms have been introduced in the foreign exchange market. Flexible exchange rate is introduced under which exchange rate is determined by market forces. In 1993-94, the rupee was made fully convertible on trade account in terms of the foreign currency. Exporters can now convert the foreign currency earned by them into Indian rupees at the prevailing market rate. Similarly, importers can now buy the foreign currency from the market at the market rate. The Reserve Bank of India (RBI) helps only to ensure that there are no extreme fluctuations in the exchange rate.

Development of Infrastructure: Private sector has been allowed to enter and develop the infrastructure such as power, roadways, communications, shipping, civil aviation, banking etc.

7.1.3. Significance of Liberalisation Policy

The policy of liberalisation has tried to overcome the problems of '*control raj*', such as problems of uncalled delays, corruption etc. It has also injected a spirit of competition in the economic system and has encouraged the entrepreneurs to undertake investment. This has increased the efficiency in the economy.

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7.2. The Policy of Privatisation

The public sector enterprises were established in many countries primarily for pragmatic reasons but partly for ideological reasons. In recent years, however, with the emergence of a new philosophy of economic liberalisation, the private sector and the market forces have acquired prominence.

In the past, the policy-makers in India traditionally held the view that the public sector was the prime mover for economic development. The Industrial Policy Resolution of 1956 assigned a strategic role to the public sector in India. Accordingly, massive investment was undertaken during the Five-Year Plans to build the public sector. There is no doubt that the public sector in India was able to establish the industrial base in the country by developing heavy and basic industries and by providing the requisite infrastructure.

However, for quite some time now, there has been a change in the perception about the role of the public sector in the process of economic development and their role is being reappraised. An important development that has been witnessed, at the same time, is the process of privatisation.

7.2.1. Meaning and Rationale of Privatisation

Privatisation basically implies the process which leads to transfer of ownership of public sector enterprises from the government to the private sector. However, taken in a wider sense, privatisation also implies the process of granting autonomy to the public sector enterprises in decision-making and infusing the spirit of commercialisation in them.

The supporters of privatisation put forward the following arguments in support of it:

a) **Ideological Grounds**: Privatisation in the advanced countries is favoured on ideological grounds. The central idea of this argument is that public sector enterprises should be confined to essential activities, which the private sector cannot or will not perform. All other activities should be performed by the private sector enterprises as they are more efficient.
b) **Improvement in Managerial Efficiency**: Privatisation is supported as a means of improving managerial efficiency. Privatisation through disinvestment (i.e. policy of sale of equities held by the government to private investors) will establish a direct relationship between the shareholders and the management. The private shareholders would have direct interest in increasing the efficiency of these enterprises. The management would not be subjected to unnecessary political pressure and interference. This would remove the managerial inefficiency of public sector enterprises that arises due to political intervention. Management would be guided by economic and commercial considerations. It will help in improving the quality of decision-making.
c) **Creation of Competitive Environment**: Transfer of the ownership of the public sector enterprises to the private sector would abolish monopoly position. These enterprises will have to compete with other similar enterprises. So a competitive environment can be created. Such an environment would help in improving the competitive strength and efficiency of these enterprises. It would infuse commercial spirit in the enterprises. These enterprises would be under pressure to increase production efficiency by using modern and improved technologies.
d) **Profit-oriented Decisions**: Privatisation policy will help in infusing the commercial spirit in the functioning of enterprises. The private sector will introduce 'profit- oriented' decision-making process in the working of enterprises. This will lead to an improvement in the efficiency and performance of the enterprises.
e) **Greater Flexibility in Decision-making**: The public sector enterprises normally do not enjoy sufficient functional autonomy. This often leads to delay in decision-making. In fact, delayed decision-making is often equivalent to making no decision at all. The policy of

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privatisation will be helpful in imparting greater flexibility in the decision-making process. Management would be free from any government intervention. It would not have to consult anyone for any decision. It would be possible to take quick and timely decisions, which is the hallmark of efficiency. Timely and prudent decisions will improve the efficiency of business operation.

f) **Reduction in Burden on Public Exchequer**: Operation of the public sector enterprises has been putting a large burden on public exchequer because of huge losses incurred by a number of enterprises and growing amount of subsidy payments. Privatisation would be helpful in reducing this financial burden on the government. Government would not be under obligation of providing subsidy and making up for the losses.
g) **Greater Attention to Consumers' Satisfaction**: It is often argued that the public sector enterprises many a time do not get personally involved with the needs of the consumers. However, the very survival of private enterprises depends on the satisfaction of the consumers. Privatisation will lead to the consumers being taken care of because of the need for creating and sustaining market. Hence, quality of service will improve.
h) **Greater Investment and Employment Opportunities**: Privatisation will lead to opening up of new areas to the private sector enterprises, hitherto reserved for the public sector. This will lead to the increase in investment by the private sector. Higher investment would mean creation of larger employment and income-earning opportunities in the economy.
i) **Revival of Sick Units**: A number of public sector enterprises have been incurring losses for a long time. They have become, more or less, sick units. Privatisation may help in reviving sick units, which have become a liability on the government.
j) **Increase in Accountability**: Personnels in the public sector enterprises are not accountable for any lapse. There is always the scope of responsibility being shifted to others. However, the areas of responsibility in the private sector are clearly defined. Thus, privatisation will lead to an increase in accountability of the personnel managing these enterprises.
k) **Increase in Financial Discipline**: The public sector enterprises can get budgetary support irrespective of their performance. But the private sector enterprises will be able to raise funds in the capital market only if they are performing well. Therefore, privatisation will put pressure on the enterprises to perform well in order to raise funds in the capital market. This will improve their financial discipline.

7.2.2. Arguments Against Privatisation

A number of arguments have been advanced against the policy of privatisation:

a) **Privatisation Not Always Desirable**: As explained already, in many cases, public sector enterprises have been set up because the private sector either does not possess the requisite resources or simply is not interested because of long gestation period and low profitability. Many public sector enterprises are set up to achieve social welfare. Privatisation of such public sector enterprises may not be possible because private sector may not be forthcoming to acquire such public sector units.
b) **Social Welfare Neglected:** Privatisation policy may sometimes neglect the consumers' interest. Private sector enterprises operate mainly with the objective of profit maximisation. For example, private operators usually do not like to provide goods at subsidised prices to the poor consumers to promote social welfare and thus do not uphold the principles of social justice and public welfare.
c) **Possibility of Unemployment**: One of the genuine fears is that privatisation will lead to unemployment. There is always the fear of retrenchment and consequent unemployment when the public enterprises are taken over by the private sector. The experience of privatisation in many countries is testimony to the fact that this indeed has happened.
d) **Growth of Private Monopoly**: Another genuine apprehension is that the sale of a public sector undertaking to a private company may only result in the substitution of a public

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monopoly by a private monopoly. This may lead to monopolistic exploitation by efficient private owners replacing the inefficient public ownership.

e) **Possibility of Corrupt Practices**: The implementation of the policy of privatisation may open the door to corruption. There is the possibility of undervaluation of assets of the public sector units to favour the private sector. There may be complicity between politicians, bureaucrats, and particular business groups.

f) **Lopsided Industrial Development**: Privatisation may result in lopsided development of industries in the country. Private enterprises will not be interested in projects which are risky and have long gestation period with lower profitability. It may retard the growth of basic and heavy industries and infrastructure in the country.

7.2.3. Features of the Policy of Privatisation in India

The New Economic Policy centred around six major measures to reform the public sector enterprises:

Policy of Dereservation: The Industrial Policy Resolution of 1956 had reserved 17 industries for the public sector. The Industrial Policy of 1991 reduced the number of such industries to eight. Subsequently, the number of industries reserved for the public sector stood, as in 2016 were:

- Atomic Energy (Production, Separation or enrichment of special fissionable materials and substances and operation of the facilities)
- Railway Operations other than construction, operation and maintenance of items specified by DIPP.

Policy Towards Sick Public Sector Undertakings: In pursuance of the new industrial policy, sick public sector enterprises have been brought within the jurisdiction of the Board for Industrial and Financial Reconstruction (BIFR) for their revival/rehabilitation with effect from 1992. Prior to 1992, this scheme was used only in the case of sick private sector enterprises. The BIFR was set up in 1987 to look into the revival of sick industrial units residing with private companies.

Policy for Navaratnas and Miniratnas: The government has granted enhanced powers to the Board of Directors of various profit-making CPSEs known as *Maharatna, Navaratna,* and *Miniratna.* The *Navaratnas* originated as a part of the programme of the government in 1996 to identify high-performing and profit-making public sector enterprises. These enterprises were to be provided financial and managerial autonomy to become global giants. Initially, nine such enterprises (and hence nicknamed as *Navaratnas)* were identified. During 2010-11, the government introduced the *Maharatnas* scheme under which mega *Navaratna* public sector enterprises have been empowered to expand their operations, both in the domestic as well as foreign market. In 2016, there were *7 Maharatnas (BHEL, GAIL (India), NTPC, SAIL, CIL, IOCL, ONGC)* and *17 Navaratnas*. The *Miniratna* companies followed *Navaratnas* in 1997. These were consistently profit-making companies and are divided in two categories. These *Maharatna/Navaratna/Miniratna* companies have been given additional power and freedom to incur capital expenditure, raise debt, enter into joint ventures, restructure their board of directors, and work out their own manpower and resource management policies.

Memorandum of Understanding (MOU): The government has entered into MOUs with the public sector enterprises with the purpose of improving their performance. The main objective of MOUs is to grant autonomy to the public sector enterprises by reducing the quantity of control and increasing the quality of accountability. It aims at bringing a balance between autonomy and accountability. This is sought to be done by specifying in clear-cut terms the measurable goals and giving each enterprise greater autonomy to achieve these goals in a competitive environment. The purpose of MOU is to ensure a level playing field for the public sector vis-a-vis the private corporate sector. The government evaluates the performance of the public sector enterprises through performance evaluation based on a comparison between the actual achievements and the annual targets set by the government. The public sector

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enterprises entering into MOU with the government are given rating as per their performance. Ratings on a 5 point scale — excellent, good, very good, fair and poor— are given to the public sector enterprises as an incentive to improve their efficiency.

Voluntary Retirement Scheme (VRS): Many of the public sector undertakings have been facing the problem of overstaffing. The Government has initiated a voluntary retirement scheme in the public sector enterprises to reduce the number of excess workers. Under this scheme, workers seeking voluntary retirement are given financial compensation. As a result of this scheme, the government has succeeded in reducing the excess number of employees working with the public sector enterprises.

Disinvestment Policy: The major plank of the privatisation programme under the Industrial Policy of 1991 is the disinvestment policy. Disinvestment means selling of investment. In the context of public enterprises**, *the policy of disinvestment refers to selling of government's equity in the public sector units in the market*.** Under this policy, a part of the government shareholding in the selected public sector undertakings would be offered to private investors, financial institutions, mutual funds, workers, and the public at large. Disinvestment of shares of a select number of profit-making public sector enterprises is done in order to raise resources with the objective of reducing public debt burden to provide funds for giving assistance to public sector undertakings or their modernisation and to encourage wider participation of general public and workers in the ownership of the public sector enterprises.

Thus, the New Economic Policy of 1991 has attempted to bring privatisation with the objective of reforming the public sector enterprises. However, it should be noted that privatisation, in itself, is not likely to remove all the shortcomings of public sector. If competitive environment does not exist in a country, transferring ownership to the private sector is unlikely to achieve much. Moreover, transferring ownership through privatisation may create private monopolies. Creation of private monopolies goes against the basic social and national interest. The policy of privatisation would fail to deliver goods unless it improves the performance of these enterprises.

7.3. Policy of Globalisation

Third feature of the new economic policy is globalisation. It is the policy of opening up the Indian economy to the world economy.

7.3.1. Meaning of Globalisation

Globalisation is a process of integrating the economy of the country with other economies of the world through trade, capital flow, and technology. It means opening up the economy to the other economies of the world. The main channels through which globalisation takes place are as follows:

a) The first channel of globalisation is opening up of the world trade. This requires liberalisation in trade of goods and services. In order to expand the world trade, there is a need for introducing import liberalisation programmes, removing the quantitative restrictions, and reducing the import duties. Globalisation implies removal of the barriers to international trade so as to allow free flow of goods and services between countries.

b) Globalisation also requires the removal of barriers to international investment. Liberalisation of foreign investment would lead to a large increase in international investment. It is particularly important to open up the economy to foreign direct investment (FDI). Foreign companies, including multinational corporations (MNCs), need to be encouraged to undertake investment in the country. Facilities should be provided to the foreign companies and restrictions on the entry of MNCs should be removed in order to encourage international investment.

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c) Globalisation can effectively take place through free flow of technology between countries. Transfer of technology from advanced countries is needed to promote economic development of developing countries such as India.

7.3.2. Effects of Globalisation

Globalisation has several advantages on economic, technological and other fronts:

a) Globalisation has led to increase in free flow of goods between countries. As a result, world trade has increased in recent years.
b) Globalisation has increased international flow of capital. Investment opportunities for the developed countries have increased. MNCs from the developed countries have started undertaking investment in the developing countries. This has led to the emergence of worldwide financial market.
c) The interdependence between different nation states has increased. Globalisation has increased interdependence between different countries of the world. This is reflected in the interdependence with regard to trading in goods and services and in the movement of capital.
d) Globalisation has brought in new opportunities for the developing countries. They have now got greater access to the advanced technologies. The technology transfer from the developed countries has led to increased productivity and higher living standard in the developing countries.
e) There has emerged worldwide product market. This has increased the range of goods available to producers and consumers.
f) The communication between people of different countries has increased as a result of revolution in the global mass media. This has made the world appear smaller. Information flow between different countries has increased.
g) Globalisation has increased economic prosperity and opportunity in the developing world.
h) Globalisation has brought people of different cultures together. It has reduced the cultural barriers. Increase in the crosscultural contacts has made the dream of global village more realistic.

However, the developments due to globalisation have by no means been an unmixed blessing:

a) One of the consequences of globalisation has been that all countries of the world have become vulnerable to the developments outside their own borders. Thus, the decade of 1990s was marked by a large number of currency crises, and large fluctuations in exchange rates and stock prices. Likewise, the recessionary conditions due to the 2008 financial crisis in USA were transmitted to the rest of the World. The same threat was faced in 2012 because of the Euro crisis.
b) Globalisation has also thrown up new challenges like growing inequality across the nations, volatility in financial market, and environmental degradation.

7.3.3. Globalisation of Indian Economy

India embarked on the programme of globalisation in 1991. However, the seeds of globalisation were sown in the early 1980s itself with liberalisation of imports, provision of some concessions to foreign capital, and permitting MNCs to enter in some areas of the Indian economy. But globalisation of Indian economy started in full earnest after July, 1991 as an essential part of the policy of economic reforms.

7.3.4. Features of the Globalisation Policy

As part of implementation of the agenda of globalisation, the Government of India has undertaken the following policy measures since 1991:

a) **Exchange Rate Reforms:** The most important measure for integrating Indian economy with the global economy was to change over from the fixed exchange rate to market-determined exchange rate. This policy of allowing the exchange rate to be determined in the international market without official intervention is known as convertibility of the currency. The full convertibility of Indian rupee on trade account was achieved in August 1994. Along with this, various types of exchange control measures were removed in a phased manner. As a result, restrictions on the transfer of foreign exchange have been considerably relaxed over the years.

Student Notes:

b) **Import Liberalisation:** India is committed to reducing trade barriers as a member of the World Trade Organization (WTO). The government has also taken a number of steps in the direction of import liberalisation.
   - The system of import licensing has been dismantled.
   - Quantitative restrictions on imports have been almost totally abolished under agreement with the WTO.
   - Duties on imports and exports have been reduced to make the trade between nations freer than before.

c) **Foreign Investment**: FDI is expected to add to the domestic investment, and thereby, contribute to industrial and economic development of the country. It leads to higher efficiency and productivity by increasing competition and by bringing new technology into the country. In the changing global scenario of industrial and economic cooperation, promotion of FDI is important. In a bid to attract foreign capital and to integrate Indian economy with the global economy, the Government of India has thrown open its doors to foreign investors. The government is committed to encourage flow of FDI for better technology, modernisation and for providing goods and services of international standard. In order to invite foreign investment in high priority industries requiring large investments and advanced technology, the government decided in 1991 to grant approval for FDI up to 51 per cent foreign equity. This limit was raised from 51 per cent to 74 per cent and subsequently to 100 per cent for many of these industries. The policy of the government is also aimed at encouraging foreign investment in the core infrastructure sectors like road development, airports, airlines, real estate, banks, power generation, oil exploration, etc. Moreover, foreign institutional investors have been allowed to invest in the Indian capital market subject to certain regulations.

d) **Foreign Technology**: With a view to encourage technological development in Indian industries, free flow of technology is allowed by the government. Government provides automatic approval for technological agreements in case of high priority industries. Similar facilities are provided for other industries as well, provided such agreements do not require foreign exchange. Foreign technology induction is facilitated both through FDI and through foreign technology agreements.

7.3.5. Effects of Globalisation on Indian Industry

Globalisation has had many positive effects on Indian industries:

a) Globalisation has attracted a number of MNCs to Indian industries. These MNCs have brought in huge amount of foreign investment into the Indian industries, especially in pharmaceutical, petroleum, chemical, textile, and cement manufacturing industries. A huge amount of FDI coming to the Indian industries has boosted the Indian economy.

b) One of the major benefits of globalisation has been the emergence of information technology (IT) sector and business process outsourcing (BPO) sector. The IT and BPO sectors are providing outsourcing to the customers in other countries, particularly the USA and Europe. The opening of the call centres, outsourcing of IT and BPO services, and MNCs have also created tremendous job opportunities in the country. The last few years have seen an increase in the number of skilled professionals in India being employed in these sectors. A new middle class has emerged around the wealth that the IT and BPO industries have brought.

Student Notes:

c) Another benefit for the Indian industries is that the MNCs have brought in highly advanced technology with them. This has helped to make Indian industry technologically advanced.
d) SEZs have been set up to attract foreign companies. Creation of SEZs has enhanced the growth of industrialisation. They have helped in generating employment opportunities, creating world class infrastructure and investment, including foreign investment.
e) Some of the leading Indian industries such as the Tata, Reliance etc., have gone global by undertaking investment abroad and by acquiring some of the leading foreign companies. From steel to textiles, from cars to IT, Indian companies have themselves emerged as the new major players in globalisation.

However, the process of globalisation in India has generated some negative effects as well.

a) One of the adverse effects of globalisation on Indian industry is that it has increased competition in the Indian market between foreign companies and domestic companies. In many cases, it has led to unequal competition between the giant cash-rich MNCs and Indian companies.
b) Another negative effect is that due to the in-coming advanced foreign technology, the requirement of labour has decreased. This has resulted in many people losing their jobs.
c) Much of FDI has gone into takeovers of the existing enterprises and towards speculative investment in Indian stock market.

Thus, despite positive effects of globalisation on Indian economy, there have been some negative effects as well. Therefore, there is a need for evolving an appropriate policy to minimise the harmful effects of globalisation.

8. Effect of Reforms on Indian Economy

The new economic policy comprising liberalisation, globalisation, and privatisation has brought about many changes in the Indian economy. Economic reforms, initiated since 1991, have resulted in improving the performance of various sectors of the economy. Some of the major achievements of the new economic policy are as follows:

Higher Growth Rates: The new economic policy has played an important role in stepping up the growth rate of the Indian economy in recent years. The growth rate of national income picked up from 5 per cent in 1990-1991 to about 9.3 per cent in 2007-08.

Performance of the Industrial Sector: The performance of the industrial sector during the post-reform period is much higher than during the pre-reform period. The period immediately following the economic reforms was marked by a low growth rate of industrial output. However, the slowdown in the industrial output was a transitional phenomenon. Industrial production in India averaged 6.59 per cent from 1994 until 2017, reaching an all time high of 20 per cent in November of 2006. It experienced a growth rate of 9.2 per cent during the Tenth Plan, and a growth rate of around 7.7 per cent during the Eleventh Plan. This allays all fears that once the economy opens up, the industrial sector will not be able to withstand the competition from other countries.

Changes in the Composition of National Income: The post-reform period has been characterised by significant changes in the composition of national income. The share of the agriculture and allied sector in national income has decreased from 29 per cent in 1991-92 to about 17 percent in 2016-17. The share of the industrial sector, on the other hand, showed a steady increase from 24 per cent in 1991-92 to about 29 per cent in 2016-17. Importantly, the share of the tertiary or service sector has increased significantly from 44 per cent in 1991-92 to about 54 per cent in 2016-17. Thus, the service sector has registered a large and consistent growth in the post-reform period. This reflects the structural transformation of the Indian economy.

Student Notes:

Savings and Investment Performance: Post-reform period showed a remarkable increase in savings and investment. Gross domestic savings increased from about 23 per cent in 1990-91 to 31 per cent in 2015-16, rate of investment (rate of gross domestic capital formation as per cent of GDP) has increased from 26 per cent in 1990-91 to about 31 per cent in 2015-16. Private sector has been assigned a major role under the new economic policy. As a consequence, rates of Private Final Consumption Expenditure (PFCE) at current and constant (2011-12) prices during 2016-17 are estimated at 58.8 percent and 55.8percent, respectively, as against the corresponding rates of 58.0 percent and 55.0 percent, respectively in 2015-16.

Foreign Trade: Post 1991, the gradual liberalization of the Indian economy, characterized by policy reforms, created a conducive environment for India's exports to flourish and evolve into an engine of social and economic growth. Since then India has transformed from a closed economy to a considerable player in the global market. Over time, the export sector has grown to be a significant earner of foreign exchange and a major contributor to India's national income.

Foreign Exchange Reserves: Indian economy faced a serious foreign exchange crisis during 1990–91 because of adverse balance of payments. But the balance of payments has shown significant improvement after economic reforms. As a result, India's foreign exchange reserves have increased rapidly. The reserves stood at US $405 billion in July 2018 as against only $1.1 billion in June, 1991.

Foreign Direct Investment: FDI in India has increased significantly since 1991. It has increased from US $1.3 billion in 1990-91 to US $60.08 billion in 2016-17. This is a reflection of liberalised policy changes as well as an improved investment climate. In the three years since 2014, the government has eased 87 FDI rules across 21 sectors to accelerate economic growth and boost jobs. Over time, FDI rules have been radically overhauled across sectors such as broadcasting, retail, trading and air transport. The present government has amended legislation to hike the foreign investment cap to 49% in insurance and pension from the earlier 26%.For retail trading of food products, the government has permitted 100% FDI with unqualified condition that such food products have to be manufactured or produced in India.

Overseas Investment by Indian Companies: Outbound investments from India have undergone a considerable change not only in terms of magnitude but also in terms of geographical spread and sectoral composition with Indian companies also undertaking overseas investment. In a significant development, UK announced that India has become the third largest source of FDI for them as investments increased by 65 per cent in 2015 leading to over 9,000 new and safeguarded jobs.

Reforms in any sector cannot be seen in isolation. There is a huge degree of complementarity among different kinds of reforms. If there is delicensing of the export of a particular item/good but production of that good remains controlled, then the benefit of the reform will be limited. Instead, if the industrial policy deregulates production of goods, then the benefit will be much greater. Similarly, external-sector reforms will reach its potential if sufficient reforms are introduced in the financial, fiscal, industrial and agricultural sectors.

9. Assessment of Reforms

Although there is a broad consensus among most of the political parties on the desirability of reforms, considerable debate has emerged on the contents of the reform programme, their sequencing and pace as well as their implementation and impact.

The balance sheet of the Indian economy in the post-reform period is mixed. The overall post-reform growth rate has been higher than the average rate achieved during the pre-reform period, largely because of the services sector. The fiscal balance and inflationary tendency have been controlled. India is emerging as an important player in fields such as manufacturing and medical services. Robust export growth especially software exports, and rising remittances by

Student Notes:

Indian workers abroad have created a new confidence in the Indian economy. It has led to phenomenal growth in foreign exchange reserves. The growth competitiveness and the business competitiveness of the country are increasing. India is emerging as a stable growth engine and as a Big Emerging Market (BEM) in the world due to robust economic performance supported by a vibrant democracy, increasing young population, expanding middle class and domestic market and well-developed private sector.

However, this growth is not inclusive. First, the growth is skewed within the economy. For example, there is a great divide separating industry and agriculture, and the infrastructure, especially the rural infrastructure, is in an appalling state. Second, the reforms are just confined to the economy and they are not spreading to the social sector. The social sector including healthcare, education, social security, gender equity and environmental protection has suffered a setback owing to the decline of the public investment in this crucial area. Low spending by the government has led to growing inequity in education and a decline in the quality of education. Indian society is marked by four great divides: rural-urban, rich-poor, and along gender and caste lines – which pervade every aspect of life, including social services. In each category, there is the existence of a disadvantaged section that finds it extremely difficult to get access to social services and thus gets left out.

Though there has been immense improvement since Independence, we do not yet have a system in place that is capable of providing access to public goods. As a result of liberalization, the state is increasingly transferring its constitutional responsibility of providing public goods to market forces. Hence, the state is failing to build human capability and to ensure dignity of life for every citizen of the country. Since the market operates on the basis of economic power, it excludes the common people and the marginalized sections that do not have economic power from its benefits. Free market, coupled with the lack of necessary state support in the social sector, has led to huge interpersonal and inter-regional inequalities. These inequalities have caused social instability manifested by increasing protests and farmers' suicides.

