

GS FOUNDATION FOR CSE 2024

ECONOMY-21 EMPLOYMENT-3

(TYPES OF UNEMPLOYMENT, MSME SECTOR)

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2. TYPES OF UNEMPLOYMENT

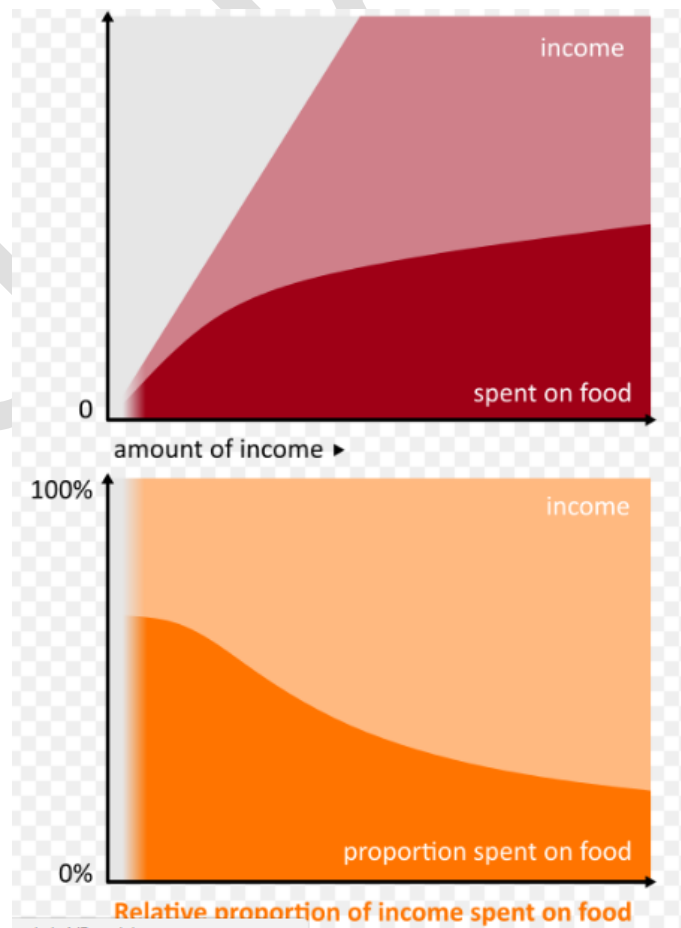
- Unemployment refers to situation where individuals who are willing and able to work are unable to find suitable employment. There are **several types of unemployment** that can occur in an economy:
 - i. **Structural Unemployment:** It occurs due to mismatch between the skills and qualifications of workers and the available job opportunities. This may happen when there is **fundamental change in the structure of the industry or economy** which renders certain kinds of skill set obsolete or low in demand.
 - » Some structural changes which may cause this unemployment include - rapidly growing population, fall in the rate of capital formation, technological change etc.
 - » This kind of unemployment is of long term in nature. It takes a longer time to correct unless some precautionary measures were taken.
 - » E.g. High population of young working age population and not availability of enough entry level jobs has led to a type of structural unemployment.
 - ii. **Frictional Unemployment:** When individuals are moving between jobs (including the period when she is searching for another job after leaving the existing one), they may remain unemployed for some times. This is called frictional unemployment.
 - It is typically of short-term nature and is part of job search process.
 - It may also occur due to technological advancements or shift in demand for certain skills.
 - iii. **Cyclical Unemployment:** Economy goes through a face of boom (high rate of growth) and depression (low or negative rate of growth). During the phase of depression, aggregate demand is very less which leads to decline in production and thus decline in available job. This unemployment which is caused by cyclical nature of economic growth is **called Cyclical Unemployment**.
 - For e.g. the loss of jobs after the 2008 financial crisis will come in this category.
 - iv. **Seasonal Unemployment:** When work is available in some part of the year and not available in the other part, it is seasonal unemployment. For e.g. agriculture is a seasonal occupation. During off-season, often the farm workers are out of job.
 - v. **Technological Unemployment:** It occurs when advancement in technology leads to loss of jobs or the replacement of human labor with machines.
 - vi. **Disguised Unemployment:** This occurs when the number of workers engaged in a job is much more than actually required to accomplish it. If some of them are withdrawn from the job, the total production will not fall.
 - This type of unemployment is rampant in Indian Agriculture because of joint family system (entire family will work) and lack of job opportunities outside agriculture sector.
 - vii. **Underemployment:** Underutilization of available manpower both in terms of time and skill is called underemployment. So, a situation where individuals are working in jobs below their skill level, qualifications, or desired hours of work is called underemployment.
 - It leads to lower income, reduced job satisfaction and wastage of human resource.

