APPROACH – ANSWER: G. S. MAINS MOCK TEST - 2344 (2024)

Answer all the questions in NOT MORE THAN 200 WORDS each. Content of the answers is more important than its length. All questions carry equal marks. ***12.5X20=250***

1. Classifying inflation on the basis of its causes, discuss the impact of inflation on the economy of a country.

Approach:

- Define inflation in the introduction.
- Classify inflation on the basis of its causes.
- Discuss the positive and negative impact of inflation on the economy of a country.
- Conclude appropriately.

Answer:

Inflation refers to a sustained increase in the general price level of goods and services in an economy over a period of time. Depending on its causes, inflation can be classified as:

- **Demand-Pull Inflation**: It occurs when the aggregate demand for products and services is more than their aggregate supply in the economy. It produces a demand-supply mismatch, with increased demand and lower supply, resulting in higher prices of goods and services.
- **Cost-push Inflation:** It is defined as an increase in the cost of production elements such as labour, raw materials, etc. As the cost of production increases, the general price level rises due to which companies raise the price levels of goods to maintain profit. Thus, resulting in an increase in the overall price of commodities.

Positive impact of Inflation on the economy:

- **Sustained demand and production:** A moderate level of inflation is generally considered to be a sign of a healthy economy. It sustains the demand in the economy. This increase in demand pushes the prices a little higher and induces the suppliers to produce more goods that are in demand.
- **Investment and capital formation:** Demand for more production induces investment in new capacities and augments the production capacities of the economy.
- **Economic growth and employment generation:** New investment creates new jobs and demand in the economy and this virtuous cycle continues, resulting in overall economic growth and augmentation of tax revenue for the state.
- **Prevents 'Paradox of thrift':** This paradox states that if consumer prices are allowed to fall consistently because the country is becoming too productive, consumers learn to hold off their purchases to wait for a better deal. The net effect of this paradox is to reduce aggregate demand, leading to less production, layoffs, and a faltering economy.

Negative impact of Inflation on the economy:

- **Erosion of purchasing power of currency:** With inflation a given amount of money can buy lesser goods and services thus reducing overall value of currency. This leads to reduced purchasing power and can make it difficult for people to even afford basic necessities. This leads to deterioration of standard of living.

- **Adversely impacting Balance of Payments:** Inflation degrades the value of domestic currency. This makes imports costlier which reduces forex reserves and deteriorates the balance of payment.
- **Shortage of goods:** During inflation, hoarding and stockpiling due to speculation may lead to shortage of goods in the market.
- **Reduced investment:** High inflation can lead to uncertainty and volatility in the economy, making it difficult for businesses to plan new projects or expansion, which can slow economic growth**.**

Thus, maintaining a moderate level of inflation is good for a healthy economy. Therefore, the state through various legislative initiatives such as the **Essential Commodities Act, FRBM Act and monetary policy** by the RBI tries to maintain moderate levels of inflation in India.

2. Discuss the significance of digital payments in India. Also, list the recommendations of the Nandan Nilekani Committee to deepen the digital payments in the country.

Approach:

- Give a brief introduction about how digital payments have increased over time in India.
- Discuss its significance.
- Suggest measures recommended by the Nandan Nilekani Committee to deepen the digital payments.
- Conclude accordingly.

Answer:

Digital payment transactions have significantly increased as a result of coordinated efforts of the Government as a whole, along with all stakeholders concerned, from 2071 crore transactions in FY 2017-18 to 8840 Crore transactions in FY 2021-22.

During the last few years various easy and convenient modes of digital payments, including **BHIM-UPI, IMPS, NETC, RuPay** have registered substantial growth and have transformed the digital payment ecosystem by increasing P2P as well as P2M payments. BHIM UPI has emerged as the preferred payment mode of the citizens. **The significance of digital payment is as follows:**

- **Instant and convenient mode of payment**: Unlike cash, money can be instantaneously transferred to the beneficiary account using digital modes like BHIM-UPI and IMPS through mobile phones. BHIM-UPI has enabled access to multiple bank accounts in a single mobile app, facilitating ease of payments for multiple services.
- **Enhanced financial inclusion:** People who may have been deterred by the time, and travelling cost involved in physically accessing a bank outlet for transactions can now conveniently access the bank account digitally and get various benefits of being part of the formal banking system and becoming financially included.
- **Increased transparency in the government system**: Benefits of government schemes are directly transferred (DBT) to the target beneficiary account through digital modes of payments.
- **Enhanced credit access**: Digital payments establish a user's financial footprint, thereby increasing access to formal financial services including credits.
- **Safe and secure:** Digital payments across India are secure as multiple levels of authentication are required for making transactions thus making it secure.

However, still around 70% of India's consumer transactions are done through cash. Thus, there is a need to introduce the following measure recommended by the **Nandan Nilekani Committee** to deepen digital payment in the country:

- **Targets for digital payments**: The Committee has set the following targets to be achieved in 3 years i.e. tenfold increase in per capita digital transactions, doubling the value of digital transactions as % of GDP and tripling the number of digital payment users.
- **Specific payment mechanism:** Currently merchants pay a Merchant discount rate (MDR) to banks for accepting payments from customers. The Committee recommended that the MDR should be subsidized by the government.