Globalization, as shaped by the new development paradigm has given rise to large-scale human displacement and the consequent disappearance of many communities and cultures, and massive protests. The continuing paradox of India and Bharat – a fast-growing economy supported by a well-developed private sector and yet with persistent mass deprivation and no effective freedom – within the democratic framework in the country has given rise to the question of whether democracy and market are incompatible. While the market excludes common people from its outcome, democracy based on universal adult franchise includes all in economic benefits.

Nevertheless, the inherent exclusionary tendencies of the market can be limited only by the State through providing public goods and services to the marginalized and the excluded sections of the population and regions of the country. This can be done most effectively in India's highly pluralist and participative democracy with a very competitive print and electronic media, since they put pressure on governments to focus on the deprived sections of the society. To foster a more inclusive growth, we need to create new employment opportunities in rural areas, improve the quality of infrastructure (both the so-called 'soft infrastructure' – political and economic policies and institutions; and 'hard infrastructure' – roads, railways and ports) and improve human capabilities by prioritizing health and education.

Keeping these concerns in view, the government decided to introduce the second-generation reforms while continuing the beneficial measures of the first-generation reforms, or the reforms initiated in the early 1990s. The second-generation reforms focus on the predominant issues of contemporary India. These include: (a) extending reforms to the states; (b) creating infrastructure through public-private partnerships; (c) reforming the labour market, agriculture, intellectual property rights regime and the telecom sector; (d) improving governance through legal and political reforms; (e) empowering the underprivileged; (f) expanding primary education and improving quality of higher education; (g) improving human-development sector

Student Notes:

through intensive engagement with civil-society actors; and (h) achieving environmental sustainability.

The aim of these reforms is not only to help turn India into a fast-growing economy, but also a knowledge economy by strengthening the knowledge sector; a strong democracy by building *social capital*; and finally a humane society with the highest levels of sustainable human development. In light of this, the government has introduced various reports, schemes and programmes which aim to eradicate poverty and unemployment and fulfill that long-awaited promise that Jawaharlal Nehru so eloquently described as our 'tryst with destiny' at Independence.

10. Previous Years UPSC Mains Questions

1. Has the Indian governmental system responded adequately to the demands of Liberalization, Privatization and Globalization started in 1991? What can the government do to be responsive to this important change?
2. Liberalisation of the Indian economy since 1991 has led to excessive consumerism and over-production of 'white goods'. Elucidate.
3. "The lesson of the current global financial crisis is that India should halt and may be even reverse financial liberalisation."
4. State the comprehensive structural reforms undertaken to improve the Indian economy since 1991.
5. "Industrial growth rate has lagged behind in the overall growth of Gross-Domestic-Product (GDP) in the post-reform period" Give reasons. How far the recent changes in Industrial Policy are capable of increasing the industrial growth rate?
6. How globalization has led to the reduction of employment in the formal sector of the Indian economy? Is increased informalization detrimental to the development of the country?
7. Normally countries shift from agriculture to industry and then later to services, but India shifted directly from agriculture to services. What are the reasons for the huge growth of services vis-a-vis industry in the country? Can India become a developed country without a strong industrial base?
8. Foreign direct investment in the defence sector is now said to be liberalised. What influence this is expected to have on Indian defence and economy in the short and long run?
9. Examine the impact of liberalization on companies owned by Indian. Are the competing with the MNCs satisfactorily?
10. Discuss the impact of FDI entry into multi-trade retail sector on supply chain management in commodity trade pattern of the economy.
11. Though India allowed foreign direct investment (FDI) in what is called multi brand retail through joint venture route in September 2012, the FDI even after a year, has not picket up. Discuss the reasons.

11. Previous Years Vision IAS GS Mains Questions

1. ***"Public debates in India often reflect either an uncritical faith in market (market mania) or a blind opposition to it (market phobia). However, there is a deep complementarity between market efficiency and state action." Comment on the applicability of this statement with respect to the current state of the Indian economy.***

Approach:

The answer should systematically highlight the role that the state and market should play in Indian economy. In the post liberalization phase, the role of state has changed to that of a regulator for the private sector and as an accountable basic service provider in the field of health, education and justice delivery system to increase the ease of doing business on the one hand and to ensure that the fruits of economic growth are distributed equitably among one and all.

Student Notes:

Answer:

In the post liberalization phase, there has been an overarching concern with sustaining high growth rates in the Indian economy. However, while on one hand, the 11th and 12th plan recognised the need of introducing market reforms like- time bound and single window clearance facilities for opening new businesses, labour reforms, providing quality physical infrastructure to the private sector etc. and on the other, it has reinstated the fact that the role of the state needs to take a new avatar where it should become an efficient and transparent regulator to provide a levelled playing field to the players in the market and to reduce the scope of "crony capitalism".

Moreover, learning from the failure of the trickle down approach in the past two decades, the planning commission and developmental economists like Amartya Sen have argued for pursuing a more socially and economically inclusive growth model. Thus contrary to a reduced role for the state, there is a need to reinvent its role where it morphs itself to become a strong basic service provider in the primary education and health sector thus ensuring that growth becomes more inclusive on one hand (or to ensure that the fruits of growth are distributed more equitably), while becoming a transparent and efficient regulator in sectors that are thrown open to the private sector.

There is an urgent need to eschew any simplistic market vs state debate and recognise the deep complementarities that exist between the two- a strong but redefined role of state would improve India's standing on the ease of doing business index (India has a dismal ranking of 134 out of 189 countries on the ease of doing business index of World Bank) thus reinforcing the faith of the private sector, while its role as an efficient, basic service provider would ensure that India performs a course correction from becoming a "country which has islands of California in a sea of Sub- Saharan Africa" and this would restore the credibility of both, a market oriented strategy and the practice of democracy in public eye both of which have increasingly come under closer public scrutiny in the recent past.

2. How has the process of liberalization, which has otherwise led to high economic growth, affected the employment rate and the nature of employment in India?

Approach:

- Briefly describe how the liberalisation has led to high economic growth in India.
- Analyse the effect of liberalisation on the employment rate and the nature of employment in India both in organised and unorganised sectors.
- Bring out both positive and negative effects.

Answer:

The process of liberalization, which began in 1990s is seen as a milestone in the economic history of India. Since the liberalization, the economic condition gradually started improving and today India is one of the fastest growing economies in the world with an average yearly growth rate of around 6-7 per cent.

Theoretically, acceleration in GDP growth of a labour-abundant country characterised by the market regime should push employment growth rate as well. However the impact of liberalisation on growth of employment in India is not as per the expectations.

A comparative analysis of GDP growth rate and employment growth rate is given below:

Student Notes:

Period	GDP growth (%)	Employment growth (%)	Productivity growth (%)	Elasticity of employment with respect to GDP
1972-1973 to 1983	4.66	2.44	2.22	0.52
1983 to 1993-1994	4.98	2.02	2.96	0.41
1993-1994 to 2004-2005	6.27	1.84	4.43	0.29
1999-2000 to 2009-2010	7.52	1.50	6.02	0.20
2004-2005 to 2009-2010	9.08	0.22	8.86	0.02

- It is clear from the above table that even though the liberalisation process has resulted in higher economic growth, the growth in employment rate has declined.
- Even during the high economic growth phase of 2005-12, employment growth rate was just 0.4% with the addition of just 13 million jobs. There has been continuous decline in employment elasticity as well. It declined sharply from 0.3 during 2000-05 to 0.05 during 2005-12.
- Most of the new jobs were located in the informal sector with low earnings and no social protection resulting in casualization of jobs.
- In the economy as a whole, the worker-population ratio declined in the 1990s for men and women in rural and urban areas in most age groups in the range 5-59.
- Amongst the young school participation has increased as child and youth labour have declined.
- There is an across the-board improvement in the growth rate of labour productivity and wages and it is estimated that average per capita earnings per annum increased.
- However the liberalization process has mainly benefited the top 10 per cent of wage earners who now make 12 times more than the bottom 10 per cent, up from a ratio of six in the 1990s.
- As per the NSSO data, only 18% of working people have regular wage salary employment. Roughly 30% are casual labourers, dependent on daily or periodic renewal of job opportunities. The remaining 52% are self-employed. Most of them are in agriculture, working as helpers in family owned businesses without salary.
- Employment share of public sector has gradually reduced as the public sector withdrew from many areas. A healthy growth rate in employment has been registered in the private sector.
- The liberalisation and globalisation process brought in more technological upgrades in manufacturing sector which increased the mechanisation and reduced the employment.
- In case of service sector, the employment growth has not matched the growth in GDP contribution. The sector presently contributes nearly 55% of total GDP but has employed a mere 27%. The problem of skill development enabling labour migration to services remains inadequately addressed.
- The conditions of employment in unorganised sector have not improved. The middlemen and employer continue to enjoy the benefits derived from their labour.
- In the Index of Economic Freedom World Rankings for 2013, India was ranked 119th among 177 countries, putting India in the category of 'mostly unfree' countries. The

report clearly states that although there is improvement in labour freedom, it is offset by declining scores in other areas. Further, the report states that corruption is endemic throughout the economy and is becoming more serious.

Student Notes:

3. Dismantling of administered price mechanism for fuels is being deemed as a significant piece of economic reform. Analyse. Also, discuss how the recently introduced dynamic fuel pricing can prove to be beneficial for both the OMCs as well as consumers.

Approach:

- Begin with a brief introduction about administered price mechanism.
- Then, write about the benefits of the initiative (dismantling of APM) for Indian economy as a whole.
- Then explain recently introduced dynamic fuel pricing.
- Further give arguments for the benefits of dynamic price mechanism to OMCs and consumers.

Answer:

Administered Price Mechanism (APM) for fuels denotes that the price of fuel was set by the dictates of government rather than the market forces, that is, the prices were either administered or subsidized.

Dismantling of APM is deemed to be beneficial for Indian economy because:

- It will lead to efficient allocation of a scarce resource which was being over-used by the consumers due to lower prices.
- The burden on the state fiscal accounts will also be reduced as higher imports of crude oil at higher prices due to increased demand need not be subsidised by state.
- The idea of providing returns on cost-plus formula to OMCs was not encouraging to encourage efficiency in production because it was not at all profit motivated.

Under APM, state-run fuel retailers used to revise rates on the 1st and 16th of every month, based on average international price in the preceding fortnight and the currency exchange rate. In dynamic fuel pricing, retail selling prices of petrol and diesel will be revised daily. It would link daily sales at all their petrol pumps with the international prices of crude oil.

Its benefits for OMCs

- Oil companies would be free to take independent decisions based on import parity and market forces in pricing of petroleum products rather than being governed by the dictates of the Government.
- Due to the reining in of speculative market forces, the impact of increasing/decreasing prices on the working capital of companies and dealers would be minimised.
- It ensures that OMCs do not lose out for an entire fortnight in the event of a sharp rise in crude prices as they will be able to immediately pass on the price hike to the customers.

Its benefits for consumers

- The move will take the economy towards greater transparency in fuel pricing and free pricing of petrol and diesel.
- It will ensure that the benefit of even the smallest change in international oil prices can be passed down the line to the dealers and the consumers.
- Besides the move will remove big leaps in rates that need to be effected at the end of the fortnight.

Student Notes:

- Consumers will be more aligned to market dynamics as India will be following the practice of the most advanced markets.
- This will also lead to public sector OMCs offering competitive prices. Not only, it will improve the competitiveness of the economy overall, but also it would incentivise investments in the oil sector.

The introduction of dynamic pricing will definitely bring consumers on a better footing as it will make the demand elasticity of the consumers reflected well in the markets. This will be possible as the price and sales data will be available in public for the market participants to reflect the same. However, there are certain obstacles to be overcome like updating of prices in unautomated petrol pumps and staying the course on hardening of oil prices.

4. While India has taken a number of steps in order to substantially improve its ranking in the World Bank's 'Ease of Doing Business' Index, it needs to take further action in this regard. Elaborate. Also analyse the utility of these rankings vis-a-vis India's objective of facilitating a sound entrepreneurial environment.

Approach:

- The answer can be developed under three sub-parts, in the following order:
  - Steps taken by India to improve its ranking
  - Areas/scope for further improvement
  - Role of ranking in facilitating entrepreneurship
- Discuss all parts in detail along with relevant data.

Answer:

World Bank's Ease of Doing Business (EODB) Index presents quantitative indicators on business regulations and the protection of property rights based on 10 parameters that can be compared across 190 economies.

India saw a rise of one position, to 130 in 2017, from 131 in 2016. However, if compared to 2015, the improvement is significant.

Steps taken by India to improve its EODB Index ranking on the 10 parameters:

- **Speeding up process**: such as company's registration within 1-2 working days, issuing of PAN in a day, providing electricity connections in 15 days with online application etc.
- **Digitisation**: It makes various processes easier for businesses and their employees such as digitization of property records and land records, ShramSuvidha Portal for filling returns for ESIC and EPFO etc.
- **Facilitating trade across borders**: through 'Indian Customs Single Window Project' as well as reducing the number of mandatory documents required by customs.
- **Enacting or amending laws & rules**: such as Enactment of the Commercial Courts, Commercial Division and Commercial Appellate Division of High Courts Act, 2015,the Insolvency and Bankruptcy Code, 2016 for speeding the exit procedure etc.
- **Protecting minority investors** through the Companies (Amendment) Act, 2015.

Though India has performed well on parameters like getting electricity, getting credit and protecting minority investors, on some other parameters like construction permits, resolving insolvency, paying taxes, enforcing contracts etc. it has performed poorly.

With the government plotting an eight-point strategy and firming up a 295-point reform agenda for states to improve India's ranking, the following steps may be taken if India wants to reach the 90th rank in 2017-18 and 30th by 2020:

Student Notes:

- As labor market regulation will be included in coming reports, simplification and rationalization of labour laws is inherent to improve the ranking.
- Setting up fast track commercial courts and redressing cases related to contracts in a time-bound manner.
- Reducing complexity and crackdown on corruption in allowing construction permits.
- Online registration of properties within a time bound manner.
- Reducing documents along with doing away with complexities in paying taxes.
- Further rationalization of import-export permits by removing bureaucratic delays.

Utility of EODB ranking and entrepreneurial environment in India

- EODB Index rankings facilitate the cause of entrepreneurship by creating awareness about the opportunities available in India.
- The central government's push has led to competitive federalism among States, smoothening out their regulatory procedures.
- As good rankings create an atmosphere for favourable investments, it may also help in spurring economic activities and generation of employment.

In this regard the collaboration between World Bank and the Central government to rank states on EODB is a step in the right direction to promote entrepreneurial environment in India. However, overemphasis on these ranking should be avoided due to the following reasons:

- It covers only two cities of New Delhi and Mumbai and do not take in to account the reforms undertaken by States.
- Also, performance in just one area may bring down the overall ranking substantially.
- As other countries also increase their efforts, jumping up in the ranking gets tougher.

Therefore, for domestic assessment of progress, internal State-based rankings will serve the cause of entrepreneurship better.

INDUSTRIAL POLICY: CHANGES AND THEIR EFFECTS ON INDUSTRIAL GROWTH

Student Notes:

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1. Introduction

The landscape of the global economy is undergoing rapid change. Developing countries are outpacing developed countries in terms of growth and diversity. Globally, the composition of the industrial sector is changing. Aspects such as technology, efficiency, environment, and competitiveness are emerging as key determinants of growth and performance. The changing patterns of economic growth are giving way to new segments and sectors. The ranking of countries in the top league of industrial growth, performance, and competitiveness have also undergone rapid change.

In this context, the Government of India has also been undertaking several policy measures and incentives, from time to time, in order to promote rapid industrialization in the country. Rapid industrialization is aimed at achieving various socio-economic objectives, including but not limited to, generating employment, economic growth, reducing debt burden, promoting foreign direct investment (FDI) inflow, enhancing self-reliant production and distribution, reducing regional disparity as well as diversifying and modernising the existing economic set up.

2. Evolution of Indian Industry

Industry accounts for about 29 per cent of GDP in the Indian economy (29.02% GVA at current prices in 2016-17 and 31.12% at 2011-12 prices). This is smaller than the average share of 35 per cent for developing countries as a whole.

Indian industry experienced slow and poor productivity performance during the period from 1950 to 1980. The policy regime had strong preference for the public sector, extensive controls over private investment, a highly protective trade policy, and inflexible labour laws (especially after the mid-1970s). Promotion of the small-scale sector and regional balance were additional objectives of the industrial policy regime. Up to the mid-1960s, policy instruments were aimed at purposive diversification within the industrial sector and increased public investment. The period after the mid-1960s witnessed a marked deepening of the import-substitution regime and strengthening of domestic regulatory structures. This period witnessed a significant deceleration in growth to 4 per cent per annum compared to 6.1 per cent in the period from 1950 to 1965.

The decade of the 1980s witnessed some experimentation with domestic deregulation that yielded handsome dividends in productivity gains and acceleration in growth to 7 percent per annum. In 1991, in response to a major balance-of-payments crisis, India made a radical shift away from its long-standing policy of inward orientation, and the subsequent reforms have moved the policy regime significantly towards market orientation, deregulation, and liberalization. Indian industry has responded to the increased competition – domestic as well as foreign – with significant restructuring although the constraints arising from poor infrastructure, largely unreformed public sector, slowly reforming banking sector, inflexible labour laws, and other barriers to exit stand in the way of faster adjustment to the new and emerging policy regime which is inspired by market orientation.

2.1. The Pre-Reform Regime

The pre-reform industrial policy regime relied heavily on the development of a public sector to cater to the infrastructure needs of development and to provide direction to the process of industrial development within a mixed economy framework. Besides 'reserving' certain strategic areas of industrial production, for example, iron and steel, coal, transport, power, mineral oils, atomic energy, arms and ammunition, and allied items of defence equipment, in the public sector, the state also acted as the leading entrepreneur in machine tools, non-ferrous metals, fertilizers, etc. Nevertheless, the private sector was expected to play a major role, especially in the provision of consumer goods and building up the small-scale sector.

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Industrial licensing was a major instrument of control of the private sector under which permission of central government was needed for both investment in new units and for substantial expansion of capacity in existing units. Licensing also controlled technology, output mix, capacity location, and import content. Large industrial houses needed separate permission for investment or expansion under the Monopolies and Restrictive Trade Practices (MRTP) Act so as to prevent the concentration of economic power. There were price and distribution controls in industries such as fertilizers, cement, aluminium, petroleum, and pharmaceuticals. Almost 800 items were reserved for production by small-scale units as a way of protecting the small-scale sector from competition from large-scale units. There were also barriers to industrial restructuring and exit of firms.

India's import tariffs were among the highest in the world, with duty rates above 200 percent being fairly common and tariff rates being highly dispersed. Imports of manufactured consumer goods were completely banned. For the rest, only some goods were freely importable, and for most items where domestic substitutes were being produced, imports were only possible with import licences. The criteria for issuing these licences were non-transparent, delays were endemic, and corruption unavoidable. Policies towards foreign investment were quite restrictive, reflecting the general protectionist thrust of industrial policy.

The period from 1950 to 1980 experienced stagnant industrial growth at the rate of 5.5 per cent per annum. However, significant diversification of the industrial structure was achieved. But total factor productivity (a measure of the efficiency with which labour and capital are used in generating value added in the manufacturing sector) is estimated to have stagnated/declined during the period from 1960 to 1980. The high-cost industrial structure resulting from the heavily protectionist policy regime created an anti-export bias in the industrial sector. The erosion of competitiveness could be seen in the secular decline of India's share in global exports of manufactured goods from 1 per cent in 1950 to 0.4 per cent in 1980.

2.1.1. Industrial Policy Regime in the Pre-Reform Period

Industrial development in India was governed by licensing policies that came into being in 1948. The first comprehensive Industrial Policy Resolution of 1956 classified industries into three categories with the state being given the primary role of industrial development and the private sector expected to supplement the efforts of the state. Industrial Policy Resolution of 1970 classified industries into four categories: core sector, heavy investment sector, the middle sector, and the de-licensed sector with the first three categories confined to large business houses and foreign companies.

The Industrial Policy Statement of 1973 gave preference and thrust to the growth of small and medium enterprises (SMEs) while that of 1977 further promoted decentralization with an increased role for small-scale, tiny, and cottage industries.

However, the Industrial Policy Statement of 1980 placed greater thrust on promotion of competition in the domestic market, technological upgradation, and modernization of industries.

2.1.1.1. Industrial Policy, 1948

The first important industrial policy statement was made in the Industrial Policy Resolution (IPR), 1948. The main thrust of IPR, 1948 was to lay down the foundation of mixed economy whereby the private and public sector were accepted as important components in the development of industrial economy of India. The policy divided the industries into four broad categories:

- **Industries with exclusive state monopoly**: It included industries engaged in the activity of atomic energy, railways and arms and ammunition.

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- **Industries with government control**: It included the industries of national importance and so needed to be registered. 18 such industries were put under this category; for e.g. fertilizers, heavy chemical, heavy machinery etc.
- **Industries in the mixed sector**: It included the industries where private and public sector were allowed to operate. Government was allowed to review the situation to acquire any existing private undertaking.
- **Industries under private sector**: Industries not covered under any of the above categories fell in this category.

IPR, 1948 gave public sector a vast area to operate. The Government took the role of catalytic agent of industrial development. The resolution assigned complementary role to small-scale and cottage industries.

2.1.1.2. Industries (Development and Regulation) Act (IDRA), 1951

IDRA, 1951 is the key legislation in the industrial regulatory framework. It gave powers to the government to regulate the industry in a number of ways. The main instruments were the regulation of capacity (and hence output) and power to control prices. It specified a schedule of industries that were subject to licensing. Even the expansion of these industries required prior permission of the government, which meant that the output capacity was highly regulated. The Government was also empowered to control the distribution and prices of output produced by industries listed in the schedule. The IDR Act gave very wide powers to the Government. This resulted in more or less complete control of the industrial development of the country by the bureaucracy.

The main provisions of the IDRA, 1951 were:

- All existing undertakings at the commencement of the Act, except those owned by the Central Government were compulsorily required to register with the designated authority.
- No one except the central Government would be permitted to set up any new industrial undertaking “except under and in accordance with a licence issued in that behalf by the Central Government.”
- Such a license or permission prescribed a variety of conditions, such as, location, minimum standards in respect of size and techniques to be used, which the Central Government may approve.
- Such licenses and clearances were also required in cases of ‘substantial expansion’ of an existing industrial undertaking.

2.1.1.3. Industrial Policy Resolution, 1956

Since the adoption of 1948 Resolution, significant development took place in India. Economic planning had preceded on an organised basis and the First Five-Year Plan had been completed. Parliament had accepted the ‘socialist pattern of society’ as the basic aim of social and economic policy. These important developments necessitated a fresh statement of industrial policy. A second Industrial Policy Resolution was adopted in April, 1956, replacing the Resolution of 1948. Important provisions of the 1956 Resolution were:

1. **New classification of Industries**: IPR, 1956 divided the industries into the following three categories:
    a) Schedule A industries: The industries that were the monopoly of state or Government. It included 17 industries. The private sector was allowed to operate in these industries if national interest so required.
    b) Schedule B industries: In this category of industries, the state was allowed to establish new units but the private sector was not denied to set up or expand existing units e.g. chemical industries, fertilizer, synthetic, rubber, aluminum etc.

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c) Schedule C industries: The industries not mentioned in the above category formed part of Schedule C. Thus the IPR, 1956 emphasized the mutual existence of public and private sector industries.

2. **Encouragement to small-scale and cottage industries**: In order to strengthen the small-scale sector, supportive measures were suggested in terms of cheap credit, subsidies, reservation etc.
3. **Emphasis on reduction of regional disparities**: Fiscal concessions were granted to open industries in backward regions. Public sector enterprises were given greater role to develop these areas.

The basic rationale of IPR, 1956 was that the state had to be given primary role for industrial development as capital was scarce and entrepreneurship was not strong. The public sector was enlarged dramatically so as to allow it to hold commanding heights of the economy.

2.1.1.4. Monopolies Commission

In April 1964, the Government of India appointed a Monopolies Inquiry Commission "to inquire into the existence and effect of concentration of economic power in private hands." The Commission looked at concentration of economic power in the area of industry. On the basis of recommendation of the commission, Monopolies and Restrictive Trade Practices Act (MRTP Act), 1969 was enacted. The act sought to control the establishment and expansion of all industrial units that have asset size over a particular limit.

2.1.1.5. Industrial Policy Statement, 1973

The Policy Statement of 1973 drew up a list of industries to be started by large business houses so that the competitive effort of small industries was not affected. The entry of competent small and medium entrepreneurs was encouraged in all industries. Large industries were permitted to start operations in rural and backward areas with a view to developing those areas and enabling the growth of small industries around.

2.1.1.6. Industrial Policy Statement, 1977

The main elements of this policy were:

1. **Development of Small-Scale Sector**: The main thrust of the new industrial policy was an effective promotion of cottage and small industries. The Government initiated wide-spread promotional and supportive measures to encourage the small-scale sector. The small-scale sector was classified into 3 categories viz. Cottage and household industries which provide self-employment; tiny sector and small-scale industries. The purpose of the classification was to specifically design policy measures for each category. The policy statement considerably expanded the list of reserved items for exclusive manufacture in the small-scale sector.
2. **Restrictive approach towards large business houses**: The large scale sector was allowed in basic, capital goods and high-tech industries. The policy emphasized that the funds from financial institutions should be made available largely for the development of small sector. The large sector should generate internal finance for financing new projects or expansion of existing business.
3. **Expanding role of public sector**: The industrial policy stated that the public sector would be used not only in the strategic areas but also as a stabilizing force for maintaining essential supplier for the consumer.