- viii. **Educated Unemployment / Open Unemployment:** When a person who is educated/trained/skilled and is seeking employment fails to obtain a job suited to her qualification, it is called educated/open unemployment.
- ix. **Voluntary Unemployment:**
- People who are neither seeking employment nor are available for employment even though adequate work/employment is available are called voluntary unemployed. These people are not in labour force.

1) RELATED TERMS

A) ENGEL'S LAW

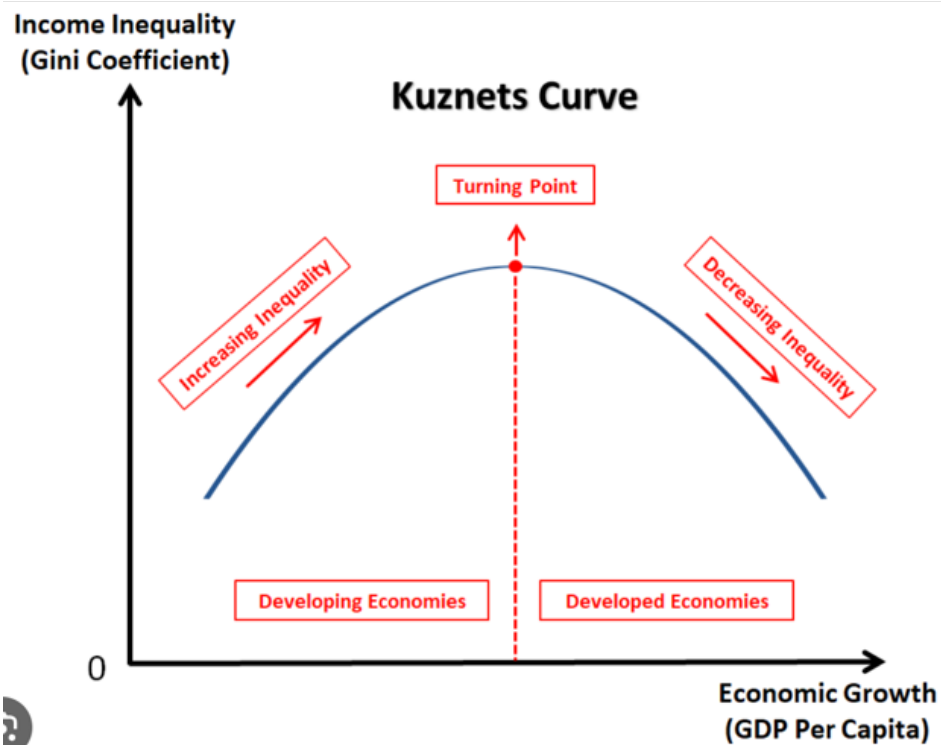
- It is an economic theory introduced in 1857 by Ernst Engel, a German statistician, which states that the percentage of income spent on food decreases as income rises. In other words, the income elasticity of demand of food is between 0 and 1.