Further, the policy statement reiterated restrictive policy towards foreign capital whereby the majority interest in ownership and effective control should rest in Indian hands.

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2.1.1.7. Industrial Policy, 1980

The industrial policy 1980 emphasized that the public sector is the pillar of economic infrastructure for reasons of its greater reliability, for the large investments required and the longer gestation periods of the projects crucial for economic development. The IPR1956 forms the basis of this statement. The important features of the policy were:

1. **Effective management of public sector**: The policy emphasized the revival of efficiency of public sector undertaking.
2. **Liberalization of industrial licensing**: The policy statement provided liberalized measures in the licensing in terms of automatic approval to increase capacity of existing units under MRTP and FERA. The asset limit under MRTP was increased. The relaxation from licensing was provided for large number of industries. The broad-banding concept was introduced so that flexibility is granted to the industries to decide the product mix without applying for a new license.
3. **Redefining small-scale industries**: The investment limit to define SSI was increased to boost the development of this sector. In case of tiny sector the investment limit was raised to Rs.1 lakh; for small scale unit the investment limit was raised from Rs.10 lakh to Rs.20 lakh and for ancillaries from Rs.15 lakh to Rs. 25 lakh.

Industrial policy, 1980 focused attention on the need for promoting competition in the domestic market, technological upgradation and modernization. The policy laid the foundation for an increasingly competitive export based industries and for encouraging foreign investment in high-technology areas.

2.1.2. Major Features of Pre-1991 Industrial Policy

a) **Protection to Indian Industries**: Local industries were given shelter from international competition by introducing partial physical ban on the imports of products and high imports tariffs. Protection from imports encouraged Indian industry to undertake the manufacture of a variety of products. There was a ready market for all these products.

b) **Import-Substitution Policy**: Government used its import policy for the healthy development of local industries. Barring the first few years after Independence, the country was facing a shortage of foreign exchange, and so to save the scarce foreign exchange, imports-substitution policy was initiated i.e. the Government encouraged the production of imported goods indigenously.

c) **Financial Infrastructure**: In order to provide the financial infrastructure necessary for industry, the Government set up a number of development banks. The principal function of a development bank is to provide medium and long-term investments. They have to also play a major role in promoting the growth of enterprise. With this objective, Government established the Industrial Finance Corporation of India (IFCI) (1948), Industrial Credit and Investment Corporation of India (ICICI) (1955), Industrial Development Bank of India (IDBI) (1964), Industrial Reconstruction Corporation of India (1971), Unit Trust of India (UTI) (1963), and the Life Insurance Corporation of India (LIC).

d) **Control over Indian Industries**: Indian industries were highly regulated through legislations such as Industrial licensing, MRTP Act, 1969 etc. These legislations restricted the production, expansion and pricing of output of almost all kinds of industries in the country.

e) **Regulations on Foreign Capital under the Foreign Exchange and Regulation Act (FERA)**: FERA restricted foreign investment in a company to 40 percent. This ensured that the control in companies with foreign collaboration remained in the hands of Indians. The restrictions were also imposed on technical collaborations and repatriations of foreign exchange by foreign investors.

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f) **Encouragement to Small Industries**: Government encouraged small-scale industries (SSIs) by providing a number of support measures for its growth. Policy measures addressed the basic requirements of the SSI like credit, marketing, technology, entrepreneurship development, and fiscal, financial and infrastructural support.
g) **Emphasis on Public Sector**: The Government made huge investments in providing infrastructure and basic facilities to industries. This was achieved by establishing public sector enterprises in the key sectors such as power generation, capital goods, heavy machineries, banking, tele- communication, etc.

2.1.3. Assessment of Pre-1991 Industrial Policy

The pre-1991 industrial policies created a climate for rapid industrial growth in the country. It helped to create broad-based infrastructure and basic industries. A diverse industrial structure with self-reliance on a large number of items had been achieved. At the time of independence the consumer goods industry accounted for almost half of the industrial production. In 1991 such industries accounted for only about 20 percent. In contrast capital goods production was less than 4 percent of the total industrial production. In 1991 it had gone up to 24 percent.

Industrial investment took place in a large variety of new industries. Modern management techniques were introduced. An entirely new class of entrepreneurs came up with the support system from the Government, and a large number of new industrial centers were developed in most parts of the country. Over the years, the Government built the infrastructure required by the industry and made massive investments to provide the much-needed facilities of power, communications, roads etc. A good number of institutions were promoted to help entrepreneurship development, provide finance for industry and to facilitate development of a variety of skills required by the industry.

However, the implementation of industrial policy suffered from shortcomings. It is argued that the industrial licensing system promoted inefficiency and resulted in the high-cost economy. Licensing was supposed to ensure creation of capacities according to plan priorities and targets. However, due to considerable discretionary powers vested in the licensing authorities the system tended to promote corruption and rent-seeking. It resulted into pre-emption of entry of new enterprises and adversely affected the competition. The system, opposite to its rationale, favored large enterprises and discriminated against backward regions. The Government announced a number of liberalization measures in the industrial policy of 1970, 1973 and 1980. However, dramatic liberalization efforts were made in the industrial policy, 1991.

2.2. Beginning of Reforms in the 1980s

A central focus of the reforms was the improvement of industrial productivity. Some important features included selective removal of industrial licensing, import liberalization for exports, partial liberalization of trade policies and procedures, and changes in the foreign direct investment (FDI) regime for capital goods. However, the reservation of production for the small-scale sector continued even while it constituted an important hurdle in the way of developing export capability in labour-intensive sectors such as garments, leather products, and sports goods, where India has comparative advantage. Industrial policy in the 1980s also paid little attention to facilitating the restructuring of the industrial sector by removing the numerous barriers to exit.

Trade policies during the 1980s were consciously designed to improve efficiency and promote exports. The driving force for the reform was easier access to imported intermediate inputs to facilitate capacity utilization and modern capital goods for technological upgradation. Export subsidies were provided in order to offset the anti-export bias resulting from the protectionist regime.

The limited domestic deregulation and trade policy reforms were successful in creating conditions in which productivity in the Indian manufacturing sector grew at 27 per cent per

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annum in the 1980s compared to a growth rate of –0.5 per cent per annum in the earlier two decades. The industrial growth rate also accelerated to over 7 per cent per annum in the 1980s. Exports of manufactured goods grew at about 11 per cent per annum during the decade. A 45 percent depreciation in the real effective exchange rate in the second half of the 1980s was one of the factors responsible for a significant acceleration in the growth of these exports from 45 percent per annum in the first half of the 1980s to 21.7 per cent per annum in the second half.

The sustainability of the better growth and productivity performance of the industrial sector, however, was being put to test by a deteriorating macroeconomic environment, largely on account of the growing fiscal profligacy of the Government of India during the 1980s. The Gulf War of 1990 and the political instability at the turn of the decade further contributed towards a collapse of international confidence in the Indian economy. The result was the balance-of-payments crisis of 1991.

2.3. New Industrial Policy, 1991

India's New Industrial Policy (NIP) announced in July 1991 was radical compared to its earlier industrial policies in terms of objectives and major features. It emphasized on the need to promote further industrial development based on consolidating the gains already made and correct the distortion or weaknesses that might have crept in, and attain international competitiveness. The liberalized Industrial Policy aimed at rapid and substantial economic growth, and integration with the global economy in a harmonized manner.

It stated that 'the government will continue to pursue a sound policy framework encompassing encouragement of entrepreneurship, development of indigenous technology through investment in research and development, bringing in new technology, dismantling of the regulatory system, development of the capital markets, and increased competitiveness for the benefit of common man'.

Distinctive Objectives of New Industrial Policy (NIP), 1991

NIP had two distinctive objectives compared to the earlier industrial policies:

- **Redefinition of the concept of self-reliance**: NIP redefined the concept of economic self-reliance. From 1956 till 1991, India had always emphasized on Import Substitution Industrialization (ISI) strategy to achieve economic-self reliance. Economic self-reliance meant indigenous development of production capabilities and producing indigenously all industrial goods, which the country would demand rather than importing from outside. The goal of economic self-reliance necessitated the promotion of ISI strategy. It helped to build up the vast base of capital goods, intermediate goods and basic goods industries over a period of time. NIP redefined economic self-reliance to mean the ability to pay for imports through foreign exchange earnings through exports and not necessarily depending upon the domestic industries.
- **International competitiveness**: NIP emphasized the need to develop indigenous capabilities in technology and manufacturing to world standards. None of the earlier industrial policies, either explicitly or implicitly, had made reference to international technology and manufacturing capabilities in the context of domestic industrial development. For the first time, NIP explicitly underlined the need for domestic industry to achieve international competitiveness.

To achieve these objectives, among others, NIP initiated changes in India's industrial policy environment, which gained momentum gradually over the decade. The important elements of NIP can be classified as follows:

1. **Public Sector De-Reservation and Privatization through Dis-Investment**:

   Till 1991, Public Sector was assigned a pre-eminent position in Indian Industry to enable it to achieve "commanding heights of the economy" under the Industrial Policy Resolution

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(IPR), 1956. Accordingly, areas of strategic importance and core sectors were exclusively reserved for public sector enterprises. Public enterprises were accorded preference even in areas where private investments were possible.

Since 1991, the public sector policy consists of:

- Reduction in the number of industries reserved for public sector: Now only two industries (atomic energy and railway operations) are reserved for the Public Sector. The essence of government's Public Sector Undertakings (PSUs) policy since 1991 has been that government should not operate any commercial enterprises. The policy emphasized to bring down government equity in all non-strategic PSUs to 26 percent or lower, restructure or revive potentially viable PSUs, close down PSUs which cannot be revived and fully protect the interests of workers. Government's withdrawal from non-core sectors is indicated on considerations of long-term efficient use of capital, growing financial un-viability and the compulsions for these PSUs to operate in an increasingly competitive and market oriented environment.
- Implementation of Memorandum of Understanding (MOU): As a part of the measures to improve the performance of public enterprises, more and more of public sector units have been brought under the purview of Memorandum of Understanding (MoU) system. A memorandum of understanding is a performance contract, a freely negotiated document between the Government and a specific public enterprise.
- Referral to BIFR: Many sick public sector units have been referred to the Board for Industrial and Financial Reconstruction (BIFR) for rehabilitation or, where necessary, for winding up.
- Manpower Rationalization: In order to achieve manpower rationalization, Voluntary Retirement Scheme (VRS) has been introduced in a number of PSUs to shed the surplus manpower.
- Private Equity Participation: PSUs have been allowed to raise equity finance from the capital market. This has put market pressure on PSUs to improve their performance.
- Disinvestment and Privatization: Disinvestment and privatization of existing PSUs has been adopted to improve corporate efficiency, financial performance and competition amongst PSUs. It involves transfer of Government holding in PSUs to the private shareholders.

2. Industrial Delicensing

The removal of licensing requirements for industries, domestic as well as foreign, commonly known as "de-licensing of industries" was another important feature of NIP. Till the 1990s, licensing was compulsory for almost every industry, which was not reserved for the public sector. This licensing system was applicable to all industrial enterprises having investment in fixed assets (which include land, buildings, plant & machinery) above a certain limit. With progressive liberalization and deregulation of the economy, industrial licenses, which are regulated under the Industries (Development and Regulation) Act 1951, are required in very few cases.

With a few exceptions, investors are free to set up a new industrial enterprise, expand an industrial enterprise substantially, change the location of an existing industrial enterprise and manufacture a new product through an already established industrial enterprise. The objective of industrial delicencing is to enable business enterprises to respond to the fast changing external conditions. Entrepreneurs are free to make investment decisions on the basis of their own commercial judgment. This facilitates technological dynamism and international competitiveness. Further industries have the freedom to take advantage of 'economies of scale' as well as 'economies of scope' in the existing industrial policy environment.

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3. **Amendment of Monopolies and Restrictive Trade Practices (MRTP) Act, 1969**

An important objective of India's earlier industrial policies was to prevent emergence of private monopolies and concentration of economic power in a few individuals. Accordingly, Monopolies and Restrictive Trade Practices (MRTP) Act, 1969 was enacted and MRTP Commission was set up as a permanent body to periodically review industrial ownership, advice the government to prevent concentration of economic power, investigate monopolistic trade practices and inquire into restrictive trade practices, which are prejudicial to public interest. An MRTP firm was mainly defined in terms of asset size. An MRTP company had to obtain prior approval of the government for setting up a new enterprise as well as for expansion. However, MRTP Act was applicable only to private sector companies.

Since 1991, the MRTP Act has been restructured and pre-entry restrictions have been removed with regard to prior approval of the government for the establishment of a new undertaking, expansion, amalgamation, merger, take over, and appointment of directors of companies. The asset restriction and market share for defining an MRTP firm has been done away with. The MRTP Act is now applicable to both private and public sector enterprises and financial institutions. Today, only restrictive trade practices of companies are monitored and controlled. The MRTP Act has been replaced by the Competition Act, 2002. This law aims at upholding competition in the Indian market. The Competition Commission has been established in 2003, which mainly controls the practices that have an adverse impact on competition.

4. **Liberalized Foreign Investment Policy**

India's earlier industrial policies welcomed FDI but emphasized that ownership and control of all enterprises involving foreign equity should be in Indian hands. The Balance of Payments (BoP) difficulties in the mid-1960s forced the country to adopt a more restrictive approach towards FDI through the setting up of a Foreign Investment Board, which classified industries into two groups: banned and favored for foreign technical collaboration and FDI. The number of industries for foreign investment was steadily narrowed down and by 1973 there were only 19 industries where FDI was permitted. The enactment of FERA, 1973 marked the beginning of the most restrictive phase of India's foreign investment policy. The NIP radically reformed foreign investment policy to attract foreign investment. The important foreign investment policy measures are as follows:

- Repeal of FERA, 1973: FERA, 1973 has been repealed and Foreign Exchange Management Act (FEMA) came into force with effect from June 2000. Investment and returns can be freely repatriated except where the approval is subject to specific conditions such as lock-in period on original investment, dividend cap, foreign exchange neutrality, etc. as specified in the sector specific policies. The condition of 'dividend balancing' was withdrawn for dividends declared. A foreign investor can freely enter, invest and operate industrial enterprises in India. The Foreign Contribution (Regulation) Act, 2010 has been enacted by the Parliament to consolidate the law to regulate the acceptance and utilization of foreign contribution.
- Dilution of restrictions on Foreign Direct Investment (FDI): FDI is allowed in all sectors including the services sector except atomic energy and railway transport.

5. **Foreign Technology Agreement**

The automatic approvals for technology agreement are allowed to industries within specified parameters. Indian companies are free to negotiate the terms of technology transfer with their foreign counterparts according to their own commercial judgment.

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6. Dilution of protection to Small Scale Industries (SSI) and emphasis on competitiveness

SSIs enjoyed a unique status in Indian economy due to its diversified presence across the country and thereby utilizing resources and skills, which would have otherwise remained unutilized. Due to their potential to generate large-scale employment, produce consumer goods of mass consumption, alleviate regional disparities, etc., industrial policies protected the sector for its growth. The principal protective measures for SSI comprised:

- Demarcating SSI from the rest of industry through a definition under the IDR Act, 1951.
- Concessional credit from the banking system.
- Fiscal concessions.
- Exemption from industrial licensing and labor legislations.
- Preferential access to scarce raw materials, both domestic and imported.
- Market support from the government through reservation of products for government purchase and price preferences.
- Reservation of products for exclusive manufacturing in SSIs and restrictions on the growth of output and capacity in the large-scale sector for products reserved for SSI manufacturing.

These policy measures protected SSIs from both internal and external competition.

However, since 1991 the protective emphasis of SSI policy has undergone dilution. In August 1991, government of India brought out an exclusive policy for SSI. The policy marked:

- the beginning of an end to protective measures to small industry.
- promotion of competitiveness by addressing the basic concerns of the sector namely technology, finance and marketing.

Subsequently, the number of items reserved exclusively for small industry manufacturing was gradually brought down. The policy of reserving items had lost its relevance to a large extent because though these products could not be manufactured by large enterprises domestically, they could be imported from abroad due to the removal of quantitative and non-quantitative restrictions on most imports by the year 2001. Concession element in lending rates for small industry was largely withdrawn during the 1990s. The number of products reserved exclusively for purchase from small industry by the government has also been reduced. Measures have been adopted to improve technology and export capabilities of SSIs. Thus, the overall promotion orientation of SSI has shifted from protection towards competitiveness.

2.3.1. Assessment of New Industrial Policy (NIP)

The response to the balance-of-payments crisis was to not only put in place policies for macroeconomic stabilization but seize the opportunity to launch wide-ranging economic reforms to realize the potential of the Indian economy for higher growth. Beginning in 1991, the policymakers attempted to take significant steps towards integrating the economy with the world and improving the macroeconomic environment from the deterioration of the 1980s. The transformation in the policy regime away from extensive control and a strong inward orientation in the decade and a half since 1991 have been attained through incremental/ gradualist changes, occasional reversals, and without any big ideological U-turns. Coalitions of various political parties at the centre and different political parties ruling the states have taken turns in moving the economic reform process forward, albeit in a haphazard manner.

The period from 1991–2 to 1996–7 saw rapid and wide-ranging reforms in industrial and trade policies, tax policies, and other policies impacting on macroeconomic management. There was a distinct slowing down of reforms after 1996–7, partly because of complacency at the favourable response to the early reforms, partly because of confusion resulting from change of

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government at the centre, and also because by the mid-1990s, the competition had begun to pinch and Indian industry was becoming less supportive of change including external liberalization. In 2001, India regained the momentum of change towards improving the environment for private investment, opening the economy to foreign competition, and infrastructure development. However, macroeconomic management (after an excellent start when the consolidated fiscal deficit of the centre and the states was brought down from 9.6 per cent of GDP in 1990–1 to 7 per cent in 1992–3) has been an area of weakness that could undermine the achievement of sustainable growth at high rates in the future.

The industrial policy reforms during the 1990s were bold in doing away with numerous barriers to entry, for example, removal of industrial licensing for investment, opening up all but a few strategic areas to other than the public sector, and replacing the earlier MRTP Act with a new Competition Law to regulate anti-competitive behaviour. Even on the policy of reservation for the small-scale sector, a beginning was made by dereserving a number of items for manufacturing as well as purchase. However, the microeconomic reforms and judicial reforms which would make the factor markets more flexible and enable individual firms to benefit from the more competitive environment were slow to come by.

Trade policy reforms made a radical break with the past by discontinuing with the complex system of import licensing and making an open commitment to lowering the tariff rates on imports. At the outset, import licensing was dispensed with for most goods other than consumer goods, thereby removing a major source of corruption and inefficiency. In 2001, India finally began to remove the quantitative restrictions on consumer goods and agricultural products over a three-year period.

Import duties were reduced gradually if not always steadily. After a sharp decline from an average of 73 per cent in 1991–2 to around 25 per cent in 1996–7, the import-weighted import duty crept up again to 36 per cent in 2000–1 reflecting a revival of protectionist pressure from established Indian industry, Subsequently there was a reversal of this trend and the government reiterated the objective of reducing India's tariff protection rates to Association of East Asian Nations (ASEAN) levels.

In the 1990s, the FDI rules were liberalized with a view to gaining improved access to technology and world markets and also helping release the resource constraints on investment. Many industries were deregulated and opened to FDI. For others, the Foreign Investment Promotion Board was set up to expedite applications for foreign investment. In addition, the Indian stock market has been opened for investment in equity to foreign institutional investors (FIIs). These policy changes have led to a sharp increase in FDI flows from almost nothing in 1990 to considerable levels at present.

A major challenge of the reforms was how to attract private investment into sectors such as electricity, telecommunications, roads, railways, ports, and airports, in order to meet the enormous investment requirements of upgrading infrastructure. These sectors were opened up to private investment at different times in the subsequent years with varying degrees of success.

Telecommunications is the area where reforms have been most successful, helped by the fact that pricing of telecom services (unlike that of power) was not uneconomic. Access to telecom services has expanded greatly, costs have come down, and quality improved as a handful of strong private-sector telecom service suppliers are competing effectively with the public-sector companies. Private investment has also been attracted in ports and airports. In roads, new investment has been dominantly in the public sector, as is the case in most countries, but there has also been some private-sector involvement, which could increase in future.

With respect to the power sector, the expectations of attracting large investments in generation capacity were belied by continuing financial problems of the distribution segment, which remained unviable for long because of a combination of unrealistically low tariffs for some

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sections of consumers (households and farmers) and very large inefficiencies in collection. In recent years, attempts have been made to depoliticize the process of fixing power tariffs. The Electricity Act of 2003 lays out a broad legal framework of regulation for the sector and effectively empowers state governments to accelerate power-sector reforms through fostering greater competition, increased involvement of the private sector, and better governance.

Profit-making public-sector units (PSUs) were allowed greater autonomy and larger freedom to raise resources in the capital market, but the relatively less well-performing PSUs languished for want of public funds and political will to restructure, privatize, or close down. A Disinvestment Commission was set up in 1997, but privatization was not seriously put on the policy agenda until 2001. A few public-sector enterprises were privatized with the transfer of management control during 2001–3, the most important being BALCO (Bharat Aluminium Company Ltd), which was sold to a strategic private investor. But resistance surfaced strongly when privatization of two oil companies was attempted. Further brakes were put on privatization by the government which came to power in 2004. However, there has been a renewed focus on disinvestment off late to increase the efficiency of the public sector.

The increased market orientation of policy regime generated a favourable investment response from the private sector up to 1996–7. Indeed, the rate of private fixed investment increased from a low of 12.9 per cent in 1991–2 to 15.9 per cent in 1996–7.

The slowdown in reforms after 1996–7, together with a worsening of the external economic environment after the Asian financial crisis, resulted in slowing down of industrial growth rate. From 12.3 per cent in 1995–6, industrial growth rate dropped to 7.7 per cent in 1996–7 and 3.8 per cent in each of the successive two years. However, the subsequent period has shown industrial revival with improved growth rates. Moreover, the software boom has continued and created a new brand image for India in world markets.

There is substantial evidence to suggest that Indian industry has been restructuring and reducing costs in a slow but steady manner since the mid-1990s. The pace of adjustment and adaptation has been slow in some of the important traditional industries, for example, textiles and garments which are facing new challenges of the competitive world market scenario after the end of the Multifibre arrangement (MFA) in January 2005. On the other hand, pharmaceuticals and automotive components are examples of manufacturing industries that have successfully turned around and developed a global vision to penetrate world markets.

The Indian pharmaceutical industry, while making inroads into the fast-growing generics market worldwide, is also positioning itself under the new Intellectual Property Rights (IPR) regime through increased research and development (R&D) expenditures and strategic alliances to move up the value chain. With a more liberal foreign investment policy, multinational corporations and international generics companies have also been attracted to restructure their operations and increase their stakes in existing ventures in India and set up new ventures.

The post-reform era has also spurred the development of the biotechnology industry which is driven by new enterprise and new innovation. Skilled human resources, active government support, and increased investment–public as well as private–promises sustained growth of this industry with global orientation. India is emerging as the most favoured destination for collaborative R&D, bioinformatics, contract research and manufacturing, and clinical research as a result of growing compliance with internationally harmonized standards. Several states have taken steps to develop bio-clusters based on academic and entrepreneurial strengths.

Student Notes:

3. Initiatives Taken by the Government for Industrial Development

3.1. Disinvestment

Owing to several shortcomings, the functioning of the public sector has often been questioned. It has been argued that the public sector works well only when it is protected by state measures. Some also argued that the public sector had entered in too many areas and, therefore, it must withdraw itself by giving entry to private players. Thus, privatization of some PSUs was advocated and disinvestment was the process through which this privatization could take place.

Various reasons given for the disinvestment were as follows:
- It will release a large amount of public resources locked up in non-strategic PSUs. Then these resources can be redeployed in areas that are much higher on social priority such as health, education, etc.
- Reduction in the public debt.
- Transferring the commercial risk to private sector where it is willing to share it.
- Releasing manpower and other intangible resources for redeployment in high priority social sectors.
- Enabling public having ownership or say in management of some PSUs.

But, the critics questioned the way in which disinvestment happened. Private sector took part in the disinvestment of only profit making PSUS. They totally neglected the loss making PSUs. Thus, the aim of sharing risk with the private sector was diluted.

The critics also questioned the disinvestment of profit making PSUs. But, the government used disinvestment as a tool to reduce fiscal deficit. In other words, to cover its inefficiency in the economic management of the country the government lost a profit making and revenue generating entity.

Proceeds of Disinvestment

The proceeds of disinvestment go into National Investment Fund (NIF), which was setup in 2005. The purpose of the fund was to receive disinvestment proceeds of central public sector enterprises and to invest the same to generate earnings without depleting the corpus. The earnings of the Fund were to be used for selected Central Social Welfare Schemes. This fund was kept outside the Consolidated Fund of India.

In 2013, NIF was restructured and it was decided that the entire disinvestment proceeds will be credited to the existing 'Public Account' under the head NIF and they would remain there until withdrawn/invested for the approved purpose. The allocations out of the NIF will be decided in the annual Government Budget.