B) KUZNET'S CURVE

The Kuznets curve expresses a hypothesis advanced by economist Simon Kuznets in the 1950s and 1960s. As per this hypothesis, as an economy develops, market forces first increase and then decrease economic inequality. It appeared to be consistent with experience at the time it was proposed.

However, in the USA and other developed countries, the inequality has risen, which invalidates the hypothesis.



3. MSME SECTOR

– Example Questions

- i. Why is MSME sector the worst hit by COVID-19 lockdown? Discuss the key initiatives launched under the Atmanirbhar Bharat Abhiyan to revive MSME sector. [10 marks, 150 words]
- ii. "Job creation in India suffers from policies that foster dwarfs, i.e. small firms that never grow, instead of infant firms that have the potential to grow and become giants rapidly" Discuss [250 words, 15 marks]
- iii. "Micro Small and Medium Enterprise (MSME) sector acts as a key catalyst in India's economic growth". Elaborate in light of the recent efforts taken to promote MSME sector. [250 words, 15 marks]
- iv. What are the key challenges faced by MSME sector in India? How will the recent announcement of redefining micro small and medium enterprises on the basis of annual turnover solve some of these problems? [200 words, 12.5 marks]

– Introduction

- » MSMEs are considered **pillar of economic growth/ engine of growth** in both developed and developing countries of the world. They have played a prominent role in the economic development of India too.
- » There are more than 6.34 crore MSMEs in India and around 50% of them are situated in rural areas.
- » The revision of the **definitions of MSMEs** brought in w.e.f. 1st July 2020 as part of the AtmaNirbhar Bharat Package introduced a **composite criterion of investment and annual turnover** - and **identical limits for manufacturing and service sector**.

| | |
|---------------|---|
| Micro | Investment [in Plant and Machinery or Equipment] <u>doesn't exceed Rs 1 crore</u> and <u>turnover doesn't exceed Rs 5 crore</u> . |
| Small | Investment <u>doesn't exceed Rs 10 crore</u> and <u>turnover doesn't exceed Rs 50 crore</u> |
| Medium | Investment <u>doesn't exceed Rs 50 crore</u> and <u>turnover doesn't exceed Rs 250 crore</u> . |

- **Note:** In the older definition, only investment criteria was used and separate parameters were there for Manufacturing sector and service sector.

– Significance of the change

- » The change in definition will facilitate expansion and growth of these enterprises.
 - The **resulting economies of scale** can enhance productivity without MSMEs losing out on several government incentives including market support, export promotion, preferential procurement in the public sector, and incentives through various government initiatives (MSE-CDP, PMEGP, SFURTI).
- » This change will also **align MSMEs with GST regime** and would prove to be a good tool to assess the contribution of the MSMEs to GDP. It will also **avoid unnecessary inspections** and enable authorities to verify claims of businesses using GST network sales data

» Same criteria for both manufacturing and Service SME will simplify the classification.

– **Importance of MSME sector for India's economy**

» **Economic:**

- Share of MSME in the country's GVA is approx. **33.08 percent** (current price, 2019-20 (as per ESI 2021-22)).
- It **employs around 11 crore people** in India.
 - High Labor to capital ratio
 - It provides maximum opportunities for self-employment and wage employment outside the agri-sector.
- **Manufacturing** -> 40% of the total manufacturing output.
- **Exports:** Around 50% of the total manufacturing exports

» **Curtailing Regional Disparity**

- Geographical distribution of MSME's are more even.

– **Potential for growth in this sector**

- » In countries like Singapore, France, Germany, Taiwan, South Africa etc, MSME contributes more than 50% in GDP and more than 50% in total employment too.
- » With India's large labour pool of engineering talent and high skill labour at competitive costs, India has the potential to become a significant player in MSME sector, especially in auto industry.