Proceeds from NIF are utilized for following purposes:

- Subscribing to the shares being issued by the CPSE including PSBs and Public Sector Insurance Companies, on rights basis so as to ensure that 51% ownership of the Government in those CPSEs/PSBs/Insurance Companies, is not diluted.
- Preferential allotment of shares of the CPSE to promoters as per SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 so that Government shareholding does not go down below 51% in all cases where the CPSE is going to raise fresh equity to meet its Capex programme.
- Recapitalization of public sector banks and public sector insurance companies.
- Investment by Government in RRBs/IIFCL/NABARD/Exim Bank.
- Equity infusion in various Metro projects.

Student Notes:

- Investment in Bhartiya Nabhikiya Vidyut Nigam Limited and Uranium Corporation of India Ltd.
- Investment in Indian Railways towards capital expenditure.

There are various ways for disinvestment like Strategic Sales, warehousing, buy-back equity, private placement and other instruments of capital market etc.

Recent changes in management of Disinvestment Proceeds

The Department of Disinvestment was set up as a separate Department in 1999 and since 2004 it has been made as one of the Departments under the Ministry of Finance. The Department of Disinvestment was renamed as Department of Investment and Public Asset Management (DIPAM) in the 2016-2017 Budget and was assigned the following functions:

- It was responsible for all matters relating to management of Central Government investments in equity including disinvestment of equity in Central Public Sector Undertakings.
- All matters relating to sale of Central Government equity through offer for sale or private placement or any other mode in the erstwhile Central Public Sector Undertakings.
- Decisions on the recommendations of Administrative Ministries, NITI Aayog, etc. for disinvestment including strategic disinvestment.
- Decisions in matters relating to Central Public Sector Undertakings for purposes of Government investment in equity like capital restructuring, bonus, dividends, disinvestment of government equity and other related issues.
- Advise the Government in matters of financial restructuring of the Central Public Sector Enterprises and for attracting investment in the said Enterprises through capital market.

However, to streamline the disinvestment process, in January 2017, the government transferred the role of advising the government on how to utilize the proceeds from disinvestment from the Department of Investment and Public Asset Management (DIPAM) to the Department of Economic Affairs. The Department of Economic Affairs in the Finance Ministry will now be in charge of "financial policy in regard to the utilisation of the proceeds of disinvestment channelized into the National Investment Fund."

3.2. Ease of Doing Business in India

- The Ease of Doing Business (EoDB) is an index created by the World Bank.
- It presents quantitative indicators on business regulations and the protection of property rights based on 10 parameters that can be compared across 190 economies.
- Higher rankings indicate better, usually simpler, regulations for businesses and stronger protections of property rights.

India's rank in Doing Business Report, 2018 jumped to 100th in comparision to 130th rank in Doing Business Report, 2017.

Steps taken by India to improve its EODB Index ranking on the 10 parameters:

- **Speeding up process**: such as company's registration within 1-2 working days, issuing of PAN in a day, providing electricity connections in 15 days with online application etc.
- **Digitisation**: It makes various processes easier for businesses and their employees such as digitization of property records and land records, ShramSuvidha Portal for filling returns for ESIC and EPFO etc.
- **Facilitating trade across borders**: through 'Indian Customs Single Window Project' as well as reducing the number of mandatory documents required by customs.
- **Enacting or amending laws & rules**: such as Enactment of the Commercial Courts, Commercial Division and Commercial Appellate Division of High Courts Act, 2015,the Insolvency and Bankruptcy Code, 2016 for speeding the exit procedure etc.
- **Protecting minority investors** through the Companies (Amendment) Act, 2015.

Student Notes:

Though India has performed well on parameters like getting electricity, getting credit and protecting minority investors, on some other parameters like construction permits, resolving insolvency, paying taxes, enforcing contracts etc. it has performed poorly. However, the government has plotted an eight-point strategy and firmed up a 295-point reform agenda for states to improve India's ranking.

3.3. E- Biz Project

- E-Biz is one of the integrated services projects and a part of the 27 Mission Mode Projects (MMPs) under the National E-Governance Plan (NEGP) of the Government of India.
- The focus of E-Biz is to improve the business environment in the country by enabling fast and efficient access to Government-to-Business (G2B) services through an online portal. This will help in reducing unnecessary delays in various regulatory processes required to start and run businesses.
- This project aims at creating an investor-friendly business environment in India by making all regulatory information – starting from the establishment of a business, through its ongoing operations, and even its possible closure - easily available to the various stakeholders concerned. In effect, it aims to develop a transparent, efficient and convenient interface, through which the government and businesses can interact in a timely and cost effective manner, in the future.
- The eBiz portal was conceptualized with support from National Institute of Smart Governance (NISG) and developed by Infosys Technologies Limited (Infosys) in a Public Private Partnership (PPP) model for a period of 10 years.

3.4. Make in India Initiative

With the objective of making India a global hub of manufacturing, design and innovation, the Make in India initiative, which is based on four pillars --new processes, new infrastructure, new sectors and new mindset-- has been taken by the government. The initiative is set to boost entrepreneurship, not only in manufacturing but in relevant infrastructure and service sectors as well.

An interactive portal http://makeinindia.com for dissemination of information and interaction with investors has been created with the objective of generating awareness about the investment opportunities and prospects of the country, to promote India as a preferred investment destination in markets overseas and to increase Indian share of global FDI. In addition, information on 25 thrust sectors, along with details of the FDI Policy, National Manufacturing Policy, Intellectual Property Rights and the proposed National Industrial Corridors including the Delhi Mumbai Industrial Corridor (DMIC), are available on the portal.

The Department of Industrial Policy and Promotion (DIPP), in consultation with various central ministries, state governments, industry leaders, and other stakeholders, has formulated a strategy for increasing the contribution of the manufacturing sector to 25 per cent of the GDP by 2020.

The Government of India has set up "Invest India" as the national investment promotion and facilitation agency. With the objective of promoting investment in the country, a full-fledged Investment Facilitation Cell has been set-up under the Make in India initiative, primarily to support all investment queries as well as to handhold and liaise with various agencies on behalf of potential investors.

3.5. National Manufacturing Policy, 2011

Rationale

- Inadequate physical infrastructure, complex regulatory environment and inadequate availability of skilled manpower have constrained the growth of manufacturing in India.

Student Notes:

- The share of manufacturing in India's GDP has stagnated at 15-16% since 1980s which needs to be increased for increasing efficiency, productivity leading to accelerated development of the people.
- Manufacturing sector will have multiplier effect on the creation of jobs in other sectors too.
- In other Asian countries the share of manufacturing sector in the GDP is around 25-34%. This shows that we have not been fully able to leverage the opportunities provided by the globalization.
- India has favourable demographic dividend with 60% of people in the age group 15-59 years. Therefore, it becomes necessary to provide gainful employment opportunities with this section of people with varying skills.
- India has many agricultural and natural resources but the amount of value addition is very less. Growth of manufacturing sector will address this problem of value addition and reduce our dependence on imports of capital equipment.
- We also need depth in manufacturing from the point of competitiveness in strategic areas of economy such as defence and telecommunications.

Features of the Policy

- It aimed to increase manufacturing sector growth to 12-14% over the medium term to make it the engine of growth for the economy and to enable manufacturing sector to contribute at least 25% of the National GDP by 2022.
- Increase the rate of job creation in manufacturing to create 100 million additional jobs by 2022.
- Creation of appropriate skill sets among the rural migrant and urban poor to make growth inclusive.
- Increase domestic value addition and technological depth in manufacturing.
- Enhance global competitiveness of Indian manufacturing through appropriate policy support.
- Ensure sustainability of growth, particularly with regard to the environment including energy efficiency, optimal utilization of natural resources & restoration of damaged/ degraded eco-systems.

Ways to achieve this

- Foreign investments and technologies will be welcomed while leveraging the country's expanding market for manufactured goods.
- Competitiveness of enterprises in the country will be the guiding principle in the design and implementation of policies and programmes.
- Compliance burden on industry arising out of procedural and regulatory formalities will be reduced through rationalization of business regulations.
- The NMP provides for promotion of clusters and aggregation, especially through the creation of national investment and manufacturing zones (NIMZs).

Recently, the government announced that NMP is being modified to align it with initiatives like 'Make in India' and also Industrial Revolution 4.0, which refers to high end automation.

3.6. Delhi-Mumbai Industrial Corridor (DMIC)

- Delhi-Mumbai Industrial Corridor is a mega infra-structure project with financial & technical aids from Japan. It covers an overall length of 1483 km between Delhi and Mumbai.
- It will pass through six states - U.P, NCR of Delhi, Haryana, Rajasthan, Gujarat and Maharashtra, with end terminals at Dadri in the National Capital Region of Delhi and Jawaharlal Nehru Port near Mumbai.
- This Dedicated Freight Corridor envisages a high-speed connectivity for High Axle Load Wagons (25 Tonne) of Double Stacked Container Trains supported by high power

Student Notes:

locomotives. The Delhi-Mumbai leg of the Golden Quadrilateral National Highway also runs almost parallel to the Freight Corridor.

- This corridor will be equipped with an array of infrastructure facilities such as power facilities, rail connectivity to ports en route etc.

3.7. Steps Taken for Promotion and Development of MSMEs

Realizing the importance of the MSME sector, the government has undertaken a number of schemes/programmes like the Prime Minister's Employment Generation Programme (PMEGP), Credit Guarantee Trust Fund for Micro and Small Enterprises (CGTMSE), Credit Linked Capital Subsidy Scheme (CLCSS) for Technology Upgradation, Scheme of Fund for Regeneration of Traditional Industries (SFURTI), and Micro and Small Enterprises Cluster Development Programme (MSECDP) for the establishment of new enterprises and development of existing ones. Some of the new initiatives undertaken by the government for the promotion and development of MSMEs, are as follows:

- **Udyog Aadhar Memorandum (UAM)**: The UAM scheme (2015) is a pathbreaking step to promote ease of doing business for MSMEs. Under the scheme, MSME entrepreneurs just need to file an online entrepreneurs' memorandum to instantly get a unique Udyog Aadhaar Number (UAN).
- **Employment Exchange for Industries**: To facilitate match-making between prospective job seekers and employers an employment exchange for industries was launched in June 2015 in line with Digital India.
- **Framework for Revival and Rehabilitation of MSMEs**: Under this framework, banks have to constitute a Committee for Distressed MSME enterprises at zonal or district level to prepare a Corrective Action Plan (CAP) for these units.
- **A scheme for Promoting Innovation and Rural Entrepreneurs (ASPIRE):** ASPIRE was launched with the objective of setting up a network of technology centres and incubation centres to accelerate entrepreneurship and promote start-ups for innovation and entrepreneurship in rural and agricultural industry
- **The India Aspiration Fund** has also been set up under the Small Industries Development Bank of India (SIDBI) for venture capital financing of newly set-up or expanding units in the MSME sector.
- **SIDBI Make in India Loan for Small Enterprises (SMILE)** has been launched to offer quasi-equity and term-based short-term loans to Indian SMEs with less stringent rules and regulations and a special focus on 25 thrust sectors of Make in India.
- **Micro Units Development Refinance Agency (MUDRA) Bank** has been set up to provide development and refinance to commercial banks/ NBFCs/cooperative banks for loans given to micro-units. MUDRA Bank would follow a credit-plus approach while also providing financial literacy and addressing skill gaps, information gaps, etc.
- **Startup India campaign** is based on an action plan aimed at promoting bank financing for start-up ventures to boost entrepreneurship and encourage start ups with jobs creation, with focus on MSME sector.

4. Previous Years UPSC Mains Questions

1. "Success of 'Make in India' programme depends on the success of 'Skill India' programme and radical labour reforms." Discuss with logical arguments.
2. Justify the need for FDI for the development of the Indian economy. Why there is gap between MOUs signed and actual FDIs? Suggest remedial steps to be taken for increasing actual FDIs in India.
3. There is a clear acknowledgement that Special Economic Zones (SEZs) are a tool of industrial development, manufacturing and exports. Recognizing this potential, the whole instrumentality of SEZs requires augmentation. Discuss the issues plaguing the success of SEZs with respect to taxation, governing laws and administration.

Student Notes:

4. "Industrial growth rate has lagged behind in the overall growth of Gross-Domestic-Product (GDP) in the post-reform period" Give reasons. How far the recent changes in Industrial Policy are capable of increasing the industrial growth rate?
5. How globalization has led to the reduction of employment in the formal sector of the Indian economy? Is increased informalization detrimental to the development of the country?
6. Normally countries shift from agriculture to industry and then later to services, but India shifted directly from agriculture to services. What are the reasons for the huge growth of services vis-a-vis industry in the country? Can India become a developed country without a strong industrial base?

5. Previous Years Vision IAS GS Mains Questions

1. Indian manufacturing is lagging in the face of stiff competition from other developing economies in Asia and elsewhere, both in domestic as well as global markets. What are the main reasons that can be attributed for this scenario? Suggest few remedies for the same.

Approach:

- The question deals with shortcomings in the Indian manufacturing sector. The limitations and efforts undertaken to overcome those limitations should be discussed. Reference to the past efforts by government and relevant policies may be mentioned.

Answer:

- The principal question which remains unanswered is that why the speeding up of reforms after 1991 did not yield faster outputs, employment and labour intensive growth in the Indian manufacturing sector. Many experts say that the reforms have remained incomplete, with the persistence of the labour market rigidities (lack of entrepreneurial freedom to hire and fire workers at will), infrastructure bottlenecks and incomplete financial integration, including full convertibility of the currency.
- A prime reason attributed to such a scenario is that India had followed idiosyncratic policies of promoting skill intensive industries, discouraging labour intensive manufacturers- a pattern that has not changed after the reforms due to labour market rigidities. Also the average Indian firms tend to be smaller as workers cannot be fired, preventing them from reaping the advantages of the economies of scale production. Also, there need to be steps to provide more flexibility to employers to adjust employment levels along with more fairness and security to employees.
- Infrastructural bottlenecks are also throttling the industrial progress which is often blamed on lack of resources, enormous cost and time overruns in project completion and poor public management in general. Attributing these problems to public ownership, the reforms have encouraged entry of private and foreign capital in these industries. Besides, *the cost of doing business* is much higher in India than in other countries due to the plethora of forms and inspections that manufacturers have to comply with, some of them arising out of legislations long pending review, such as the Factories Act. The streamlining of these requires action by government agencies in the state and in the centre.
- Besides, the government had released its new *National Manufacturing Policy* with an aim to increase the sectoral share of manufacturing in GDP to at least 25% by 2022; to increase the rate of job creation so as to create 100 million additional jobs by 2022; and to enhance global competitiveness, domestic value addition, technological depth and environmental sustainability of growth. The policy envisages specific interventions broadly in the areas of industrial infrastructure

Student Notes:

development through the creation of National Investment and Manufacturing Zones (NIMZs); improvement of the business environment through rationalization and simplification of business regulations; development of appropriate technologies especially green technologies for sustainable development and skill development of the younger population.

2. ***"There is a myth that small firms create the most jobs in an economy. The fact is that small firms that grow big create the jobs". In context of the Indian economy what are the factors that prevent firms that start small from growing bigger. What progress has India made in this respect and what other measures are required?***

Approach:

- The answer is centered on the employment potential of small firms and the problems faced by them. Therefore, the answer should start with elaboration of the given statement.
- The next part should discuss some problems being faced by those firms.
- Finally, the answer should discuss some measures taken by the government to improve the situation.

Answer:

MSME sector employs close to 40 percent of India's workforce plays a critical role in generating millions of jobs, especially at the low-skill level. According to NSSO, there are about 57.7 million non-corporate business units outside construction sector, mostly unregistered and self-employment units. However, SMEs in India, due to their low scale and poor adoption of technology, have very poor productivity. The total employment in MSME sector is about 80.5 million (4th All India Census for Small Scale Industry), which averages to less than 2 people per firm.

Although they employ 40% of India's workforce, they contribute less than that (~35%) to the GDP. Too many firms stay small, unregistered and un-incorporated in the unorganised sector so that they can avoid taxes and regulations. These firms need to expand, grow and innovate in order to continue to scale up and hire more people to run their operations.

In a journey from a small firm towards a big one, it may face following roadblocks:

- **Finance:** with most of the 57.7 million units unregistered, banks, perhaps rightly, do not finance them. Lack of institutional credit means exploitation by usurious moneylenders.
- **Regulations:** Compliance cost- money, time and labour rise drastically once a firm graduates from M to S to Medium and large. As such, about 90% of MSMEs are Micro only and remain so.
- **Marketing and Branding:** Generally, small firms have good business idea but lack marketing and branding strategy to evolve themselves as a big firm.
- **Access to technology** – partly because of limited finance and partly due to inertia. This hampers productivity and renders the enterprise uncompetitive..
- **Strict Labor Laws & Lack of skilled workforce:** Firms deliberately remain small because as they grow they come under strict labour laws.
- **Tax incentives:** SMEs have tax concessions, therefore to continue to enjoy those benefits, they remain small.

However, these problems can be overcome through the following measures:

- **Finance:** We need banks that specifically cater the needs of the small firms- Recently launched Payments Banks, MUDRA Bank, and Small Finance Banks.

Student Notes:

- **Regulations:** Self-certification to some compliances and single online portal for registration, clearances and approvals as envisaged in different programs (like Start Up India).
- **Collaboration Hub:** Setting up a hub like Start Up India hub for collaboration of governments, consultants, R&D institutions etc. that would assist small firms to adopt best practices through exchange of ideas can be a way for adoption of better technology.
- **Incentives:** Innovation awards as provisioned in Atal Innovation Mission should be provided to prompt small firms to spend on R&D and hence become more competitive.
- **Focus on manufacturing:** The recently launched Make in India program is another move by the government to promote manufacturing, with a focus on SME sector.
- **Skill development:** Since majority of people employed in this segment is unskilled or semi-skilled, therefore skilling programs can be important game changer. In this regard, the government has launched the Skill India Mission.
- **Dedicated e-commerce portal** with the help of National Small Scale Corporation has been launched to provide wider market coverage.

Apart from these already launched, or proposed measures, there is a need to bring in much awaited tax reforms for streamlining the tax structure. SMEs is really the backbone of our economy, a very strong tool for poverty alleviation, and empowerment of marginalized segment, therefore there is an urgent need to bring in reforms to this sector.

3. While India has made great strides in removing the barriers to the entry of firms, talent and technology, less progress has been made in relation to exit. In this context, discuss the causes of and costs associated with impeded exit in India.

Approach:

- First, briefly explain the statement.
- Then bring out the causes that impede exit in India.
- Also discuss the costs associated with impeded exit.

Answer:

A market economy requires unrestricted entry of new firms, new ideas, and new technologies so that the forces of competition can guide capital and labour resources to their most productive and dynamic uses. But it also requires exit so that resources are forced or enticed away from inefficient and unsustainable uses. Over the course of six decades, the Indian economy has moved from 'socialism with limited entry to "marketism" without exit'.

Since the early 1980s, the Indian economy has made remarkable progress in increasing entry: industrial licensing has been dismantled, public sector monopolies have been diluted, some public sector assets have been privatised, foreign direct investment has been considerably liberalised and trade barriers have been reduced. However, there has been less progress in relation to exit and impeded exit has been resulting in substantial fiscal, economic and political costs.

Associated costs

- **Fiscal costs**: Exit is impeded often through government support of incumbent, mostly inefficient, firms. This support – in the form of explicit subsidies (for example, bailouts) or implicit ones (tariffs, loans from state banks) – represents a fiscal cost to the economy.

Student Notes:

- **Economic costs**: Economic losses result from resources and factors of production not being employed in their most productive uses. In a capital scarce country such as India, misallocation of resources can have significant costs. Another cost, in the current context, stems from the overhang of stressed assets on corporate and bank balance sheets. The consequence is a reduced flow of new investment, dampening medium term growth.
- **Political costs**: The lack of exit can have considerable political costs for governments attempting to reform the economy. The benefits of impeded exit often flow to the rich and influential in the form of support for "sick" firms. This can give the impression that governments favour large corporates, which politically limits the ability to undertake measures that will benefit the economy but might be seen as further benefitting business.

In India, the exit problem arises because of three types of reasons, what might be called the three I's: interests, institutions, and ideas/ideology.

Causes of impeded exit in India:

- **Interests**: The first, most obvious, and perhaps most powerful reason for lack of exit is the power of vested interests. Often, this vested interest problem is aggravated by a certain imbalance or asymmetry that confers greater power on concentrated producer interests in relation to diffused consumer interests. An example of interest groups blocking reforms is the introduction of JAM for MGNREGA. In case of administrative schemes, vested interests often create a market of their own, planning their actions to benefit from it. Thus, schemes may become an instrument of granting favours.
- **Institutions**: Another reason for impeded exit is institutions – both weak and strong institutions. Examples of weak institutions are legal procedures that increase the costs – time and financial costs – of exit. One example is the debt recovery tribunals (DRTs). On the other hand, strong investigative agencies are responsible for the tendency of risk-aversion in decision makers, perpetuating status quo and impeding exit. **Ideas/ ideology**: A third reason for impeded exit relates to ideas/ideology. In a democratic country like India with sizable poverty and inequality, it is very difficult to phase out entitlements/incentives.

To address the exit problem, the government must allow inefficient firms to exit through its direct policies and transparent actions. Recent initiatives like Bankruptcy Code, rehabilitation of stalled projects, changes in Prevention of Corruption Act etc. are steps in the right direction.

4. What is the significance of start-ups for Indian economy? Critically analyse the provisions of "Start-up India" program and the challenges that lie ahead in its effective implementation.

Approach:

- Discuss the significance of start-ups.
- Critically analyse the provisions of Start-up India program.
- Mention the challenges that lie in its implementation.

Answer:

The significance of start-ups for Indian economy is manifold:

- *India needs 10 million jobs a year and Start-ups being the centers of innovation will enhance employment creation in economy when the manufacturing sector is down.*

Student Notes:

- *With more start-ups India can aspire to be world leader in skilled labour more than an outsourcing destination.*
- *They will enable India to reap its demography dividend.*
- *They encourage competition in the market.*
- *They induce backward and forward linkages stimulating multi-sectoral development.*
- *They lead to formalisation of the work force.*
- *They have the potential to create demand within the country, which may last longer given the global economic prospects.*
- *They can provide a boost to the "Make in India" and other initiatives of the government.*
- *They have the potential to bring social change in the society by empowering the weaker sections.*

*The provision of **Start-up** policy are as follows:*

- **Self certification** with regard to labour and environment laws. However, this must be done for all businesses and not just start-ups to improve ease of doing business.
- **Startup India Hub** single point of contact for the startup community.
- **Mobile app and portal** will allow startups to register in one-day.
- **Legal support and fast-tracking patent applications:** Startups entitled to 80 percent rebate in filing patents. However, corruption makes this difficult and IPR procedure must be made transparent, not just for startups but for everyone. The cost of filing an IPR has been kept very low for them, which is a welcome step.
- **Faster Exit:** To make it easier for startups to wind up operations in 90 days thus preventing stuck of funds.
- **Tax exemption from capital gains** but higher risk involved make this step nominal.
- **Income tax** exemption for a period of three years. But most start-ups become profitable only after 3-5 years.
- **Fund of Funds** of Rs 10,000 crore will support startups but, this is very small amount
- **Credit Guarantee Fund to** catalyse entrepreneurship by providing credit to innovators.
- **Relaxed procurement norms** especially in the manufacturing sector. But the nexus that exists in government procurement needs to be broken.
- **Setting up of incubators and research parks** across different educational institutes which must treat everyone equally, should not give preference to their alumni.

However, to make this policy successful the government needs to focus on the following:

- Creating infrastructure across the country like connectivity through roads, rails, electricity.
- Technology must be deployed at every level for reducing corruption and faster service delivery.
- Reduce red-tape from the administration.
- Streamlining of labour laws and wage payment issues.

Student Notes:

5. ***Highlight the reasons for the importance attached to the MSME sector. In this context, enumerating the government schemes to promote this sector explain the role that the MSME sector can play in the success of the Make in India initiative.***

Approach:

- Attribute the importance of MSME to its share in production, exports and employment creation etc.
- Explain how MSME sector complements "Make in India" and how the various Government schemes promote the development of MSME.

Answer:

Importance of MSME in India

MSME sector in India employs 8.05 crore people, contributes 37.5% to India's GDP, 45% to the total manufacturing output and 40% to exports from country. The sector has huge potential to address problems like unemployment, regional imbalances, unequal distribution of income and wealth across the country.

MSME related schemes and impact on Make in India:

MSMEs are complementary to large industries as ancillary units and possess forward-backward linkages with other sectors (many of which are priority sectors under Make in India). A robust growth of this sector will therefore be crucial to the Make in India initiative. However the sector is mired by inadequate finance (especially in rural areas), low level of technology, low productivity and competitiveness etc. Improvement on these indicators will invariably give a boost to "Make in India".

Various initiatives by the government aim to address the same are listed below:

- **Providing more credit to MSME sector, especially in the rural areas**
  - **MUDRA:** credit linked scheme to facilitate participation of financial institutions for higher credit flow to micro sector.
  - **Prime Minister's Employment Generation Programme (PMEGP)** - credit flow scheme
  - ***Credit Guarantee Trust Fund for Micro and Small Enterprises (CGTMSE)*** – provision of collateral free loans
- **Promoting entrepreneurship**
  - **Employment Exchange for Industries**: To facilitate link between job seekers and employers.
  - **Micro and Small Enterprises Cluster Development Programme (MSECDP)** for establishment of new enterprises and development of existing ones.
  - **A scheme for Promoting Innovation and Rural Entrepreneurs (ASPIRE)**: setting up a network of technology centers and incubation
  - **Start-up India:** To promote entrepreneurship
- **Quality upgradation for world class competitiveness and leveraging technology**
  - **Credit Linked Capital Subsidy Scheme (CLCSS) for Technology Upgradation**-technology Upgradation of MSME.
- **Ensuring Ease of Doing Business**
  - **Udyog Aadhar Memorandum (UAM):** online entrepreneurs' memorandum to instantly get a unique Udyog Aadhaar Number (UAN) and get registered to avail various government benefits.
  - **Framework for Revival and Rehabilitation of MSME**-banks to constitute a Committee for Distressed MSME enterprises to prepare a Corrective Action Plan (CAP).
  - **Bankruptcy Code** for easy exit.

Student Notes:

- **Reform in labor laws.**
- **Increasing Productivity, enhancing competitiveness and skill development**
  - **Scheme of Fund for Regeneration of Traditional Industries (SFURTI)** - to organize the traditional industries and artisans into clusters to make them competitive and sustainable.
  - **PMKVY**: Giving industry linked skills to youth

The success of Make in India invariably depends on the growth of MSME sector in the country. The government has taken commendable steps, but it should focus on their effective implementation so that they can bear fruit and Make in India achieves its potential.

6. Successive governments have resorted to disinvestment of sick and loss-making PSUs. What, according to you, are the targets which the government seek to meet from this exercise? Also explain why the disinvestment targets have not been met in the past.

Approach:

- Explain the reasons why disinvestment is required and what are its objectives.
- Explain why the disinvestment targets have not been met .
- End with positive note like how to overcome this kind of crisis.

Answer:

Often protected from competition and subsidized by government, PSUs frequently suffer from low productivity, higher costs, inefficiency and non-competitiveness. To address these challenges government resorted to disinvestment with following objectives:

- Reduce financial burden on Government
- Improve public finances
- Introduce, competition and market discipline
- Create Fund for infrastructure growth (NIF)
- Encourage wider share of ownership
- Depoliticise non-essential services
- Up gradation of existing PSUs.

Initially only sick PSUs were to be disinvested but later others were also included but with a cap of 49% so that government remains majority stakeholder. As per Department of Disinvestment it was decided that 20 per cent of equity of PSUs will be disinvested incrementally and they will be sold to financial institutions, banks and employees etc.

However, the disinvestments did not succeed as expected because:

- People were not taken into confidence before disinvestment was started; therefore whole move was opposed by certain group of people and parties in opposition.
- 2006 CAG report found that the valuation of the companies' assets was done without "due seriousness". In several instances substantial "surplus land" was sold along with the company when they were privatised.
- The unfavourable market conditions were mainly responsible for this downward trend of disinvestment hence the receipt generated was sub-optimal.
- The amount realized through disinvestment was not paid to the enterprise concerned for its expansion and improving efficiency but the Government has been using such disinvestment proceeds to bridge the budget deficit.
- The Government was not transparent about its approach towards sequencing the restructuring and methods of disinvestment of PE‟s.

Student Notes:

- The offers made by the Government for disinvestment of PE‟s were not attractive and stringent bureaucratic procedures discourage the private sector interest.
- The Government had no clear cut policy on disinvestment of its PE‟s when the disinvestment process was started.
- Lack of consultation with the specialists.

In 2012, a government panel headed by Vijay Kelkar recommended monetizing surplus government land, which represents a huge opportunity cost, from port trusts, railways and PSUs as the ideal solution to India's urban problems in cities that are land-starved—allowing for civic infrastructure such as hospitals, schools and roads —besides the obvious benefits of unlocking huge revenue and betterment of the fiscal consolidation situation.

Recently government has transferred advising role of DIPAM on utilization of proceeds from disinvestment to Department of Economic Affairs (DEA). It has approved an alternative mechanism to decide modalities related to stake sales in PSUs, so as to speed up and streamline the process. Under this mechanism, the quantum of disinvestment in a PSU will be decided on a case-by-case basis subject to Government retaining 51% stake.

Student Notes:

INCLUSIVE GROWTH

Contents

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1. What is Inclusive Growth?

Globally there is no uniform definition of Inclusive Growth. Different agencies define it differently.

According to OECD '***Inclusive growth is an economic growth that "creates opportunity for all segments of the population and distributes the dividends of increased prosperity, both in monetary and non-monetary terms, fairly across society***".

The **UNDP** perspective on inclusive growth is **based both on outcome and process**. It implies that everyone should be able to participate in the growth process and the benefits should be shared equally. The UN Sustainable Development Goals (SDGs) do not directly mention inclusive growth, but some targets, if achieved, will help move towards inclusive growth. These include:

- **Goal 1**: Removal of poverty by half by 2030
- **Goal 2**: ending hunger by 2030
- **Goal 3**: reducing maternal mortality rates and infant mortality rates to fixed targets by 2030
- **Goal 4**: completely free, equitable and quality primary and secondary education to all girls and boys by 2030
- **Goal 4:** ensuring equal access for all women and men to affordable and quality technical, vocational and tertiary education, including university by 2030
- **Goal 8:** Sustained per capita economic growth and reduction of youth unemployment
- **Goal 9:** developing quality, reliable, sustainable and resilient infrastructure, promoting inclusive and sustainable industrialisation and, by 2030, significantly raise industry's share of employment and gross domestic product (GDP).

Thus, Inclusive Growth has various manifestations as per different definitions.

2. Dimensions of Inclusive Growth

Some of the broad dimensions which can be included in Inclusive Growth are depicted as follows-

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Based on the above dimension, some of its key features will include:

- **Rapid growth and poverty reduction**: It is an essential requirement to achieve inclusive growth since it is an instrument for achieving a steady increase in employment and incomes for large numbers of our people.
- **Access to essential services**: It also determines whether the person is poor or not because a person is poor not only because her endowments of capital, land, labour and skills are meager, but also because her access to public goods and services and natural resources is limited.
- **Employment opportunities**: The ability not only to generate adequate number of productive employment opportunities but also effective distribution of those opportunities across all segments of population is a major factor on which the inclusiveness of growth is judged.
- **Social Justice and Empowerment**: The vision of inclusiveness encompasses equality of opportunity, as well as economic and social mobility for all sections of society.
- **Environmental sustainability**: It includes a clear commitment to pursue a development process which is environmentally sustainable.
- **Recognition of women's agency**: It means integrating the needs and demand of the female gender for achieving gender justice in growth.
- **Good governance**: It implies improvement in governance in terms of not only efficiency and economy, but also effectiveness, equity, empowerment.

Thus, it can be said Inclusive Growth is that **pro-poor growth strategy** where the poor not only become the beneficiaries of the growth process but also contribute by participating in it.

3. Need of Inclusive Growth in India

Inclusive growth is important for India to **alleviate three main problems** that India is facing-

3.1. Poverty

Poverty is a state of deprivation, in which some people are not able to meet their basic needs. Although poverty rates have fallen drastically over the years, India still hosts the largest number of poor people in the world. One in five people in India live below the national poverty line of $1.90 per day, and more than half of the population lives on less than $3 a day.

Economic growth has not automatically resulted in inclusive growth. According to Joseph Stiglitz, despite long period of high growth, 14.5 percent of the population in the World in 2011 still faced poverty. It is a testimony that growth has not been all inclusive and policies have to go beyond just promoting growth.

Impact of economic reform on poverty in India-

There are two conclusions on trends in poverty:

- Poverty declined by 1.3 percentage points per annum after 1991, compared to that of 0.44 percentage points per annum prior to 1991. Among other things, urban growth is the most important contributor to the rapid reduction in poverty in the post-reform period.
- In the post-reform period, poverty declined faster in the 2000s than in the 1990s.

According to Tendulkar committee, around 138 million people were lifted above the poverty line during 2004 to 2009 alone. Rangarajan committee report also showed faster reduction in poverty during 2009- 10 to 2011-12. This indicates the success of reforms in reducing poverty.

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IMPACT OF COVID-19 ON POVERTY

India has an estimated 812 million poor people, which could increase to 915 million, due to the impact of COVID pandemic, as per the 'Estimates of the impact of COVID-19 on Poverty' report of United Nations University. This is based on the World Bank's poverty line for lower-middle-income countries which is $3.2 a day.

IMPACT

- **Largescale informal sector-** As per the International Labour Organization **(ILO)**, around **400 million workers** from India's informal sector are likely to be pushed deeper into poverty
- **Reduced sources of income-** due to following reasons-
  - Decline in income of self-employed, due to reduction of economic activity (sales, production) in micro and small enterprises due to fall in demand and disruptions in supply of inputs.
  - Decline in domestic remittances from urban migrants to their households in rural areas.
  - There is absence of adequate safety nets like savings and insurance cover. This might force the poor to indulge in activities like **sale of productive assets with long-lasting negative effects.**
- **Increase in out of pocket expenditure-** due to the following reasons-
  - The **poor in urban areas** are **highly vulnerable to disease** as they live in in congested settlements with low-quality services. This **impacts their ability to work** and also **invites health spending** due to illness, or the need to take care of sick household members.
  - The school closures can lead to a decline in food intake among children of **poor families who rely on government programs like Mid-Day Meal.**
- **Impact on economic demand-** The rise in unemployment and fall in incomes could lead to reduced spending and consumption. **Many people in agriculture sector would be affected** by falling prices due to decline in demand in urban areas over time.
- **Impact on poor women-** due to various added pressures in the COVID lockdown such as-
  - They face **increased burden due to demand of care of children and elderly**, as a result of school closures and their vulnerability to disease.
  - Women are more exposed to infection due to **larger share of women in healthcare sectors.** o Women face a **higher likelihood of domestic violence** during home confinement.

CHALLENGES

- **Uncertainty over the disease-** With 80% asymptomatic patients and lack of vaccination, the magnitude of the crisis at hand still remains uncertain for the government.
- **Constrained financial resources-** as public finances at both central and state levels have been under considerable strain. It makes it difficult for the government to put more cash in the hands of the distressed.
- **Issues with the public distribution system-** such as lack of documentation and its updating of the PDS beneficiaries.
  - **Implementation issues-** such as only 10% out of the total monthly allocation of 1.95 lakh metricton (LMT) pulses under the Pradhan Mantri Garib Kalyan Ann Yojana **(PMG-KAY)**, had been issued by the states till April 22.
- **Inadequate compensation-** Although the governments at Union and state have taken various steps, however, many experts state the relief packages in itself are inadequate.

STEPS TAKEN BY VARIOUS STATE GOVERNMENTS

- **Kerala-** Everyone in need, whether the below poverty line (BPL) or not, will get free rice. There will be **home delivery of mid-day meals** and the ASHA workers would ensure that **food reached its 26,000 children registered under ICDS.**
- **Haryana-** All BPL families received their monthly ration for April free of cost. All government school children and those enrolled in anganwadis were to be given dry rations.
- **Chhattisgarh-** Dry ration instead of hot-cooked meals were to be provided to children aged between three and six years and who were registered with anganwadi centres.
- **Bihar-** Provision of direct cash transfers **(DCTs)**, depositing funds to the bank accounts of ration card holders. It also decided to give 5 kg rice and 1 kg pulses for three months as lockdown relief.

One of the major issues with poverty measurements is that there is no unanimity on appropriate parameters among different scholars, as shown above. Poverty line mainly focuses

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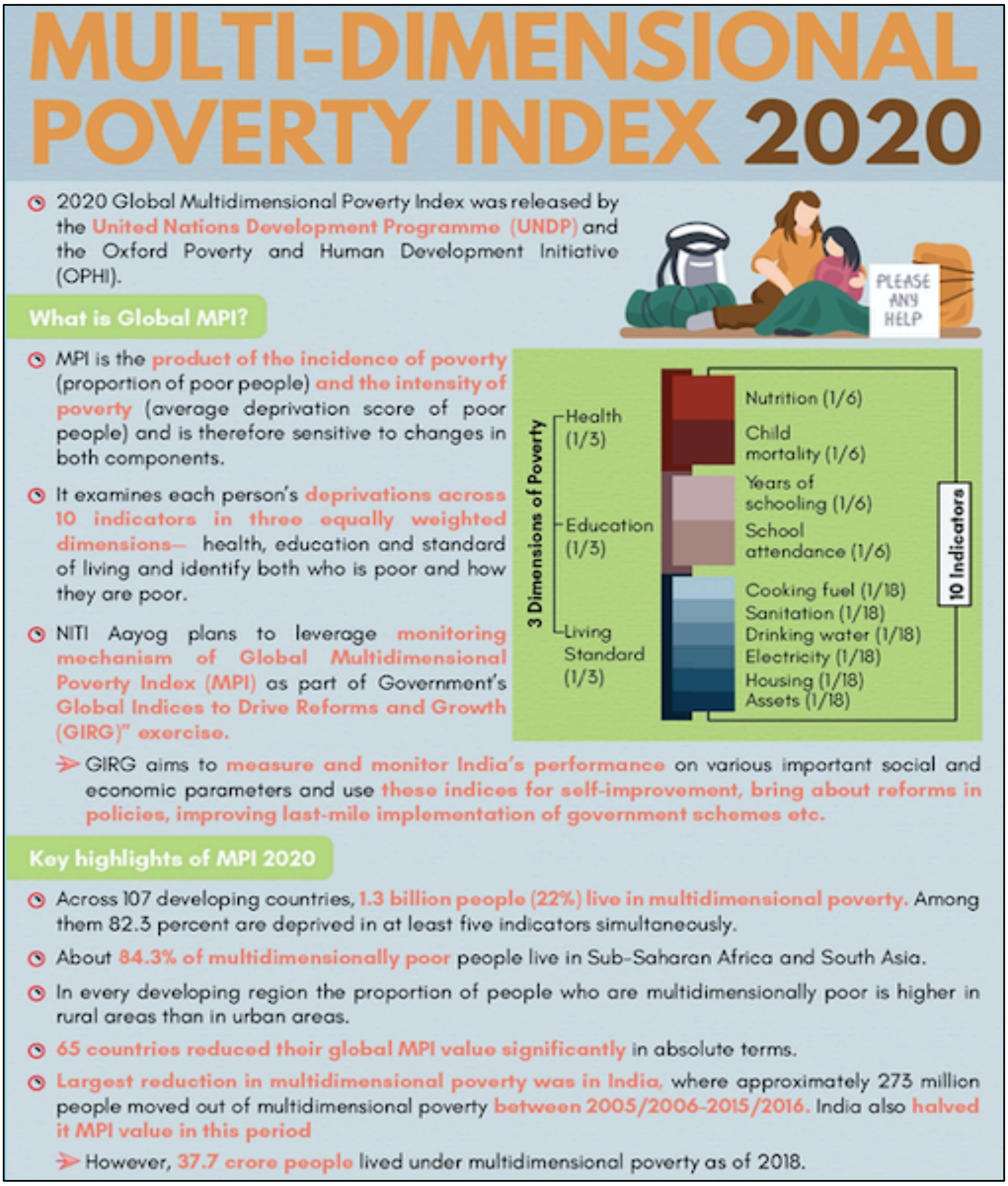
on economic criteria, whereas poverty may also have social, cultural, and political aspects, which are not addressed by the current approach.

For evaluating the effectiveness of poverty alleviation programs, we need to measure the extent of poverty, which is done using a poverty line. In India, Poverty line was determined by erstwhile Planning Commission based on consumption data provided by NSSO. However, what constitutes the representative basket of consumption is debatable and is decided differently by different committees.

(For more on this, refer to the document on Poverty in Social Justice)



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How is MPI better than other models?

- **Multidimensional approach:** MPI takes advantage of the availability of multipurpose household surveys which allows data on different dimensions to be drawn from the same survey. It identifies the people who experience overlapping deprivations.
- **Better Comparison:** MPI can show the composition of multidimensional poverty across different regions, ethnic groups or any other population sub-group, with useful implications for policy.
  - HPI could not identify which specific individuals, households or larger groups of people were poor.
- **Complement to income-based poverty measures:** Income poverty data come from different surveys, and these surveys often do not have information on health, nutrition etc.
  - People may be above the poverty line but still deprived of needs such as housing.

Limitations of MPI

- **Less sensitive:** To be considered multidimensionally poor, households must be deprived in at least six standard of living indicators or in three standard of living indicators and one health or education indicator. This requirement makes the MPI less sensitive to minor inaccuracies.
- **Unable to capture inequality:** While the MPI goes well beyond a headcount to include the intensity of poverty experienced, it does not measure inequality among the poor.
- **Unable to capture Intra-household inequalities:** Intra- household inequalities may be severe, but these could not be reflected precisely because there is no individual-level information for all the indicators.
- **Lack of availability of data:** There are limits to the cross-country comparability of the MPI. The estimates presented are based on publicly available data and not all countries have data on all indicators. Better and more frequent data on poverty is urgently required.

Recently, NITI AAYOG has proposed following options to arrive at a poverty line with due considerations from other stakeholders-

- Track progress over time of the bottom 30% of the population.
- Track progress along specific components of poverty such as nutrition, housing, drinking water, sanitation, electricity and connectivity.
- NITI Aayog is favouring for the Tendulkar line which set poverty ratio to 21.9 % as compared to Rangarajan committee which had a higher poverty ratio of 29.5%.
- To remove any criticism that many poor would be left behind if poverty line as per Tendulkar committee is adopted, NITI Aayog has underlined that it will only be used to track progress in combating poverty rather than identifying the poor for entitlements.
- SECC data as suggested by Saxena and Hashim committee will be used for entitlements.

3.2. Inequality

It has been pointed out in recent times that there has been a problem with redistribution of income in India as high economic growth is not reducing inequality. In fact, inequality has only increased in the past two and a half decades, lowering the effectiveness of growth to combat poverty and preventing the building of a substantial middle class.

Status of Inequality in India

- **Income Inequality**: India’s top 10% of the population holds 74.3% of the total national wealth. India's richest 1% of the population hold 42.5% of national wealth while the bottom 50%, the majority of the population, owns a mere 2.8%
- **Wealth Inequality**: Wealth inequality in India is rising with the Gini wealth coefficient having risen to 83.2% in 2019 from 81.2% in 2008. The wealth of the top 1% increased by 46% in 2018 while the bottom 50% saw wealth increase at just 3%.1
- **Social Inequality**: In India, one of the most distinctive forms of social inequity come within the spheres of gender and caste, where, people coming from the marginalized sections of these social categories, are directly impacted in terms of their opportunities, access to livelihood, education and health facilities.

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- For example: In India, poor women and girls put in ₹19 trillion of unpaid care work every year. The unequal distribution of unpaid care work, effectively, allows men to participate in the labour market while limiting a woman's capacity to do the same.
- A **new generation of inequalities is emerging**, with divergence in enhanced capabilities. For instance, access to more advanced knowledge and technology are widening. o E.g. the proportion of the adult population with tertiary education is growing more than six times faster in very high human development countries than in low human development countries, and fixed broadband subscriptions are growing 15 times faster.

What are the consequences of these Inequalities?

- **Low social mobility and slower poverty reduction**: Extreme inequality inhibits social mobility which means that children of poor parents will stay poor. It results in inequality in opportunities due to lack of proper education, training in skills, lack of connections and assets.
- **Social unrest**, as high inequality is likely to undermine democracy, promote corruption and cronyism. The gap between rich and poor is helping to fuel authoritarianism.
- **Inequality and the climate crisis are interwoven**. E.g.
  - Developing countries and poor communities have less capacity than their richer counterparts to adapt to climate change and severe weather events.
  - Also, High income inequality within countries can hinder the diffusion of new environmentally friendly technology.
  - Inequality can also influence the balance of power among those arguing for and against curbing carbon emissions.
- Income and wealth inequalities are often translated into political inequality and power asymmetries among various groups (which may be defined by ethnicity, language, gender or caste etc.) potentially leading to even more inequalities and even lead to breakdowns in institutional functions, weakening the effectiveness of policies.

In this context, there is a need for broadening access to health, education and promoting financial inclusion as well as reducing the inequality of opportunities to bring down overall inequality levels.

3.3. Unemployment

According to the Labour Ministry, the rate of unemployment grew steadily from **3.8% in 2011-12 to 5% in 2015-16**. It has stayed consistently **around 5% in last five years**. Most of the labour force in India is engaged in low-paying jobs due to the absence of alternatives, resulting into "disguised unemployment" or "underemployment". In general, the government focuses on rapid growth for reducing unemployment, but the generation of employment requires growth in labour-intensive sectors. Thus, higher Gross Domestic Product growth may come from better performance of the services sector, which does not end up creating adequate jobs. Far from jobs being created, employment actually contracted by 0.1% in 2015-16.

As per some experts, **under-employment rather than unemployment** is the key problem facing India today. Underemployment is a measure of employment and labor utilization in the economy. It exists when employed do not attain full employment potential, i.e., they are working in a low paying or low skilled job as compared to skills possessed by them. According to Niti Aayog's three-year action agenda, rather than unemployment severe under-employment is the key problem facing India. As evident by NSSO survey, in 2011-12, 49%of work force was employed in agriculture, but sector contributed only 17%to India's GDP at current prices.

Thus, contrary to some assertions that **India's growth has been "jobless"**, NSSO data have consistently reported low and stable rates of unemployment over more than three decades. Underemployment remains a severe problem due to following reasons:

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- **Social factors**: Such as over-population and societal pressure to get a job force people to take a job below their skill levels.
- **Techno-economical**: Economic advancements and technological changes cause entry level jobs replaced by machines and technology, causing existing skill set to become obsolete.
- **Low utilisation of human capital**: Lack of high productivity job results in productive capacity of employed population underutilized.
- **No timely up gradation of skills** with on the job training coupled with instances of double training where in productive time and resources are channelised in an undesired direction.
- **Quality of life**: Underemployment widens gap between expectation and actual standard of living.
- **Civil unrest and violence**: Various violent incidents witnessed in Haryana, Maharashtra are not just due to unemployment but underemployment as well.
- **Promote mediocrity**: Lack of access to good jobs also dis-incentivize people from acquiring advanced skills, thus, hurting country's innovation potential.
- **Other issues**: Brain drain to developed countries, low self-esteem, low motivation for job profile in hand, various emotional problems leading to aggravated stress and diseases such as hypertension, depression etc.

Hence, the need is creation of high-productivity and high-wage jobs.

4. Challenges to Inclusive Growth in India

Various governments have tried to dealth with the issues of poverty, inequality and unemployment. However, following structural economic and social challenges have hindered the progress towards Inclusive Growth in India. These include-

- **Slow economic growth:** Since the financial crisis of 2008-09, the global economy has not fully recovered from the recession. This is reflected in growing jobs deficits (both the quantity and quality of new jobs) in many countries, including India.
- **Wealth concentration:** Studies by ILO and other organization have shown that declining share of total GDP that goes to working people through their pay checks.
- **Changing labour market:** The new 'disruptive' technology and new global digital infrastructure has changed the face of 'work'. Many existing jobs are vanishing and new ones are emerging. According to a report by Raghuram Rajan (2018), there is need to move from routine and less productive work like agriculture and low productive industry and services and seize the opportunity in other spaces in areas of exports, tech start-ups in India.
- **Automation:** Robotics and automation will make worker's skill obsolete at much faster rate. It is estimated that between 400 million to 800 million individuals could be displaced by automation and need to find new jobs by 2030 around the world.
- **Corruption:** The country remains shackled in corruption, red tape, age old social barriers and a puzzling lack of transparency. Tackling corruption in high places, removing the ills of the electoral system, shunning politics of agitations and keeping national interest above petty politics should be the major goals of country's policy makers.
- **Smaller Incomes**: While unemployment is under control in India, smaller incomes have resulted in a higher dominance of working poor, lower share of skilled workforce and lack of old-age security.
- **Education**: In terms of Education, inequality in India is more than that in the South Asian region and the world. Indian girls attend school for a shorter period than the regional average.
- **Informalization of labour:** More than 90% of the jobs are in the informal sectors. In the informal sector, workers are effectively excluded from accessing many of the resources they need to make themselves more productive and thereby improve their life chances.

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- **Unequal Women Participation**: Inequality in participation of women in the workforce is another issue. According to McKinsey Report 2015, if women play identical role in the labour market $28 trillion, or 26 per cent, could be added to global annual GDP by 2025. The report said that in Indian case, there would be 60 per cent increase in GDP by 2025.
- **Dependency on Agriculture-** The agriculture sector employs close to half the labour force in the country but generates the **lowest per capita output** (and hence is associated with the highest levels of poverty). It is clear that if there is to be **inclusive growth in India**, it has to begin in the agricultural sector. Statistics show that the smaller the landholding of a farmer is, slower is the income growth. As far as land ownership is concerned, the opposite of inclusive growth—a **regressive growth**—had taken place for agriculture.

If the above challenges are addressed, Inclusive Growth can also lead the Human Capital Formation in India which can bring multi-fold returns.