– **Problems faced by MSME Sector**

- i. **Poor access to Institutional Credit** - UK Sinha committee (expert committee on MSME) singles out access to finance as the **foremost constraint** hindering the growth of MSME sectors.
 - » **Banks are often unwilling to lend to MSMEs and charge higher interest from them.**
- ii. **COVID-19 Pandemic** had hit MSMEs the most as they didn't have the deep pockets to sustain the lock down which the country went through.
 - » **Lack of deep pockets -> More than 95% of India's MSMEs are micro enterprises and they have found it difficult to survive after not being in business for 1 or 2 months.**
 - » **Most in Unorganized sector -> unregistered -> difficult to access government benefits.**
 - » **Difficulties in finding labour force after opening up of the economy.**
- iii. **Delayed Payments**
 - » Many MSMEs take part in supply chain as a supplier of intermediate goods and services to large firms including PSUs, resulting in low bargaining powers. Delayed payments significantly hamper MSMEs ability to repay loans and make wage payments.
- iv. **Poor state of infrastructure and Logistics**
 - » **Our MSMEs still work with older technologies**
 - » **New advanced technologies are generally too expensive for them.**
 - » **Poor state of logistic sector in India makes our MSMEs less competitive.**
- v. **Lack of skilled workforce**

- » Since most of MSME are in informal/unorganized sector, they mostly hire contract labourers who don't have any regular training.

vi. Lack of proper market linkages

- » Attracting the buyers to sell the products is one of the biggest challenges because a MSME doesn't have a credible brand name and at times it has to face big rivals in their product segment who have a natural benefit of their scale of operations

vii. Excessive Regulation

- » For e.g.: Local entrepreneurs still have to go through 12 procedures to start a business in Mumbai, the business hub of the country

viii. Policy Changes, Complicated labor laws, changing taxation policy are also creating hindrance to the sector.

- » GST, though supposed to simplify tax structure, had become a problem for MSMEs in the initial phase.
- » Demonetization had also badly impacted MSMEs as most of them worked in informal sector.

– **Initiatives of Government of India to promote/help MSMEs**

- » The importance and contribution of the MSME sector to the economic growth and prosperity is well established. Towards this, government has taken a number of steps:

1. Initiatives under Atmanirbhar Bharat Abhiyan

- **Emergency Credit Liquidity Guarantee Scheme (ECLGS)** (extended till March 2023)
- **New Definition of MSMEs**
- **Rs 20,000 crore of subordinate debt to stressed MSMEs.**

2. Raising and Accelerating MSME Performance Scheme (RAMP) in July 2022:

- **Ministry:** Ministry of MSME
- It is a World Bank supported Central Sector Scheme. It is aimed at strengthening institutions and governance at the Centre and State, improving Centre-State linkages and partnership and improving access of MSMEs to market and credit, technology upgradation and addressing issues of delayed payments and greening of MSMEs.
- **Duration:** it will be implemented over a period of five years.
- **Outlay:** The total outlay of the scheme is Rs 6,062.45 crores or USD 808 million, out of which Rs 3750 crore or USD 500 million would be a loan from the World Bank and the remaining Rs 2312.45 crore or USD 308 Million would be funded by Gol.

3. MSME Cluster development program of Ministry of MSME

- » MSME is running two cluster development programs
 - i. Micro and Small Enterprises - Cluster Development Program (MSE-CDP)
 - ii. Scheme for upgradation of rural and traditional industries (**SFURTI**)

» **Advantages of such cluster programs**

- Quicker dissemination of info allows easy sharing of knowledge and best practices.
- Better cost effectiveness due to distribution of common cost
- Focuses on holistic development covering infra, common facility, testing, technology, & skill upgradation, marketing and export promotion.
- Weaves the fabric of networking, cooperation and togetherness in the industry

4. Other Past steps for Easy Credit Availability

» **Interest Subvention Scheme for MSME Sector**

- The scheme was launched in 2018 and provides a 2% interest subvention to GST Registered MSME sector.
- » **MUDRA** initiative focuses on collateral free loans of upto Rs 10 lakh for non-farm sector.
- » MSME sector brought **under PSL** by RBI from July 2016. From 2018, foreign banks also have to follow the PSL norms.
 - Banks should **advance 7.5% of their loans to MSME** under PSL guidelines.