5. Inclusive Growth and Human Capital Formation in India

Human Capital is a term introduced by Theodore Schultz in 1960s to quantify the economic value of a worker's skill sets. It recognizes the fact that all labor is not equal and quality of employees/humans can be improved by investing in them through education, on-job training, increasing its ability through investment in health, spreading awareness, etc.

Human capital is a key factor for growth, development and competitiveness of an economy. Like physical capital, the value of human capital also depreciates. Long period of unemployment, mental decline, inability to cope up with innovations, etc. are some of the few reasons for depreciation in human capital. It also has mobility associated with it i.e. it can migrate and can cause brain-drain from the region of emigration.

Role of human capital in economic development:

- **Increases productivity**: It promotes innovations and creativity; creates ability to absorb new technologies for optimum utilization of natural resources.
- Higher levels of human capital **lead to higher employment rates**. This increases income levels and help reduce income inequality.
- **Brings positive outlook to society**: helps overcome regressive thinking, thereby increasing the rate of participation of the workforce, example: promotion of gender inclusive employment.

Challenges to human capital formation in India:

- **Education**: There is a large gap between the educational entitlements of the rich vis. a vis. the poor. The poor find it challenging to spend on education and invest in human capital and are thereby likely to get trapped in a cycle of poverty. In this context, arises the need for greater public investment in providing basic education as well as enhancing incentives for boosting school attendance from the demand side, including cash transfers conditional on school attendance (used successfully in Latin America including Brazil).
- **Health**: There is also a significant gap in the access to healthcare between high- and low-income households. This inequality of opportunity and access can worsen health outcomes, hampering productivity and perpetuating income inequality.
- **Financial Services:** The lack of adequate financial services constrains the ability of people, particularly low-income individuals, to borrow for investment purposes and to finance education spending. It can thereby create and perpetuate income inequality. In view of the large disparities in financial access across the income distribution, it is imperative to broaden access to financial services as financial inclusion is an important factor in promoting equality.
- **Low public expenditure** on health, education and skill development
- Rising population reduces **per head availability** of the existing social and economic infrastructure.

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- High level of **poverty and regional inequality** denies a large population access to basic amenities.
- Increasing gender gap hampers equal opportunity and reduces labour productivity
- Brain drain slows down the human capital formation in the domestic economy.
- The process of skill formation is long term, hence slow.
- Insufficient on the **job training** to absorb emerging new technologies.

Opportunities for human capital formation in India:

- **Demographic dividend** - 65% of India‟s population is below the age of 35 years and the working age population (15-64 years) is over 25%.
- A large **english-speaking population** and a strong IT base may be harnessed for further skill development (For example SWAYAM platform for e-learning))
- Global and **technological interconnectedness** providing for broad opportunities for skill development and training.
- Provision of **Constitutional and socio-legal rights** to provide a support base for improvement of health and social status in India.
- NITI Aayog's **Sustainable Action for Transforming Human Capital in Education** (SATH-E) Roadmaps 2018-2020 to improve learning outcomes.

Currently, India ranks 103 out of 130 countries in World Economic Forum‟s Global Human Capital Index, 2017. As a way forward, steps should be taken in domains of skill development, social security, health and education among others. Initiatives like National Institutional Ranking Framework (NIRF), grading of ITIs, Takshashila (Trainers and Assessors Portal) etc. will go a long way in enhancing the human capital in India. If India has to reap its demographic dividend, it has to develop its Human Capital effectively.

6. Some sectoral steps taken for Inclusive Growth

- **Education and Skill Development-** Apart from the recent **New Educational Policy**, the government has taken various steps in the domains of skill development like **Pradhan Mantri Kaushal Vikas Yojana.**
- **Health- Ayushman Bharat**, the National Health Protection Scheme, has been proposed in the Union budget 2018-19 which is expected to cover over 10 crore poor and vulnerable families providing coverage upto 5 lakh rupees per family per year for secondary and tertiary care hospitalization.
- **Social Security-** Several initiatives have been taken up by the Government of India to eliminate poverty, inequality and to empower the marginalized sections of the society by expanding the social security net through
  - **Pradhan Mantri Suraksha Bima Yojana (Accident Insurance)**
  - **Atal Pension Yojana (Unorganized Sector)**
  - **Pradhan Mantri Jeevan Jyoti Yojana (Life Insurance)**
  - And institutional support for entrepreneurship with the help of **MUDRA Bank** to provide microfinance to entrepreneurs in rural hinterland of India and
  - A **national Hub for SC/ST entrepreneurs** has been created to support the entrepreneurs belonging to the marginalized communities.
- **Financial Inclusion-** Apart from providing the social security net and institutional credit support to the marginalized sections of the society, the **Prime Mantri Jan Dhan Yojana** is operational that strives to achieve financial inclusion by ensuring that the economically weaker sections have access to bank accounts. According to Economic Survey 2017-18, **utmost priority to social infrastructure like education, health and social protection is being given by the Government to engineer an inclusive and sustainable growth in India.**
- **Employment Generation-** Various schemes are being implemented by the Government in both rural and urban areas of the country which aim to create directly and indirectly

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additional employment opportunities to reap the benefits of the demographic dividend. They include:
- **Mahatma Gandhi National Rural Employment Guarantee Act Scheme (MGNREGA)**
- **Prime Minister's Employment Generation Programme (PMEGP)**
- **Pradhan Mantri Rojgar Protsahan Yojana**
- **Pt. Deen Dayal Upadhyaya Grameen Kaushalya Yojana (DDU-GKY)**
- **Deendayal Antyodaya Yojana- National Urban Livelihoods Mission (DAY-NULM)**

- **Agriculture-** Given this state of affairs in **Indian Agriculture**, the government has decided to set a target of '**doubling of farmers' income by the year 2022**'. Parallelly, the Government is aiming to reorient agriculture sector by focusing on income centeredness. In order to realize net positive returns for the farmer, various schemes have been launched including the **Soil Health Card (SHC) scheme, Pradhan Mantri Krishi Sinchayee Yojana (PMKSY)** etc.
- **Infrastructure-** The government has launched scheme for **affordable housing** apart from various projects like **Bharat Net** for internet connectivity, **DDU Gram Jyoti Yojana** for power connectivity among others.

The biometric-based unique identification system, **Aadhaar**, now ensures that the poor are no longer invisible and, therefore, more empowered. A bank account for every adult now ensures **universal access to financial services**. When combined with Aadhaar, such access will accelerate financial inclusion.

7. Miscellaneous strategies to achieve Inclusive Growth

7.1. Universal Basic Income

Universal Basic Income is a periodic cash payment unconditionally delivered to all irrespective of their contribution to the economy. It **characterises** the basic income in five divisions:

- **Periodic** (being paid at regular intervals, not lump sum)
- **Cash payment** (not in kind or vouchers, leaving it on the recipient to spend it as they like).
- **Individual** (not to households or families),
- **Universal** (for all), and
- **Unconditional** (irrespective of income or prospects of job)

Recently, Sikkim has proposed implementation of UBI by 2022.

Advantages of Universal Basic Income over other social protection schemes

- **Will reduce administrative burden:** There are about 950 central sector and centrally sponsored sub- schemes which accounted for 5% of GDP by Budget allocation. Implementing such a range of scheme needs extensive administrative network.
- **Easy to implement:** Targeted welfare schemes such as ICDS and PDS need extensive groundwork to identify beneficiaries and auditing to prevent leakages. However, an across-the-board basic pay would be simpler to deliver and monitor.
- **Individual Liberty**: It gives 'Choice over current entitlement' (Economic Survey 2016-17). It promotes equality by reducing poverty, promotes efficiency by reducing waste in government transfers.
- **Increased productivity**: A 2011 study by UNICEF and SEWA in rural Madhya Pradesh showed that people become more productive when they get a basic income. While schemes like MGNREGA have come under scanner for failing to provide productive employment.
- **Credit Culture and freedom of occupation**: Unlike farm waiver schemes, UBI does not impair credit culture and does not tie-down people to certain occupation (farming in case of farm related transfers).

Student Notes:

- Compared to a farmer-centric scheme, universal basic income holds **greater appeal as it does not discriminate based on occupation** or land ownership and does not depend on accuracy of targeting to work.

However, there are several challenges when it comes to implementing UBI, such as-

- **Fiscal Burden**: Estimates suggest that poverty line equivalent UBI in India would cost about 11.4 % of the GDP.
- **Conspicuous spending**: Households may spend this additional income on wasteful activities or on temptation goods like alcohol, tobacco.
- **Moral hazard**: A minimum guaranteed income might make people lazy and opt out of the labour market.
- **Gender disparity induced by cash**: Men are likely to exercise control over spending of the UBI which may not always be the case with other in-kind transfers.

- **Fiscal cost given political economy of exit**: Given the large population size, the fiscal burden on government would be high. Also, once introduced, it may become difficult for the government to wind up a UBI in case of failure.
- **Political economy of universality ideas for self-exclusion:** Opposition may arise from the provision of the transfer to rich individuals as it might seem to trump the idea of equity and state welfare for the poor.

Universal Basic Income vs Targeted Transfer Scheme

Targeted Schemes

- The evidence from Indonesia and Peru shows that existing targeting methods in developing countries, while imperfect, appear to deliver substantial improvements in welfare compared to universal programs, because they can transfer much more on a per-beneficiary basis to the poor as compared with universal programs.
- The primary downside of these programs is exclusion error – because targeting is imperfect, there will be a substantial number of poor households who are excluded.

Improving the method of targeting

- **Community-Based Targeting Process**: fixed number of program slots are allocated to a given community, and through a participatory meeting they decide who among them is most in need. It leads to more transparency, and better inclusion. To better institutionalized it, local bodies should be strengthened, and people should be made aware of using social auditing tools.
- **Use of technology:** cash transfers at an accelerated pace with the use of Jan-Dhan, Aadhaar and mobile would lead to better targeting and operational efficiency. This will help reduce costs and spare resources for capital spending to augment growth.
- **Conditional Transfers**: programs with explicit conditions that beneficiaries must meet in order to receive assistance. For example, giving cash transfers to poor households who also meet basic maternal and child health and education conditions. A number of randomized trials of these programs showed that these programs led to substantial improvements on the conditioned indicators.

Conclusion- The gains or leakages from welfare schemes ultimately depend on the precision of the targeting mechanism. Regardless of whether India moves towards a quasi-universal Universal Basic Income or continues with targeted programs, better targeting can certainly sharpen the impact of government expenditures on welfare programmes.

UBI, when carefully analyzed and successfully implemented, can have many potential benefits. Therefore, UBI is a powerful idea, whose time even if not ripe for implementation, is ripe for serious discussion.

7.2. Skill Development

According to NSSO Report 2011-12, India's formally trained workforce stand at merely 2.3% in comparison to economies like South Korea which are at a mammoth share of 96%.

Student Notes:

According to Periodic Labour Force Survey (PLFS) 2017-18, only 1.8% of the population reported receiving formal vocational/technical training. 5.6% reported receiving informal vocational training (such as hereditary, self-learning, and on the job training). The bulk of the trainees were in the fields of electronics, IT/ ITeS sector, apparels, and mechanical engineering. Moreover, around 33% of the formally trained youth was unemployed in 2017-18. Nearly a third of trained young men and more than a third of trained young women were unemployed.

Issues with Skill Development in India

- **Poor accreditation process**- The Quality Council of India (QCI) has often compromised with the quality of accreditation and affiliation process.
  - For e.g.- It had not followed the prescribed National Council for Vocational Training norms with respect to building infrastructure, equipment, and faculty.
- **Multiplicity of norms, procedures, curricula, certification**- Policies and initiatives related to skill development are spread across nearly 20 ministries and hence lacks coherency and holistic approach.
- **Reluctance of the industry** in providing a wage differential for skilled workers, leading to low absorption of skilled manpower.
- **Poor Industry interface**- For instance, there are too many sector skill councils (industry bodies mandated to ensure that skill development efforts are in accordance with the actual needs of the industry), each trying to maximise their business. Also, there is no of credible assessment board to uphold the accountability of these sector skill councils
- **Lack of integration with formal education** and lack of focus on outcomes.

Flagship Schemes

Initiatives	Objectives
Pradhan Mantri Kaushal Vikas Yojana	Mobilize youth to take up industry relevant skill training. Targets to train 1 crore youth by 2020. **Recognizes and certifies prior learning** PMKVY version 2 has **mandatory provisions for placement tracking**.
Pradhan Mantri Kaushal Kendra (PMKK), 2015	Aspirational Model Training Centers to be opened in every district.
National Apprenticeship Promotion Scheme, 2016	To promote apprenticeship. Consists of Basic Training and On-the-Job Training/ Practical Training at workplace.
SANKALP, 2017	**Creating convergence** among all skill training activities, improving quality of skill development programmes, creating industry led and demand driven skill training capacity.
STRIVE, 2017	Creating awareness through industry clusters, integrating and enhancing delivery quality of ITIs.

7.3. Increasing Insurance coverage

India's insurance gap has widened despite deeper penetration according to report "A world at risk- Closing the insurance gap" by Lloyd's of London.

Insurance Sector in India

- In India, the **insurance gap** has widened from $19.7 billion in 2012 to $27 billion in 2018, even though non-life insurance penetration has improved marginally from 0.7 per cent of Gross Domestic Product (GDP) in 2012 to 0.9 per cent as of 2018.
- India currently accounts for less than 1.5 per cent of the world's total insurance premiums and about 2 per cent of the world's life insurance premiums despite being the second most populous nation.
- India's life insurance sector is the biggest in the world with about 360 million policies which are expected to increase at a Compound Annual Growth Rate (CAGR) of 12-15 per cent over the next five years.
- The insurance industry plans to hike penetration levels to five per cent by 2020. ? India had also increased FDI limit to 49 per cent from 26 per cent in insurance sector to increase the investments in insurance.

Student Notes:

Role of Insurance

- **Provide safety and security**: Insurance provide financial support and reduce uncertainties in business and human life. Insurance facilitates spreading of risk from the insured to the insurer
- **Generates financial resources**: It generate funds by collecting premium which are further invested in government securities and stock. It also helps in providing Employment opportunities leading to capital formation.
- **Promotes economic growth**: It generates significant impact on the economy by mobilizing domestic savings. It provides capital into productive investments especially for long-term investment needs. It enables to mitigate loss, financial stability and promotes trade and commerce activities those results into economic growth and development.
- **Spread of financial services in rural areas**: IRDA Regulations provide certain minimum business to be done in rural areas, in the socially weaker sections

Challenges in Insurance Sector

- **Low Awareness**: A large majority of people in India believe that health insurance is not a worthy investment and therefore, avoid buying such insurance products.
- **Poor Distribution:** Distribution outside large cities is poor. There are large parts of the country where access to general insurance is limited. The reason insurers and distributors do not build a presence in small towns is that it is unviable.
- **Fewer product innovations**: While many essential products to mitigate risk are available, there are gaps in the insurance product portfolio that leaves large risks uninsured.
- **Pricing**: Insurers have been focusing on growing sales even if that creates a distortion in pricing for individuals.
- **Perception by influencers**: Another major challenge is posed by the media and influencers. Often, the life insurance industry is portrayed in a negative manner and hence the consumers become skeptical of the life insurance industry.

Govt's Initiatives for Insurance

- **National Health Protection Scheme** launched under Ayushman Bharat to provide coverage of up to Rs 500,000 to more than 100 million vulnerable families for secondary and tertiary care hospitalization.
- **Pradhan Mantri Jeevan Jyoti Bima Yojana** (PMJJBY) and Pradhan Mantri Suraksha Bima Yojana (PMSBY) to cover all poor households will bring the security of insurance benefits to the marginalised sections, giving basic economic protection in cases of death or injury through accidents of a family member.
- **Prime Minister Jan Dhan Yojana** (PMJDY) proposes to bring 60-crore basic accounts within its fold and providing services of micro insurance and unorganised sector pension schemes through these accounts, which will further bolster the economic security of lower income groups.
- **Pradhan Mantri Fasal Bima Yojana** (PMFBY) provides crop insurance to farmers against any losses to their crops

Way forward

- **Promote Awareness**: It is necessary to promote more awareness among public about benefits of insurance through videos, social media, ads, organizing campaigns etc.
- **Multiple Channels of Distribution**: Linking insurance with allied finance products like housing loan, mutual fund investment, banks credit cards etc are the new channels for life insurance.
- **Huge Untapped Market**: The demographics and macro-economic factors in India are diverse and insurance systems have to be aligned to other programmes in the country in order to target every section.

Student Notes:

- **Better regulation**: Regulatory policies can be made to ensure that insurance companies focus more on insurance targets than profitability.
- **Use of Technology**: Stakeholders will have to leverage Internet and other technology options to provide single window service so as to cross-sell and retain customers.

7.4. Transformation of Aspirational Districts

Transformation of Aspirational Districts (TAD) programme aims to quickly and effectively transform the chosen 115 districts (at least one from 28 states, excluding Goa). NITI Aayog will anchor this programme, along with the States as the main drivers.

- The broad contours of the programme are:
  - **Convergence** – of Central and State Schemes.
  - **Collaboration** – of Central, State level 'Prabhari' Officers and District Collectors, and
  - **Competition** – among districts based on the real time data and driven by a Mass Movement.
- It will focus on the strength of each district, identifying low-hanging fruits for immediate improvement, measuring progress, and ranking districts
- One of the main elements of the strategy is to identify selected Key Performance Indicators (KPIs), monitor the progress made in these indicators and carry out annual ranking on the incremental progress made. The KPIs chosen are to be district specific (see graphic)
- Central and State Government Officers will be appointed at the level of Additional/Joint Secretary as the "Prabhari" and Nodal Officers, to act as a bridge between the Centre, the state and the district
- A district level team would prepare a baseline report of the current status of different indicators and based on the resources available, would also prepare year-wise targets
- The central representatives would be visiting the district at least once in two months and prepare a report for NITI Aayog, which after analysing it would place the findings for consideration to the Empowered Committee of Secretaries.

7.5. Strategy on Resource Efficiency

NITI Aayog in collaboration with the European Union delegation to India released the Strategy on Resource Efficiency (RE). Various countries have taken relavant steps and pioneered in RE highlighting the need for similar steps to be taken by India, for example German Resource Efficiency Programme (ProgRess), and European Commission's Roadmap to a Resource Efficient Europe.

- MoEFCC and Indian Resource Panel (InRP) (in April 2017), launched the **Indian Resource Efficiency Programme** (IREP) to make resource use economically and environmentally sustainable
- IREP recommended the development of Strategy on Resource Efficiency for enhancing resource-use efficiency in Indian economy and industry.
- Since a single universally applicable indicator does not exist, the strategy recommends India to use **GDP per Domestic Material Consumption** for measuring RE in the initial phase
- The strategy focuses on **abiotic material resources** (excluding fossil fuels) of two strategic sectors: Construction & Mobility (these sectors have witnessed high growth rate, are biggest consumers of materials, contribute significantly to GDP and employment in the country)
- In 2010, **India's material demand** was the third largest in the world, after China and the United States. India consumed about 7.2% of globally extracted raw materials in that year.
- Consumption patterns remain highly differentiated in India with an urgent need to reconcile the oversupply of resources and materials to the upper and middle classes and an undersupply along with severe lack of access of basic minimum resources for the poor.

Student Notes:

Thus, concerns over larger economic, social, political and environmental consequences like resource depletion, price shocks and rapid degradation of natural resource base have emerged which calls for a judicious use of resources urgently. The SDG 12 (Responsible consumption and production) also recognizes the potential of resource efficiency in resolving the short-term trade-offs between growth and environmental sustainability towards enhancing the overall security of human beings.

7.6. Hill Area Development Program

HADP has been launched on pilot basis in the hilly districts of Manipur, and would be expanded over other states of the Northeast. The basis for selection of the districts for this programme is the Composite District Infrastructure Index – by discovery of the districts that have fallen behind in terms of development

Such a dedicated programme is designed due to the distinct geophysical nature of the Northeast States – to ensure development based on dedicated research and deliberation. The approach of the Government is twofold:

- To ensure equitable development of every area, every section of society and every tribe living in the North Eastern Region and;
- To bring the eight North Eastern Region States at par with the more developed states in the rest of India.

Special focus on hill areas has been part of the planning since the Fifth Five Year Plan, when the HADP and the Western Development Programme were first launched. Such programmes are being implemented in various forms and dimensions since then.

7.7. Island Development Authority

Island Development Authority was constituted in June 2017 for the holistic development of islands. It is chaired by Union Home minister and includes secretaries of various ministries.

- IDA had identified 10 islands for development which include five among the Andaman and Nicobar Islands (i.e. Smith, Ross, Long, Avis and Little Andaman) and five in Lakshadweep (i.e. Minicoy, Bangaram, Thinnakara, Cheriyam, Suheli)
- Projects will be undertaken after giving due consideration to unique maritime and territorial bio-diversity of the islands

Further development of tuna fishing industry and community-based tourism to boost livelihood options and building a sustainable approach for thriving maritime economy of project islands is also envisaged.

Student Notes:

7.8. Social Stock Exchange

SOCIAL STOCK EXCHANGES (SSE)

Social Stock Exchange (SSE) is an **electronic fundraising platform** that allows investors to buy shares in a **social enterprise** that has been vetted by the exchange

- Social **enterprises include is a revenue-generating business** whose primary objective is to achieve a social objective, for example, providing healthcare or clean energy.
- Idea of a SSE for **listing of social enterprise and voluntary organisations** for raising capital as equity, debt or like a mutual fund was **mooted in the Union Budget 2019-20.**
- **Later, SEBI constituted panel** to suggest norms for SSEs.
- The most prominent SSEs in the world are in **UK, Canada, USA, South Africa, Singapore and Mauritius.**

Benefits of Social Stock Exchange (SSE)

- This will **unlock funds** from donors, philanthropic foundations, Corporate Social Responsibility (CSR) spenders and impact investors **for social development.** As per Brookings India, **currently only 57% of the social enterprises** have access to debt and equity, which is barrier to growth and sustainability.
- Listing of social enterprises on an SSE **would also improve visibility of social enterprises** in the eyes of large investors and philanthropic organisations. Also, SSEs will **provide investors a better understanding of social sector** for routing their investment.
- **Banks, NBFCs and other investors can also raise capital from SSE** to participate in the growth journey of the social enterprises and thereby deepen their impact.
- SSE will help to **improve essential social services and important social sectors like education, health, agriculture and clean energy** by channelling greater capital to them.
- SSE is expected to **unlock large pools of social capital,** and encourage blended finance structures so that conventional capital can partner with social capital to address the urgent challenges of COVID-19.

Challenges in setting up SSE

- There is **no consensus about what is and isn't a social enterprise.** Prof Muhammad Yunus definition of social business can be adopted which who defined it as "a non-loss, non-dividend paying company which is created and designed to address a social problem."
- **Valuing social initiatives,** welfare and non-profits organisations is difficult, because there is no set benchmark, no uniform structures to set minimum thresholds to enable their listing.
- Apart from equity capital, social enterprises need debt particularly to meet working capital requirements, but **only handful of private impact investors provide debt to early-stage social enterprises.**
- India has **more than 2 million social enterprises** (non-profits, for-profits and hybrid model), which needs careful planning while designing a social stock exchange.

Way forward

- **Social impact assessment** can be adopted as way to **assess social initiatives,** welfare and non-profits organisations.
- **Bringing policy and regulatory reforms** to support investors and facilitating research and development for small social enterprises.
- **Educating market participants** about the valuation metrics weighing both on social and financial returns.
- **Transparency and accountability** can be achieved by online platform, similar to **NITI Aayog's Darpan portal,** which provides platform for interface between Voluntary organisations/ NGOs and Government Ministries.

7.9. Corporate Social Responsibility

CSR is a concept that suggests that it is the responsibility of the corporations operating within society to contribute towards economic, social and environmental development that creates positive impact on society at large.

Student Notes:

Primary objective of CSR: To promote responsible and sustainable business philosophy at a broad level and encourage companies to come up with innovative ideas and robust management systems.

The Companies Act, 2013 is a landmark legislation that made India the first country to mandate and quantify CSR expenditure. The inclusion of CSR is an attempt by the government to engage the businesses with the national development agenda.

Section 135 of the Act lays down rules for CSR activity in India. o It mandates that every company, private limited or public limited, which either has a net worth of Rs 500 crore or a turnover of Rs 1,000 crore or net profit of Rs 5 crore, needs to spend at least 2% of its average net profit for the immediately preceding three financial years on CSR activities.

The CSR activities in India should not be undertaken in the normal course of business and must be with respect to any of the 17 activities of CSR mentioned in Schedule VII of the act.

Recently, the report of a High-Level Committee (HLC) on Corporate Social Responsibility, set up under Injeti Srinivas in 2018 to review the existing framework submitted its report. Findings of the HLC include-

- **CSR expenditure by companies**: The total CSR expenditure by companies has increased substantially by 44% from the year 2014-15 to 2015-16 and thereafter marginally declined in the year 2016-17. It has further dipped by 6.9% in the year 2017-18.
- **CSR compliance**: The compliance percent has decreased from 72% in 2016- 17 to 57% in 2017-18. Some of the major reasons reported for underspending the prescribed amount on CSR are:
    - Problems in identifying a suitable project,
    - Selection of suitable implementing agency
    - Multi-year projects, etc.
- **CSR expenditure across areas or subjects:** Out of the total expenditure on CSR activities, the projects related to education and health have received maximum CSR funds almost every year post 2014-15 followed by projects related to rural development.
- **Contribution to Central Government funds:** At present, CSR funds can be contributed to PM National Relief Fund, Swachh Bharat Kosh, Clean Ganga Fund and any other fund set up by Central Government. The contributions to these funds have been in small proportion (approx. 5.6%) of the total CSR expenditures for the years 2014-15 to 2017-18.
- **Local area spending & Geographical disparity in CSR:** A major share of the total CSR fund available in a particular year is getting distributed in a few states, mainly due to the location of the Companies.
    - A state-wise analysis of CSR expenditure reveals that the states like Maharashtra, Karnataka, Andhra Pradesh, Gujarat, Tamil Nadu and Delhi have received approximately 40 % of the total expenditure on CSR, whereas States like Jharkhand, Bihar, Chhattisgarh and Uttar Pradesh are receiving only 9% of the total expenditure towards CSR.
    - The North East Region and areas affected by Left wing extremism are receiving a miniscule proportion of the total CSR expenditure.

Student Notes:

Key Recommendations of the HLC-2018

Applicability of the CSR Provisions:	**Provisions of CSR need to be applicable across all business entities and there should be a level playing field.**
CSR Activities in Local Areas:	The emphasis on local area in the Act should not be treated mandatory in nature. Companies should engage in CSR activities by balancing local area preference with national priorities.
Schedule VII of the Act	It should be mapped and aligned largely with SDGs and some important items such as senior citizens' welfare, disaster management, and heritage be additionally included to develop an SDG+ framework.
Contribution to Central Government funds	This provision should be discontinued as CSR spend. However, a specific designated fund may be created for transfer of unspent CSR funds lying with the company beyond the proposed 3-5year time limit.
Issues related to Reporting for CSR:	Enhanced disclosures should be made for better information dissemination with respect to selection of projects, locations and implementing agencies to facilitate better monitoring.
CSR Audit:	CSR may be brought within the purview of statutory financial audit, by making details of CSR spending as part of the financial statement of a company.
Creation of 'Social Impact Companies'	To express object of pursuing social outcomes, while being permitted to achieve conditional profit which can be distributed.

7.10. Reforms in MGNREGA

Centre is planning to link wages under the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) scheme to an updated inflation index (CPI-Rural), which will be revised annually.

MGNREGA is a flagship programme of the Ministry of Rural Development (MoRD). It has provided nearly 235 crore person days in the last three years, each year.

Reforms introduced and their benefits:

- **Transparency in wage payments, asset creation, and payment for materials:** Efforts were started for a 100% of geo-tagging of assets, AADHAAR linking of Bank Accounts, IT/DBT transfers for all wages, and material payments and Geographic Information System (GIS) based planning of works.
    - The generation of payment within 15 days has moved up from 26% in 2014-15 to 91% in the current.
- **Durable Asset creation**: The 60:40 wage- material ratio mandated at Gram Panchayat level often led to non-productive asset being created simply because 60% had to be spent on unskilled wage labour in that Gram Panchayat. The first big reform was to allow 60:40 at the District level rather than at the Gram Panchayat level.
    - In spite of this reform, the ratio of expenditure on unskilled wage labour to overall expenditure remains higher than 65%. This has enabled a new thrust on durable assets that generate incomes. It allows the flexibility to undertake only those assets that are productive.
- **Creation of durable community and individual beneficiary assets**: A very large number of Individual Beneficiary Schemes like goat sheds, dairy sheds, Pradhan Mantri Awaas Yojana - Gramin (PMAY-G), farm ponds, water soak pits etc. have also been taken up. These assets have helped the under privileged to have access to alternative sustainable livelihood.
    - Similarly, building of Anganwadi Centres (AWC) has been a significant effort towards creation of durable community assets. Nearly 1,11,000 AWCs are being constructed in convergence with Ministry of Women and Child Development.
    - **Solid Waste Management** works have also been taken up on a large scale leading to cleaner villages, higher incomes, and more diversified livelihoods for the poor.
- **Mission Water Conservation Guidelines**: were drawn up in 2015-16 to focus on the dark and grey blocks where the ground water level was falling rapidly.

Student Notes:

- This partnership allowed to avail the technical knowledge of engineers, scientists from Central Ground Water Board to build a robust technical manual and implement capacity development programme for the frontline workers.
- A special Barefoot Technicians programme was rolled out to ensure better technical supervision.

Challenges with MGNREGA which must be tackled to make it more efficient:

- **Low Wages**: The national average wage of an MGNREGA worker is ₹178.44 per day, less than half of the ₹375 per day national minimum wage recently recommended by a Labour Ministry panel under the chairmanship of Anoop Satpathy.
- **Wage Disparity**: Presently, five states have a daily minimum wage of Rs 375 or above while the highest MGNREGA wage is Rs 284 a day in Haryana. Uttar Pradesh pays among the lowest NREGA wages at Rs 182/day (which is 95% of the notified Rs 192).
- **Wage Revision method**: The wages paid under the scheme are tied to the consumer price index (CPI) for agriculture work (CPI-AL). This is problematic.
- **Underemployment**: As per the official numbers available on the MGNREGA website, in FY18 average days of employment provided per household was 45.77 which was only 46 in FY17 and 40.17 days in FY15.
- **Workers penalized for administrative lapses**: The union ministry withholds wage payments for workers of states that do not meet administrative requirements within the stipulated time period e.g., submission of the previous financial year's audited fund statements, utilisation certificates, bank reconciliation certificates etc.
- **Too much centralization weakening local governance:** A real-time MIS-based implementation and a centralized payment system has further left the representatives of the Panchayati Raj Institutions with literally no role in implementation, monitoring and grievance redressal of MGNREGA scheme.

Some Initiatives to streamline MGNREGS

- **NREGAsoft** is a local language enabled workflow-based e-Governance system which makes available all the documents like Muster Rolls, registration application register, job card/employment register etc.
- **GeoMGNREGA** uses space technology to develop a database of assets created under MGNREGS using technological interventions like mobile based photo geo-tagging and a GIS based information system for online recording and monitoring.
- **Increased accountability**: Various citizen centric mobile Apps like Gram Samvaad Mobile App and JanMnREGA (an asset tracking and feedback app for MGNREGS assets) have been developed, which aim to empower the rural citizens by providing direct access to information and improve accountability to the people.
- **Project 'LIFE-MGNREGA'** (Livelihood In Full Employment) aims to promote self- reliance and improving the skill base of the MGNREGA workers, so that they can move from current status of partial employment to full employment status.

7.11. Circular Economy

The circular economy is a model of production and consumption, which involves sharing, leasing, reusing, repairing, refurbishing and recycling existing materials and products as long as possible. In this way, the life cycle of products is extended.

This is a departure from the traditional, linear economic model, which is based on a takemake-consume-throw away pattern. It relies on large quantities of cheap, easily accessible materials and energy.

Student Notes:

Need for a Circular Economy

- **Rise in consumerism**: The rise in consumerism has led to more frequent replacement of assets on account of increased spending power and economies of scale.
- **High resource demand**: At the current rate of growth of the economy, India's resource requirements are projected to be nearly 15 billion tonnes by 2030. Therefore, there is an urgent need for decoupling economic growth from resources, which can be achieved through a circular economy approach.
- **Import dependence**: India's dependence on the international market for accessing critical resources like rare earth minerals etc. due to shrinking reserves, technical constraints etc.
- **Waste creation**: The traditional linear economy approach results in massive waste generation at all stages of a product life cycle.

Benefits of a Circular Economy

- **Fewer Greenhouse Gas Emissions:** As a circular economy uses renewable energy, it could halve carbon dioxide emissions by 2030, relative to today's levels.
- **Fewer Negative Externalities** – Following the circular economy's principles, negative externalities such as land use, soil, water and air pollution are better managed, as well as the emission of toxic substances and climate change.
- **Increased Potential for Economic Growth:** The increase in revenues from new circular activities, together with a cheaper production by getting products and materials more functional and easily disassembled and reused, has the power to increase GDP.
- **Employment Growth** – According to the 'World Economic Forum ', the development of a circular economy model, can bring greater local employment in entry-level and semiskilled jobs. New job will be created through increases in:
  - Recycling and repairing practices,
  - An increase in new businesses due to innovation processes and new business models
- **Volatility Reduction and Safeguarded Supplies**: More recycled inputs would be used, leaving companies less dependent on the volatility of the price of raw materials.

Way Ahead

- **Need for Legislation** to promote the circular economy in the country. Several countries have recognised the centrality of the circularity as the new paradigm for sustainable development.
- Policies like Zero Effect, Zero Defect in manufacturing stage, National Electricity Mobility Mission Plan in consumption stage, and the various Waste Management Rules in disposal stage, if tweaked properly, can be the ideal for integrating circular economy into the fabric of the Indian economy.
- Ensuring the transition to circular economy call for extensive collaborative efforts between key stakeholders, including regulators, policy makers, corporates, and financial institutions would need to work to adopt circular business models.
- **Adequate financing needed** for realization of these newer opportunities through innovative financing instruments, such as Green bonds, municipal bonds, SDG-aligned bonds.

8. Towards Inclusive Growth

We have the target of faster, inclusive and sustainable growth as defined by the twelfth plan. With the world moving towards a fourth industrial revolution and innovation driving its growth, it is essential for us to allocate resources towards these ends. Also, inclusiveness demands that the sectors that we promote going forward should be employment intensive as well highly productive.

Student Notes:

- **Service sector** is the major employer in India. this sector accounts for 68% of GDP and 30% of employment. Continued growth in domestic and export services is expected, and will be increasingly important in the face of uncertainty in the manufacturing sector.
- **Manufacturing Sector:** In face of **automation,** workers need to adapt to changing demand. India must develop an enhanced skills development framework. Such a framework should be accessible, driven by demand, linked to employment opportunities and enable individuals to quickly up-skill and re-skill.
- **MSMEs:** The adoption of digital technologies and emergence of digital platforms, such as in e-commerce and digital financial systems, are improving the business viability of microenterprises in India. In order to support inclusive growth among micro and small-sized firms, India must improve financial connectivity.
- **Digital Economy:** With increased digitization, new kinds of jobs will be created. It will create contract work and self-employment. Social benefits that are linked to employment should be accessible to individuals directly. Potential issues such as depressed wages, low productivity, and economic insecurity need to be managed through new policy frameworks.
- **Formal Labour:** It is imperative that India leverages digital technologies to bring workers into the formal labour force, connects individuals to social protection systems, and finds ways to effectively prepare people for a changing employment ecosystem.

Further, growth is a necessary but not a sufficient condition and **multiple interventions** are required at different levels to achieve the objective of decent jobs for all, such as:

- **Non-farm jobs**: As of 2011-12, agriculture accounts for 18% of Gross Domestic Product (GDP) and it absorbs about 50% of the workforce. Thus, over-dependence on agriculture should be reduced and alternative avenues of employment in the manufacturing and services sector must be created.
- **Shift to the formal sector**: A shift to the organized/formal sector should be encouraged by creating incentives in terms of regulations, tax reduction, labour laws etc.
- **Reforming export strategy:** India can increase exports by playing on its strengths such as exporting simple consumer goods, thereby creating employment.
- **Strengthen small and medium enterprises (SMEs):** SMEs generate much more employment than large capital-intensive enterprises.
- **International agreements**: India should push for inclusion of Free Trade in Services Agreement as part of ongoing trade negotiations, thereby creating more employment opportunities.
- **Competitiveness**: Measures such as lowering of corporate tax rates, better public infrastructure, access to quality affordable power supply, better access to finance etc. need to be taken to increase competitiveness in the economy.
- **Increasing public sector investment:** to crowd in private sector investment and kick-start growth.
- **Retraining**: Automation is impacting existing employment not only in IT and BPO but in a host of other manufacturing sectors like automobiles, engineering etc. This requires retraining of existing workforce.
- **Start up:** Youth should be encouraged to explore the entrepreneurship option, and create jobs, rather than looking for secure wage employment.

Therefore, effective measures must be taken to curb unemployment and reap the rich demographic dividend of India. Success of a future inclusive growth agenda would depend investment in employment intensive sectors and ensuring equal participation across various regions, gender and social groups. For India, investment on universal quality education and universal quality health care hold the key for inclusive growth.

Student Notes:

9. Previous Years UPSC Mains Questions

1. With a consideration towards the strategy of inclusive growth, the new Companies Bill, 2013 has indirectly made CSR a mandatory obligation. Discuss the challenges expected in its implementation in right earnest. Also discuss other provisions in the Bill and their implications.
2. Capitalism has guided the world economy to unprecedented prosperity. However, it often encourages short-sightedness and contributes to wide disparities between the rich and the poor. In this light, would it be correct to believe and adopt capitalism for bringing inclusive growth in India? Discuss.
3. Comment on the challenges for inclusive growth which include careless and useless manpower in the Indian context. Suggest measures to be taken for facing hese challenges.
4. What are the salient features of 'inclusive growth'? Has India been experiencing such a growth process? Analyze and suggest measures for inclusive growth.
5. It is argued that the strategy of inclusive growth is intended to meet the objectives of inclusiveness and sustainability together. Comment on this statement.

10. Vision IAS GS Mains Test Series Questions

1. ***What do you understand by inclusive growth? Highlight the challenges in attaining inclusive growth in India. How can these challenges be addressed?***

Approach:

- Introduce by briefly discussing the meaning of inclusive growth.
- Highlight the challenges in attaining inclusive growth in India.
- Enumerate the steps that can be taken to address these challenges.
- Conclude on the basis of the above points.

Answer:

The Eleventh Five Year Plan defined inclusive growth as a "growth process which yields broad-based benefits and ensures equality of opportunity for all". It stands for "equitable development" or "growth with social justice". According to UNDP, inclusive growth is both an outcome and a process. On one hand, it ensures that everyone can participate in the growth process. On the other, inclusive growth is one whose benefits are shared equitably.

Although, the Government of India has undertaken various initiatives such as Jan Dhan Yojana, Saubhagya, MGNREGA, Sarv Shiksha Abhiyan etc towards making the growth inclusive, India remains far behind in this aspect. Efforts towards inclusive growth face the following challenges:

- **Poverty and unemployment**: About 22% of India's population is living below the poverty line (Census 2011). Also, the unemployment rate has peaked at its 45 years high (NSSO data). Further, the employment generated as of now is of poor quality and is mainly created in informal sector.
- **Inadequate health & education:** India faces high infant and maternal mortality; out of pocket expenditure in health; hunger and malnutrition. Also, the quality of primary and secondary education is unsatisfactory.
- **Highly cleavaged society**: The Indian society is divided on many fronts like rural-urban divide, interstate regional disparities, and disparities due to religion, gender or caste.
- **Economic challenges:** It includes fragmentation of lands in agriculture, lack of access to institutional credit, low financial services awareness, low growth rate (especially in agriculture, which is the single largest employer).

Student Notes:

- **Environmental issues**: Degradation of land, air and water are exacerbating all the above issues and further disproportionately affects the most vulnerable sections of society.

Various steps that can be taken to address these challenges are:

- **Increased focus on lagging states**: The states which are lagging behind others should be supported with investment in physical and human capital, technology, institution building and governance.
- **Formalization of economy**: There is need to generate jobs in the formal sector to ensure social security. At present, more than 90% jobs are there in unorganized sector.
- **Reforming governance**: The governance needs to be reformed to make it more transparent, accountable, efficient and participatory to ensure that the resources are equitably distributed.
- **Strengthening social infrastructure**: The steps need to be taken towards universal health coverage, increasing insurance coverage, imparting skill training and fostering environment for job creation and entrepreneurship, increased public expenditure on health and education.
- **Promoting MSME's**: Since MSME's are labor intensive, they should be incentivized through state support. Challenges such as power cuts, increasing compliance cost due to GST, lack of marketing skills, etc. needs to be addressed to ensure access to local and international market.
- **Agriculture sector:** The sector needs to be made productive through use of technology and state support.

India has made significant progress on several indicators of inclusive growth. Between 2006 -2016, it lifted 271 million people out of poverty. However, there is a need to make every section of the society including elderlies, specially-abled, transgenders an active participant in the growth process. This will help India maximize its growth potential.

2. ***Gross Domestic Product (GDP) of a country can not be taken as an index of the welfare of the people of that country. Analyse.***

Approach:

- Explain the concept of GDP.
- Discuss the view that GDP is not an index of welfare in a country.
- Conclude briefly by using examples of some other indicators used to depict the level of social well-being in a country.

Answer:

Gross Domestic Product (GDP) is the total monetary or market value of all finished goods and services produced within a country's borders in a specific time period. As a broad measure of overall domestic production, it functions as a comprehensive scorecard of the country's economic health.

It is a good indicator to depict the living conditions of people in a country, as it includes a number of factors such as consumption and investment. However, it can not be taken as an index of the welfare of the people of a country. The reasons include:

- **It doesn't measure equity in income distribution:** If the GDP of a country is rising, its social indicators may not rise as a consequence. This is because rise in GDP may be concentrated in the hands of a few individuals or firms. For the rest, the income may, in fact, have fallen.

Student Notes:

- **Non-monetary exchanges**: Many activities in an economy are not evaluated in monetary terms. For example, the domestic services that women perform at home are not paid for. Since there is no transaction of money, their contribution is generally not counted in the GDP, leading to underestimation of GDP.
- **Externalities**: Externalities refer to the benefits (or harms) a firm or an individual causes to another for which they are not paid (or penalised). For instance, while calculating GDP, pollution caused by industries is not accounted for. Therefore, if we take GDP as a measure of welfare of the economy, we will overestimate the actual welfare. In cases of positive externalities, GDP will underestimate the actual welfare of the economy.
- **Type of goods produced**: GDP does not describe the kinds of goods that are being produced. Since GDP measures the value of all finished goods and services within an economy, it also includes products that may have negative effects on social welfare. For example, tobacco, armaments etc. sold and used within the country, would adversely impact the overall social welfare.

In view of the shortcomings mentioned above, there have been various attempts to develop more accurate and reliable indicators in order to measure social well-being. Among others, these alternative approaches include the Human Development Index (HDI), the Gross National Happiness Index (GNH), and the Social Progress Index (SPI).

3. *Elaborate on the poverty estimation methodologies adopted after independence in India.*

Approach:

- Briefly, write about the poverty estimation in India.
- Discuss the poverty estimation methodologies adopted after independence in India.
- Give a brief conclusion.

Answer:

Poverty estimation in India is guided by the concept of poverty line, which indicates minimum level of income required to meet basic living conditions. The perception regarding minimally acceptable standards of living varies over time and place. Post-independence, there have been several attempts to work out a mechanism for poverty estimation, in accordance with these changed perceptions.

- In India, the first official rural and urban poverty lines at the national level were introduced in 1979 by **Y. K. Alagh Committee** and official poverty counts began for the first time. It constructed a poverty line for rural and urban areas ***on the basis of nutritional requirements*** – 2400 calories for rural and 2100 for urban areas.
- Later, in 1993, **Lakdawala Committee** recommended ***state specific poverty lines*** while continuing with the methodology of calorie consumption for poverty estimation.
- In 2009, the Planning Commission appointed the **Tendulkar Committee** which further refined the poverty estimation methodology and recommended following major changes:
    - Shift away from calorie consumption-based poverty estimation;
    - Adopt uniform poverty line basket across rural and urban India;
    - Change in the price adjustment procedure to correct spatial and temporal issues with price adjustment;
    - Incorporation of private expenditure on health and education while estimating poverty.

Student Notes:

- Use of Mixed Reference Period (MRP) based estimates, instead of Uniform Reference Period (URP) based estimates.

- Continued criticism regarding low poverty lines led to the appointment of **Rangarajan Committee** in 2012 to revisit the methodology for estimation of poverty. The committee recommended that the consumption basket should contain a ***food component*** that satisfied certain minimum nutrition requirements, as well as consumption expenditure on ***essential non-food item*** groups (education, clothing, conveyance and house rent) besides a residual set of behaviorally determined non-food expenditure.

The measurement of poverty has important implications such as in identification of beneficiaries, evolving nature of the conceptualization of poverty, policy formulation etc. Use of SECC for identification is a case in point. Therefore, there is a need for a suitable measure of poverty. Only then, it will be possible to evaluate how the economy is performing in terms of providing a certain minimum standard of living to all its citizens.

4. Identify the different types of unemployment. What are the factors affecting unemployment in India?

Approach:

- Briefly define unemployment.
- List the different types of unemployment.
- Highlight the factors affecting unemployment in India.
- Conclude on the basis of the above points.

Answer:

Unemployment is defined as a situation in which all those who are able and willing to work cannot find work. This includes the pool of persons who seek work through employment exchanges, friends, relatives and other contacts and express their willingness to get employed, however, remain unemployed due to the lack of work.

There are different types of unemployment, which include:

- **Disguised unemployment**: It refers to a situation where labour is visibly employed but is not actually involved in the production of goods and services. It is also known as hidden unemployment.
- **Seasonal unemployment**: It occurs when a person is available for work but is unable to find work at particular times of the year.
- **Structural unemployment:** It refers to a situation where a person is available for work but is unable to find work due to an obsolete skill set. It is caused due to fundamental changes in the economy such as technological advancement, change in demand pattern etc.
- **Cyclical unemployment:** It occurs when a person available for work is unable to find work due to cyclical fluctuations in the economy such as recession and depression
- **Frictional unemployment:** It arises when a worker remains idle for some time while transitioning from one job to another job. It is witnessed among migrant workers.
- **Voluntary unemployment:** It is defined as a situation when workers choose not to work at the current equilibrium wage rate, which is deemed below the wage necessary to encourage individuals to supply their labour.

Student Notes:

There are numerous factors that affect unemployment in India. These are:

- **Inadequate skills**: Low or no educational levels and lack of vocational skills among the working population act as barriers for them in the employment market. This is not even captured in any employment data.
- **Seasonal nature of Indian agriculture:** Due to this, agriculture provides employment to the rural population only in particular seasons of the year.
- **Constraints of the manufacturing sector:** Employment potential of the manufacturing sector is restricted by inadequate growth of infrastructure and low investment.
- **Administrative factors**: Ineffective implementation of the skill development programmes due to focus on short-term skill courses, impractical target setting, bureaucratic red-tapism, poor coordination amongst ministries and departments etc.
- **Social factors:** Patriarchal social norms deter women from taking/continuing employment. Also, people belonging to lower caste groups often face caste-based barriers while seeking employment.
- **Population pressure**: Rapid population growth without a simultaneous increase in employment opportunities has worsened the unemployment situation.

Currently, the unemployment rate in India is approximately 6.1% according to the Periodic Labour Force Survey of NSSO. India has a window of opportunity in the global employment market due to its demographic dividend. However, the government needs to invest in health, education and skill development to convert human resources into human capital, to ensure that India's demographic dividend may turn into a demographic disaster.

5. What do you understand by human capital? State how human capital formation contributes to economic growth and development.

Approach:

- Introduce by defining human capital.
- Write a brief note on the economic and non-economic benefits of investment in human capital.
- Giving few examples discuss how human capital formation contributes to economic growth and development.
- Conclude on the basis of the above points.

Answer:

Human Capital can be defined as the **knowledge, skills, competence** and other attributes that individuals or groups of individuals acquire during their life and use to produce goods, services and ideas in the economy. It can be developed through **skilling, training and providing quality education & health care facilities**.

Contribution to economic growth and development:

Investment in human capital generates economic benefits to the person and society at large. Furthermore, this has a spill over effect in the form of non-economic benefits, which increase a person's participation in activities not related to production. This improves developmental status of an economy. This happens in the following ways:

- At the individual level, investment in human capital **enhances employability** of the human resources. This is because good education and proper training creates skilled labour force with higher efficiency and outcome.

Student Notes:

- If the person is already employed, human capital formation has a positive correlation with **improved earnings and career prospects**.
- An educated and skilled individual is **receptive to modern and scientific ideas**. Technical and professional knowledge promotes the **use of advanced technology** in the production process thus promoting economic growth.
- At the organizational level, higher productivity of some educated and experienced employees may increase the performance of other workers too and, hence, the **firm's profitability**.
- At the societal level, human capital contributes to **efficient use of physical capital** such as buildings, equipment, machinery & other resources. This is important, in the longer run, for rise in productivity and capital value.
- Increase in real income for people fuels **further consumption of goods & services**, thereby contributing to economic growth.
- Individuals with improved education and training will further invest in **personal benefits** like health and subjective well-being both of their own and dependents. This has the potential to **reduce the burden** on an economy.
- Investment in human capital creates **more informed citizens** and increases their **participation** not just in economic but other social and political activities too. This leads to greater **social cohesion** and also **strengthens institutions** in a nation.
- Human capital formation has **'feedback effects'** on economic growth & development. For instance, more educated citizens will share feedback leading to improvements in the quality of education, making learning easier & more efficient and vice versa.

Hence, human capital and economic growth and development are positively related with each other. The success of Chinese and Indian economy can also be attributed to human capital formation, even though there still remain gaps in human capital formation in these countries when compared with developed countries.

6. ***While identifying the need for providing social security to gig workers, highlight the challenges that exist in this regard.***

Approach:

- Explain what you understand about the gig economy.
- State the need for adequate provision for social security to gig workers.
- Mention the challenges that exist in this regard.
- Conclude on the basis of the above points.