5. Steps to increase production by MSME and demand of MSME products

- » **Reservation of items to be manufactured by MSME** sector -> provided in the Industries (development and regulation) Act, 1951.
- » **Purchase Preference Policy: All CPSUs/Central Government Departments are required to procure 25% of their annual procurement** from MSMEs (including 4% from MSEs owned by SC/ST and 3% from MSEs owned by women entrepreneurs) and there is a sub-target of 20% for procurement of MSMEs owned by SC/STs under the Procurement Policy launched in 2012.
 - 1. **MSME SAMBANDH Portal** - To monitor the implementation of the public procurement from MSEs by Central PSUs.
- » **Price Preference Policy:** For selected items a price preference of 15% premium over the lowest quotation of the large scale unit is provided to MSME.
- » **Benefits in tendering:** MSMEs are provided benefits such as exemption from payment of security deposit etc.
- » **Marketing Assistance Scheme:** Provides assistance to MSMEs for the following activities: Organization of exhibitions abroad, co-sponsoring of exhibitions organized by other organizations, organizing buyer seller meets etc.

6. Other Initiatives to Increase Ease of Doing Business for MSMEs

i. **Udyam Registration (UR) Portal** (became operational in July 2020)

- It provides faceless, fully online, paperless, and transparent MSME registration process fully integrated with Income Tax and GSTIN system.

It is also integrated with government e-market place to make end to end MSME registration paperless.

- In 2021, government has included Retail and wholesale trade as MSMEs. They are allowed to be registered on Udyam registration portal. But the benefits to them is restricted to PSL only.
- **Progress:**
 - As of 7th Jan 2022, the portal has a total registration count of 1.32 crores.

ii. **MSME SAMADHAN PORTAL**

- It was set up under the Micro, Small and Medium Enterprise Development (MSMED) Act to monitor the outstanding dues to the MSME sector.
 - MSMEs can directly register their cases relating to delayed payments by Central ministries/departments/CPSEs/Statements governments.
- As of 7th Jan 2022, the portal has received a total of 1.3 lakh applications.

iii. **TReDS (Trade Receivable Discounting System) Platform** for facilitating the discounting of trade receivable of MSMEs through multiple financiers.

- TReDS is an institutional mechanism for financing of trade receivables of MSMEs from corporate buyers through two or more financiers.
- There are 3 direct participants involved in the activities of TReDS viz.
 - MSME Sellers
 - Corporate Buyers
 - Financiers
- TReDS provides a platform to bring these participants together for facilitating, uploading, accepting, discounting, trading and settlement of the invoices / bills of MSMEs.

iv. **The CHAMPIONS portal (www.champion.gov.in):**

- It is a grievance redressal portal for MSMEs launched by Ministry of MSME in June 2020.
 - It is an ICT based technology system for making the smaller units big by helping and handholding them. A network of control rooms is created in a Hub & Spoke Model where hub is situated in the Ministry of MSME.
- As of Jan 2023, more than 56K grievances have been received and more than 98% of them have been resolved.
- The portal continues to improve through initiatives such as localization of the portal in 11 regional languages and introduction of chatbot.

v. **GST Composition Scheme** (turnover limit 1.5 crore (75 lakh in case of NE States)

vi. **Budget 2020-21: Easing Compliance burden**

- In order to reduce the compliance burden on small retailers, traders and the MSME sector, **the auditing threshold has been raised by 5-times from INR 1 Cr in turnover to INR 5 Cr.** This would be applicable only to those **MSMEs that transact less than 5% in cash.**

viii. **Zero Defect Zero Effect (ZED) Scheme** to rate and handhold MSMEs to delivery top quality products using clean technology.