Answer:

A gig economy refers to a workforce environment where temporary and flexible jobs are commonplace and companies hire part-time workers, contractors etc. instead of full-time employees. The companies pay the gig workers as per the services provided, number of hours of work etc.

The need for providing social security to gig workers arises due to following reasons:

- **Rising number of gig workers:** Gig economy companies generate an estimated 56% of new employment in India, across both blue-collar and white-collar workforce. Also, it has been growing exponentially in size in recent years without any social security. Thus, a large number of workers remain outside the ambit of social security cover.
- **To ensure labour rights:** Those working in the gig economy do not enjoy the same rights and protections as employed workers, such as health benefits, overtime pay and sick leave pay.

Student Notes:

- **Lack of adequate regulation:** Unlike the traditional employees, gig workers are not regulated by the existing employment laws. This permits organisations to determine the terms and conditions of the gig workers without incurring the costs associated with providing statutory employee benefits.
- **Social welfare:** According to the ILO, social security is a human right which responds to the universal need for protection against certain life risks and social needs. It also contributes to the prevention and reduction of poverty and inequality.
- **Threat to social protection system:** Rising numbers of gig workers threaten to erode the contribution base of social protection systems as the firms have an incentive to shift work onto those workers who enjoy the least protection.

The government has recently proposed to include gig workers and platform workers within the ambit of unorganised workforce through the Draft Code on Social Security, 2019.

However, several challenges remain in this regard, including:

- **Definition issue:** Gig workers do not fit into the definition of "employee" or "worker" and, therefore, remain out of India's labour law coverage. Recent draft Code on Social Security has also not defined gig workers clearly.
- **Increase compliance cost:** Considering that the gig economy has an increasingly important role in providing employment in India, overregulating the gig companies may increase compliance costs and create entry barriers for new gig companies.
- **Hamper flexibility:** The gig economy has been lucrative for employers and employees because of the flexibility that it offers. However, regulation of the economy by introducing new laws may erode the flexibility.
- **Fewer benefits compared to formal workforce:** In the proposed Draft Code, the provisions for gig and platform workers fall under the chapter on unorganised workers. Thus, they are not deemed as a part of the formal workforce where the workers get more comprehensive social security benefits.

Given the nature of the gig economy, its cost reduction structure and contribution to employment level etc. any policy/law affecting the economy should be passed after consultation with the affected stakeholders.

7. ***While some associate increased penetration of technology and industrialization with increase in inequality in India, the reasons for the same lie somewhere else. Discuss.***

Approach:

- Introduce by providing statistics about increasing inequality in India.
- Critically examine the role of technology with respect to increasing inequality in India.
- Discuss other factors for rise in inequality in India.
- Conclude by suggesting the measures that the Government should take as the way forward.

Answer:

According to the latest survey by Oxfam, **India's top 1 percent now holds almost 40 percent of the nation's wealth, while the top 10 percent holds almost 70-80 percent.** This has brought India among the top three most unequal countries in the world.

Several experts hold **increased penetration of technology and industrialization** as the main reasons behind this because of the following reasons:

Student Notes:

- **Skill requirement:** Technology intensive jobs demand skilled labour. This skill addition requires investment of capital and time which could be a huge opportunity cost for some workforce because of which they forego their chance to upgrade.
- **Automation:** Advancements in labour saving technology leads to frequent replacement of blue collared medium-skill jobs due to automation/machines, increasing the wage gap further.
- **Monopolistic markets:** Contemporary economies especially digital economies tend to follow the 'winner takes it all' approach which leads to their market monopolies and quasi monopolies. This affects the bargaining capacity of the job seekers. Technology giants like Google, Facebook, Amazon, Ola, Uber have also led to disintermediation killing jobs in the process.
- **Imbalanced income growth:** It has been observed that the incomes of skilled workers increased at a rate far greater than their unskilled counterparts. Furthermore, the disproportionate rise in income at the higher management levels in comparison with mid management and staff is alarming. This exacerbates income inequality in society.

However, the above arguments may not always hold true. Several **industrialized societies with a higher penetration of technology** and automation are considerably less unequal than India. Proliferation of **technology-based service companies** — Ola, Flipkart, Zomato, OYO etc has created an ever-expanding employment market for the unskilled and the medium-skilled. Similarly, digitization has enabled Indian businesses **to establish linkages with foreign customers,** allowing both scale-up and scale-out in terms of employment of low-skilled and medium-skilled workers.

This suggests other factors being more powerful than technology **really responsible for increasing inequality in the country**. Some of these factors are:

- Large numbers of **workforce work in sectors with low productivity**. For e.g. **Agriculture provides employment to 53 percent jobs, while contributing only 17 percent to the GDP**.
- Lack of training facilities for the workforce, which will lead to underutilization of India's demographic dividend and even increase unemployment.
- The country's **abysmal performance across social and environmental aspects such as health, education, gender equality etc** can explain its widening inequality to a large extent.
- Large **contribution of the informal sector where labour lacks social safety net, poor bargaining power** etc.
- **Lack of competitiveness** in comparison with its global trade partners has also impacted India's economy and income growth especially across labour intensive sectors.
- **Other reasons include:** poor implementation of anti-poverty alleviation programmes, development is not democratized at the level of policy making etc.

Government should ensure that technology and industrialisation is engaged to bridge inequality amongst different strata in the society. For this, policy interventions like skilling, introduction of labour reforms and social safety net for informal workers etc are required.

Student Notes:

8. ***Explaining the reasons behind India's lower female labour force participation rates (LFPR), list the steps that have been taken to augment it. What more needs to be done?***

Approach:

- Explain the reasons for low female labour force participation rates (LFPR) in India.
- List out the steps that have been taken and suggestions to tackle low female labour force participation rates (LFPR).

Answer:

India has one of the lowest female labour force participation rates (LFPR) among the emerging market economies and developing nations. As per reports of the yet unreleased National Sample Survey data, labour force participation rates of women aged 25-54 have stagnated at about 26-28% in urban areas, and fallen substantially from 57% to 44% in rural areas, between 1987 and 2011. According to a report of the International Labour Organization, India's female labour force participation rate (LFPR) fell from 35.8% in 1994 to merely 20.2% in 2012.

Reasons for low LFPR among women:

Economic

- With growing requirement of specialised and skilled jobs, women facing structural unemployment may be dropping from the labour force.
- Absence of jobs leaves self-employment as the viable option for work. However, difficulty in accessing credit also closes the opportunities for entrepreneurship
- Because of mechanization, there is lower demand for female agricultural laborers.
- Increased household income and wages in rural areas because of various factors like remittances from urban migrant workers, MGNREGA, etc. has reduced the requirement of supplementing incomes by means of working women.

Socio-cultural

- Less women are entering workforce because of increased access to education and consequent increase in years spent in schooling.
- Organisational hierarchy is setup in such a way that rising up to the top becomes almost impossible for women ('glass ceiling'). This acts as deterrent for working women and they drop from the workforce midway.
- Working conditions, even in organized sector are not conducive for women, such as maternity benefits law being gender specific.
- Crime against women also acts as a deterrent.
- Patriarchal mindset which sees women good for household work and men for earning household income.

Steps taken

- Enactment of laws to prevent sexual harassment at workplace and hence develop a safe environment to work.
- Facilitating women enterprenuership through Stand-up India mission.
- Ministry of Skill Development and Entrepreneurship coordinates the skill development schemes across various sectors, addressing the problem of lack of or outdated skills.
- National Career Service (NCS) Project provides a nation-wide online platform for jobseekers and employers, which will provide employment information with ease.
- Maternity Benefit (Amendment) Act, 2017 provides for enhancement in paid maternity leave and provisions for mandatory crèche facility in the establishments having 50 or more employees

Student Notes:

- Advisory to States under the Factories Act, 1948 for permitting women workers in the night shifts with adequate safety measures.
- Training to female workers through a network of Women Industrial Training institutes, National Vocational Training Institutes and Regional Vocational Training Institutes.
- Protective provisions in various labour laws for creating congenial work environment for women workers.
- Addressing discrimination in wages through Equal Remuneration Act, 1976 and Minimum Wages Act, 1948.

Way forward:

- Generation of education and skill-based livelihood opportunities in rural areas.
- Policies to make workplace gender friendly, such as making men eligible for maternity benefit leave, flexibility in working conditions such as attending to children, etc.
- Skill development initiatives must focus on women entrepreneurship through self help groups and women cooperatives.
- Easing availability of finance such as specialised window under the MUDRA yojana.
- Recognition of the problem in the societal attitude towards women in general and working women in particular and addressing it in an accelerated manner. .

Gender will play a bigger and more strategic role in India's future growth. Drawing more women into the labour force, supplemented by structural reforms that could help create more jobs would be a source of future growth for India.

9. A rapidly changing economic structure and demography require a comprehensive employment policy to address the multitude of challenges that might arise in future. Discuss in the context of India.

Approach:

- Highlight the changing economic and demographic situation in India.
- Mention the challenges in the light of huge demography of India.
- Discuss some interventions through which it would address these challenges.

Answer:

India's economic structure is undergoing a rapid transition. The share of agriculture in Indian economy has declined over the years and that of industry and service sectors has increased. This structural transition from farm to the non-farm sector and advances in technology is suggestive of new emerging avenues for employment.

Data from India's Labour Bureau on employment creation suggest that fewer than two million jobs are being created annually, a seemingly dire situation in a country where the working age population grows by some 16 million every year. Also, India's female labour force participation rate (LFPR) fell from 35.8% in 1994 to merely 20.2% in 2012, which is a cause of concern.

World Bank Development Report, 2016 estimates that 69 per cent jobs in Indian economy face threat due to technological advancements which are likely to impact India's information technology and business process outsourcing sectors. Consequently, it may lead to mismatch between the skill sets needed by the industry and those held by the Indian labour force.

Nearly 81% of those employed in India are in the informal sector which has multiple adverse consequences for workers, enterprises and the society. Further, 65 per cent of

Student Notes:

India's population is under the age of 35. This demographic dividend may turn in to demographic disaster if better paying jobs are not created at a faster pace.

Thus, India faces challenge of creating adequate decent employment opportunities for scores of young men and facilitating the transition from informal to formal employment. A comprehensive and convergent policy can address the challenges brought forth by these economic and demographic transitions through interventions such as:

- Laying stress on an effective Labour Market Information System (LMIS) for identifying skill shortages, training needs and available employment opportunities.
- Ensuring coordination and coherence across policy initiatives and programmes in different sectors.
- Ensuring that the education, training and skill development system is aligned with the changing requirements of the labour market.
- Developing women's human capital and capabilities and establishing gender-sensitive labour market regulations.
- Ensuring that the rural unemployed finding adequate employment on a more sustainable basis through online employment discovery platforms.
- There is the need to link the various employment oriented government schemes. For example linking MGNREGA with Skill India Mission can generate permanent employment in relevant sectors.

Thus, there is need of a National Employment Policy (NEP) that would encompass a set of multidimensional interventions to overcome multitudes of challenges posed by a rapidly changing economic structure and demography.

10. Despite having a statutory framework for minimum wages since long, many workers continue to remain outside its reach. Examine the reasons and suggest corrective measures in this regard.

Approach:

- Briefly mention the state of statutory framework for minimum wages in India.
- Explain with the help of data that many workers remain outside the reach of such wages.
- Mention the reasons due to which such situation exists.
- Discuss the measures that can be taken to address this issue.
- Conclude in a balanced forward looking manner.

Answer:

The **Minimum Wages Act, 1948** provides framework for minimum wages set by the Central as well as the State Governments. It is applicable for regular and casual workers in selected 'scheduled' employment and these wages are revised every five years. The act does not set ONE single national minimum wage. Rather, it sets wages according to skill level in a sector.

In order to have a uniform wage structure and to reduce the disparity in minimum wages across the country, a concept of National Floor Level Minimum Wage was mooted on the basis of the recommendations of the National Commission on Rural Labour (NCRL) in 1991. Presently, at Rs. 176/day, it is the minimum wage below which states cannot fix minimum wages. However, it is a non-statutory measure - and not part of the MWA, 1948.

Student Notes:

Despite having a statutory framework, there exists high wage inequality in India. According to the Periodic Labour Force Survey 2017-18, 45% of regular workers (formal sector) are paid less than the minimum wage. Also ILO's 2018 report says that one in every three wage workers in India is not protected by the minimum wage law.

Reasons behind such situation:

- **Norms for fixing minimum wages:** The Act just stipulates that the wage be a living wage that provides for bare subsistence, just above the poverty level.
  - The government can fix a different minimum wage for different industries or even similar industries in different localities.
  - Also, the manner of fixing wages is not laid down, except that they will be laid down with a tripartite consultation of employer, employee and an expert.
- **Complexity in the Act:** Wage rate variations exist even within states due to large number of job categories (1,915) for unskilled workers.
- **Coverage:** The criterion for inclusion in the list of scheduled employment is that there should be at least 1000 workers engaged in that activity in the state. Thus, many activities are excluded from the list. Self-employed are also not included.
- **Implementation:** Exemptions are often granted to several industries in payment of minimum wages. In addition, minimum wage levels have not been revised regularly by several states.
- **Adjustment**: Inflation measures vary across different states and different categories of workers. As such, revision of minimum wages is non-uniform and leaves many workers outside the purview of a fair wage.
- **Enforcement:** The issue arises mainly due to lack of awareness amongst the workers about minimum wage provisions and their entitlement under the labour laws. Besides, there is lack of adequate numbers of inspectors.

Corrective Measures that can be adopted:

- **Rationalisation** of minimum wages as proposed under the **Code on Wages Bill, 2019.** The code subsumes relevant provisions of The Minimum Wages Act, 1948, The Payment of Wages Act, 1936, The Payment of Bonus Act, 1965 and The Equal Remuneration Act, 1976.
- Setting a National Floor Level Minimum Wage **depending upon geographical regions** to reduce distress migration and ensure competitive labour cost.
- Minimum wages criteria can also be **based upon skill category, not just skill level.** E.g**.** for Unskilled, Semi-Skilled, Skilled and Highly Skilled workers, as done in Madhya Pardesh.
- **A national level dashboard** can be created at the Centre with access to the state governments whereby the states can regularly update the notifications regarding minimum wages.
- **Grievance Redressal Mechanism** such as a Toll free number to register grievance on non-payment of statutory minimum wages and swift action on those complaints.
- In addition to this there is the need to **regularly revise** the wages keeping inflation in mind.

An effective minimum wage policy is a potential tool not only for the protection of low-paid workers but is also an inclusive mechanism for more resilient and sustainable economic development. Thus, balancing the interests of both the workers and the employees. The recently notified **Labour Code on Wages, 2019** makes several provisions in this regard.

Student Notes:

11. Providing social security, especially to those working in unorganised sector, is an important requirement to achieve the goal of inclusive growth. Discuss.

Approach:

- Explain what social security cover implies, especially for unorganized sector workers.
- Discuss the need to bring them under the social security net

Answer:

Social Security refers to protection extended by the society and state to its members to enable them overcome various contingencies and lead a dignified life.

According to NSSO, about 83% of employed persons work in the unorganised sector such as the small and marginal farmers, landless labours, rural artisans, fishermen, building and construction workers- majority of them being from the socially and economically underprivileged sections of society. Women constitute an important section of workers in this sector.

Further, the unorganized sector faces following vulnerabilities:

- Inability to Secure Minimum Wages
- Long working hours
- Higher incidence of poverty
- Poor working conditions

This makes social security measures indispensable for unorganized sector workers. Such measures help in promoting inclusive growth as these redistribute the resources equitably. These enable the workers to deal with contingencies without falling into debt or experiencing extreme poverty.

To further the cause of inclusive growth and provide comprehensive social security cover, the government enacted Unorganised Workers' Social Security Act, 2008, which includes various schemes like Rashtriya Swasthya Bima Yojana, Janani Suraksha Yojana, National Family Benefit Scheme etc. Beside these, the central government launched three other schemes i.e. Atal Pension Yojana, Pradhan Mantri Jeevan Jyoti Bima Yojana, Pradhan Mantri Suraksha Bima Yojana, to specifically extend social security to the unorganized sector.

However, due to various fault lines in the design and implementation of these schemes, the unorganised sector continues to be exposed to the risks of mortality, health ailments and longevity. Some of the flaws include:

- Fragmented ownership structure of these schemes
- Overlap between schemes of central and state governments, since social security is a subject in the concurrent list
- Inequitable distribution of social security benefits, where richer states provide much higher benefits compared to poorer ones

Thus, a large number of persons working in unorganized sectors such as the small and marginal farmers, landless labourers, rural artisans and others are excluded from the social security net.

In order to overcome these faults, following should be undertaken:

- Effective implementation of Social Security Act, 2008
- Effective coverage under Rashtriya Swasthiya Bima Yojana and universal insurance scheme for unorganised workers
- Exploring the possibility of implementation Universal Basic Income

Thus, India's growth requires budgetary and political commitment from the government to yield broad-based benefits and ensure equality of opportunity for all.

Student Notes:

12. In the inclusive development index of World Economic Forum (WEF), India stands very low. Discuss briefly the issues associated with living standard, environmental sustainability and protection of future generations from further indebtedness in India, on which the ranking is done.

Approach:

- Briefly discuss India's ranking in the Inclusive Development Index of the WEF.
- State the parameters on which the ranking is based and elaborate on issues that India faces based on those parameters.
- Suggest a way forward for improving India's ranking on the index.

Answer:

India is ranked at 62nd place out of 74 emerging economies on WEF's Inclusive Development Index, much below China's 26th position and Pakistan's 47th position. The index takes into account "living standards, environmental sustainability and protection of future generations from further indebtedness". This index has been developed as a new metric of national economic performance as an alternative to GDP, thus urging the countries to move to a new model of inclusive growth and development.

Issues associated with these parameters and ensuing low ranking of India are:

- **Living standards:** Even though the incidence of poverty has declined in India over the past five years, 6 out of 10 Indians still live on less than $3.20 per day. The reasons for low ranking in living standards include high debt-to-GDP ratio translating into low government spending, thus slowing down the pace of economic reforms and exacerbating income inequality. Even the educational enrolment rates are relatively low across all levels, leading to notable differences in performance and living standards among students coming from different socioeconomic backgrounds. Additionally, low labour force participation coupled with large informal economy restricts the social mobility of workers, thus exposing them to vulnerable employment situations, ultimately lowering their living standards.
- **Environmental sustainability:** Despite its initiatives on the global scale for combating environmental problems, India faces problems related to environmental sustainability including increasing air and water pollution especially in metropolitan and industrial cities, degradation of forest and agricultural land, loss of biodiversity, loss of ecosystem resilience, rapid depletion of resources due to industrialization etc.
- **Protection of future generation from further indebtedness:** India has performed relatively well (Rank 44) in terms of intergenerational equity and sustainability. This is due to a low dependency ratio that is set to further decline as the economy reaps the dividends of an extremely young population (28% of the Indian population was younger than 14 years in 2017). However, issues like high debt-to-GDP ratio, income inequality, increasing external debt, , prevailing corruption, tax evasion, etc. can led to increased indebtedness and economic problems for future generation.

Way forward:

Despite its low overall score, India is among the ten emerging economies with 'advancing' trend where both labour productivity and GDP per capita posted strong growth rates. Given the prevalence of inequality both in terms of income and wealth, there is substantial scope for improvement for India in this aspect.

Focus should be on improvement in above parameters because slow progress on these contributes to political polarization and erosion of social cohesion. Thus, efforts should be made for increasing expenditure on healthcare, basic services, education, lowering

Student Notes:

corruption and creating a conducive environment for business expansion. Further, efforts need to be taken by all tiers of government for reducing pollution, increasing forest cover, improving the condition of water bodies and encouraging sustainable environmental practices.

13. Suggest the measures needed to improve the employability of labour force as well as increasing number of employment opportunities in light of structural changes being brought by disruptive technologies.

Approach:

- Introduce by giving brief account of the structural changes being brought by disruptive technologies.
- Support your arguments with the appropriate data.
- Suggest measures that can be taken to improve the employability of labour force as well as increase number of employment opportunities.
- Conclude on the basis of the above points.

Answer:

The overall effect of new technology on the number of jobs in the economy is a race between automation and invention of new complex tasks which creates new jobs. The research firms have also predicted that by 2020, 75 percent of all organisations will experience visible business disruptions owing to infrastructure and operational (I&O) skill gaps.

However, automation and rapid technological changes also bring the promise of higher productivity, economic growth, increased efficiencies, safety, and convenience apart from the new jobs it has created.

Measures needed to improve employability:

- Equipping the labor force with employable skills in the light of ever changing technology and associated skills set. This demands regular update in curriculum.
- The collaboration between educational institutes and industry should be enhanced with programs like Apprenticeship.
- A whole continuum of skill sets must be available for training unskilled labour and further upgrading their skills.

Measures needed to address the challenge of unemployment:

- **By the government**
  - Support the competitiveness-enhancing initiatives of corporates and facilitate the transition of workers in adapting to new technologies.
  - Support labor-intensive industries such as apparel and leather, in order to drive job creation.
  - Leverage the attractive size of the Indian consumer market to gain access to latest technologies through insistence of technology transfer during FDI deals in key sectors.
  - Skilling and reskilling initiatives- Use the time window of 2 to 3 years to effect large-scale reforms in the general, technical and vocational education system to successfully meet the objectives of Skill India.
  - Expand and upgrade the technology tools to enable the MSME sector to adopt exponential technologies.
  - Formulate life-long learning strategies and drive behavioral change among citizens toward life-long learning, like setting-up career counseling centers, establish centers of excellence (CoEs) in emerging exponential technologies, etc.

Student Notes:

- Encourage startups that help transform unorganized sectors to organized ones using technology.
- Drive job creation through Government investments in infrastructure and transform the public healthcare, education, tourism and hospitality and other development sectors through use of technology-assisted outreach workforce.

- **By the industries**
  - Create collaborative learning ecosystems and develop workforce re-training programs across organization levels.
  - Work in close partnership with the Government to ensure success of its efforts to take advantage of Industry 4.0 technologies.
- **By the academia**
  - Focus on cognitive/judgment-driven skills- The rapid pace of change in jobs and skills is creating a growing demand for updated skills.
  - Tailored courses with flexible completion timings to enhance students' inclination towards learning.
- **By the Individuals**
  - Take responsibility for life-long learning- The current model of formal learning up to the age of 20 - 25 years and then working and experiential learning for the rest of our lives is outdated. People need to take advantage of the enabling ecosystem that the Government and the companies they work for are providing in terms of learning opportunities.
  - Embrace the online economy- They need to understand the importance and evaluate the benefits of contractual labor/project-based work arrangements.

The irony with technology is that it threatens jobs we can see, but creates jobs that we can't yet imagine. Traditional businesses have no choice but to ramp up digital and new technology talent to enhance productivity, ensure ease of business and adopt technology with open arms to stay ahead of the curve in the face of digital disruption.

14. Critically discuss the role of private sector in skill development in India in recent years. In this context, what are the measures required to improve oversight as well as financing in the skill development sector?

Approach:

- In the introduction, show the current state and the need of overhauling the skill development sector and the role private sector.
- Divide the question into two parts – role of private sector and improvement in that. Divide the second part further into two – improvement in oversight and financing.

Approach:

1.1 million young people join the workforce in India every year. According to a McKinsey report, only a quarter of them are employable. It shows the poor state of skill development in India.

Private sector off late has started playing a major role in skill development in India as can be observed through:

- Increase in number of private ITIs from 2000 in 2007 to 11000 today.
- The National Skill Development Corporation (NSDC) today has more than 6,000 private training centres.
- Private training partners with government support have mushroomed at the rate of five a day, especially under Skill India Mission and PM Kaushal Vikas Yojana.

Student Notes:

Role of private sector was recognised keeping in mind two aspects- the inability of government alone to cater to the massive skill deficit in the labour force, and making skilling more industry led for it to be more industry relevant.

However, their increasing role is also associated with various issues such as

- **Disregard of norms and standards** for skill development while scaling up. For e.g. no Aadhaar checks, attendance requirements and batch size limitations are put in place.
- **Lack of proper regulation** - Due to poor organizational strength Quality Council of India (QCI) does not follow accreditation norms created by the National Council for Vocational Training (NCVT).
- **Inadequate powers with NCVT** - The NCVT performs majorly an advisory role. One example of lack of authority is examination process — where the question paper is prepared by the NCVT, but administered and evaluated by instructors of the State Councils for VT. Thus, no role in actually assessing the quality
- **Inadequate result orientation** as the private centers of skill development are not demand driven
- **Lack diversity and applicability** - Private ITIs offer training in less than five trades, have fewer classrooms and workshops for practice; and their teachers also are very poorly paid.
- **No follow-up** in the post training period to assess the skills set acquired by way of training module.

To systematically solve these problems, following steps should be taken for

- **Improving Oversight**
  - Like every other educational board, there must be a board for skill development sector which will look after accreditation, assessment, certification and course standards.
  - There must be rating and ranking system which should be frequently published.
  - There must be unified national vocational education and training system. For this purpose, a legal framework should be put in place.
  - There must be mechanisms to assess the impact of skill training program, during skill development and in the post training period.
- **Financing**
  - The source of finance should be government, multi-lateral agencies and corporate social responsibility.
  - For resource mobilization the role of employers is pivotal. It should be promoted through tax benefits and reimbursable industry contribution.

In the rapidly changing job market, India needs to revamp its skill development sector with adequate role of private sector.


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