7. Pre-Packaged Insolvency Resolution:

– **Steps that further needs to be taken**

- Identify, Formalize and Spread awareness about government initiatives:** Identification of informal units in the sector and enabling the reach of policy intervention is significant.
- Promote Digitization and Widen the use of Fintech Services**
 - Mandating the payments to MSME by UPIs can reduce the delays in payments
 - Fintech services (for e.g. Capital float) use technology to evaluate the financial capabilities of an MSME and provide collateral loans to them. It can thus deal with the financial woes of the MSMEs.
- Provide more incentives for technology upgradation of MSME sector** specially for new and emerging technologies like Industry 4.0.
- Mandatory procurement requirement should be extended to State PSUs also.** Right now, only CPSUs have mandatory procurement requirement from MSMEs.
- Increase the limit for collateral free loans to 20 lakh** from the current 10 Lakh limit (under MUDRA)
- Re-structure initiatives like Skill India** to fulfill the human resource requirements of MSMEs
- Act proactively within international laws to deal with dumping from countries like China.**
- Ending the bane of dwarfs**
 - **Bring a sunset clause for benefits enjoyed by MSME**
 - I.e. an MSME should be able to enjoy certain benefits only for some period let's say 10 years. This will contribute towards ending the bane of dwarfism which limits job creation and productivity.
 - It will also help direct more funds towards new MSMEs thus promoting entrepreneurship, innovation and fast job creation.
 - **Prioritize PSL for infant (new MSMEs)**
 - **Reform labor laws** to incentivize expansion.
- Work towards Sustainability of MSMEs** -> Government should try to mobilize international climate finance for the purpose of MSME.

– **Conclusion:**

- » Necessity is the mother of invention. The Pandemic has certainly created the need for innovative policies to rescue the ailing MSME sector.

4. BANE OF DWARFISM IN MSME

– Current Situation: Bane of Dwarfs

- ESI has defined dwarfs as firms that never grew beyond their small size. They are both small (< 100 employees) and older than 10 years and have continued to be stunted in their growth despite surviving for more than 10 years.
- Key facts about Dwarfs and small firms based on Annual Survey of Industries (ASI) for the year 2016-17:**
 - Dwarfs make up more than 50% of the firms in organized manufacturing by number** -> their share of employment is only 14%, Net Value added is only 7.6%.
 - And, the **firms that are able to grow over time to become large are the biggest contributors to employment and productivity** in the economy.
- The above data dispels the common notion that small firms generate the most employment.** Small firms may generate higher number of new employments, however, they destroy as many jobs.
- As compared to the small firms, it is the young firms that contribute significantly to employment and value added.**

– In India, with age the firm's size hasn't grown to the extent in other countries

- For e.g. According to ESI's analysis, the **average employment** level for 40-year old enterprise when compared to when enterprise was newly set is:
 - 7 times in USA
 - 1.4 times in India
 - 2 times in Mexico
- Similar is the story for productivity (4 times in USA, 1.6 times in India 1.7 times in Mexico)
- Thus, both employment creation and productivity doesn't grow adequately as firms age in India.**

– The Role of Government Policies in Fostering Dwarfism

- In India, the government policies create a '**perverse incentive**' for firms to remain small. If the firms grow beyond the thresholds that these policies employ, then they will be unable to

Table 1. Size based Limitations posed by Key Labour Legislations

| S.No. | Labour Acts | Applicability to Establishments |
|-------|--|---|
| 1 | Industrial Disputes Act, 1947, Chapter V relating to strikes, lockouts, retrenchment, layoff | Employing 100 or more workers |
| 2 | Trade Union Act, 2001-Registration of trade unions | Membership of 10 per cent or 100 workmen whichever is less |
| 3 | Industrial Employment (Standing Orders) Act, 1946 | 100 or more workmen |
| 4 | Factories Act, 1948 | 10 or more workers with power and 20 or more workers without power |
| 5 | Contract Labour (Regulation & Abolition) Act, 1970 | 20 or more workers engaged as contract labour |
| 6 | The Minimum Wages Act, 1948 | Employment in the schedule having more than 1000 workers in the State |
| 7 | Employees' State Insurance Act, 1948 - ESI Scheme | 10 or more workers and employees monthly wage does not exceed ₹21000 |
| 8 | Employees' Provident Fund & Miscellaneous Provisions Act, 1952 | 20 or more workers |

Source: Compiled from Ministry of Labour and Employment

obtain the said benefits. And since the economies of scale stem primarily from firm size, these firms are unable to enjoy such benefits and therefore remain unproductive.

- Impact of Labor Regulation**

- The regulations exempt smaller firms from complying. Given the compliance cost, a large majority of firms would prefer to be below the threshold of 100 employees.
- **ESI's analysis also shows that Flexible States** (states which provided flexibility/reforms in Labor laws) **create a more conducive environment for growth of industry and employment generation.**
- Studies have found that on average, plants in labour-intensive industries that have transitioned towards more flexible labor markets, such as UP and Gujarat are 25.4% more productive than their counterparts in states like WB or Chhattisgarh that continue to have Labor rigidities.

– Impact of Small Scale Reservation

- The policies which promote small firms irrespective of their age include:

| Scheme | Objective |
|--|--|
| Priority Sector Lending | Direct and indirect finance at subsidized interest rates shall include all loans given to micro and small enterprises, irrespective of their age. |
| Credit Guarantee Fund Scheme | This scheme makes available collateral-free credit to the micro and small enterprises, irrespective of their age. |
| Purchase Preference Policy | A group of items (Group IV) are reserved for exclusive purchase from small scale units, irrespective of their age. Group V items are to be purchased from MSMEs, irrespective of their age, up to 75 per cent of the requirement. |
| Price Preference Policy | For selected items that are produced by both small scale and large scale units, price preference is provided to small firms, irrespective of their age. This price preference amounts to a 15 per cent premium over the lowest quotation of the large-scale units. |
| Benefits in tendering | MSMEs, irrespective of their age, can avail benefits such as availability of tender sets free of cost, exemption from payment of earnest money deposit, exemption from payment of security deposit. |
| Raw Material Assistance Scheme of National Small Industries Corporation (NSIC) | This scheme aims to help MSMEs, irrespective of their age, with financing the purchase of raw material (both indigenous and imported). |
| Marketing Assistance Scheme | Provides assistance to MSMEs, irrespective of their age, for the following activities: organization of exhibitions abroad, co-sponsoring of exhibitions organized by other organizations, organizing buyer-seller meets, intensive campaigns and marketing promotion activities. |
| GST Composition scheme | Scheme allows MSME firms, irrespective of their age, to pay GST at a flat rate. The turnover limit for businesses availing of the GST composition scheme is set at ₹1.5 crore. |
| Exemption under Central Excise law | Small scale units below a turnover of ₹4 crore, irrespective of their age, manufacturing good specified in SSI are eligible for exemption. |

- **Because of above policies, India has created a number of dwarfs and they are consuming most of the resources that could possibly be given to infant firms.** These dwarfs contribute less to creation of jobs and economic growth as compared to infants.
- **Way Forward**

- MSMEs that grow not only create greater profits for their promoters but also contribute to job creation and productivity in economy. Our policies must therefore focus on enabling MSMEs to grow by unshackling them. Further there is a need of recalibration of policy towards supporting infant firms.
- **Prioritize PSL lending towards 'start ups' and 'infants'** in high employment elastic sectors.
 - This will ensure direct credit flow to sectors that can create the most jobs in the economy.
- **Sunset clause for the incentives:** Intensive should be available to firm only for 5-7 years thus ensuring most funds goes to start ups and infants.
- **Focus on High employment elastic sector:**
- **Focus on Service Sector with high spill over effect such as tourism**