- To improve the acceptance of digital payments, the Committee recommended removal of import duties from point of sale devices and waiving GST on IMPS.

- **Government payments**: The Committee recommended that the government departments must ensure that all pay-outs are through digital means, including payments for goods and services procured, DBT, salaries and pensions.
- **Grievance redressal**: The Committee recommended that government departments and banks must provide a dedicated grievance redressal mechanism, particularly in vernacular language to process connectivity and authentication errors in DBT.
- **Curb transaction failure:** Government agencies should ensure the use of validation services such as Public Financial Management System and National Payments Corporation of India to reduce the incidence of transaction failure because of wrong account / Aadhaar details.

Also, the government should focus on improving digital connectivity, and making robust cyber security. There should be awareness creation and digital literacy to further deepen digital payment in India.

3. What do you understand by digital tax? Bringing out the rationale behind introducing digital tax in India, discuss the associated challenges.

Approach:

- Explain the concept of digital tax.
- Bring out the rationale behind introducing digital tax in India.
- Discuss the associated challenges.
- Conclude accordingly.

Answer:

Digital Tax refers to the **tax levied on digital goods or services or digital business activities**. In 2016, India was one of the first countries to introduce a **6% equalization levy (EL)** i.e., Digital tax on non-resident digital companies like Google or Facebook.

In 2020, the Indian **Income tax Act** expanded the scope of Equalization Levy as part of the Finance Act 2020. The new levy now **includes 2% digital service tax (DST)** or EL on trade and services of foreign e-commerce companies such as amazon or Flipkart and others having an annual turnover of Rs. 2 crore or more. DST is aimed at ensuring that non-resident digital service providers pay their share of tax on revenues generated in the Indian digital market.

Rationale behind introducing digital tax in India:

- **Overcoming lacunas of obsolete laws:** Current tax regulations, both international and domestic, were formulated decades ago using brick-and mortar economy capabilities as a guideline.
- **Adhere to International commitment:** The agenda to reform international tax law to tax digital companies was formally framed within the OECD's BEPS programme.
- **Proliferation of DSTs:** Due to the changing international economic order, countries such as India, which provide large markets for digital corporations seek a greater right to tax incomes.
- **Fair competition**: Equalisation levy ensures fair competition, reasonableness and aids the ability of governments to tax businesses.
- **Global competitiveness**: To ensure a level-playing field with respect to e-commerce activities undertaken by entities resident in India and outside it.

Challenges associated:

- **Retaliatory tariffs:** US initiated the US Trade Representative (USTR) investigations, which found DST to be discriminatory, and then announced retaliatory tariffs which could lead to digital tax war.
  - **USTR** states that the DST discriminates against US digital businesses because it specifically excludes from its ambit domestic (Indian) digital businesses.
- **Burden on customers**: Experts suggest that such taxes can be passed on to consumers. Therefore, instead of companies, it will tax the consumers.

- **Lack of consensus**: To address disputes arising out of tax compliance on a service or consumer grievance, there is a need for a dispute resolution process such as arbitration which is itself a challenge due to lack of consensus among different countries.
- **Tax sovereignty compromised**: India and other developing countries have objected to a provision that bars nations from enacting any future digital services taxes such as equalization levy as it will unduly restrict sovereign rights to make laws.

Thus, there is a need for coordination among world countries to develop guidelines and set up a dispute redressal mechanism. A new basis to tax i.e., the number of users in a country can be adopted. Also, bilateral, and multilateral renegotiation of tax treaties superseding domestic tax laws are required to address the issue of double taxation.

4. *Give an account of the different tools available with the RBI to control money supply in the economy.*

Approach:

- Explain the different policy tools – both qualitative and quantitative - available with RBI to control money supply.
- Conclude accordingly.

Answer:

The **Reserve Bank of India (RBI)** uses the monetary policy to manage liquidity or money supply in a manner that balances inflation and at the same time aids growth. In 2016, the RBI Act was amended to empower the central government to constitute a six-member Monetary Policy Committee (MPC) to achieve the inflation target (**4% with an upper tolerance limit of 6% and a lower tolerance limit of 2%**).

The different tools available with RBI to control money supply can broadly be categorized into two types: 1) **Quantitative** (2) **Qualitative**

Quantitative Measures: Quantitative measures are employed to regulate the credit creation by the banks and these include:

- **Open Market Operation:** It refers to the sale and purchase of securities by the central bank to commercial banks. A sale of securities by the central bank, that is, the purchase of securities by the commercial banks, results in a fall in the total cash reserves of the latter.
- **Cash reserve Ratio (CRR):** CRR is a specified minimum fraction of the total deposits of customers, which commercial banks have to hold as reserve either in cash or as deposits with the central bank.
- **Statutory Liquidity ratio (SLR):** SLR is the amount of money that is invested in certain specified securities predominantly central government and state government securities.
- **Liquidity Adjustment Facility (LAF):** It includes Repo rate and Reverse repo rate. **Repo Rate** is the rate at which the central bank lends money to commercial banks for short term in the event of any shortfall of funds. RBI periodically oversees this rate. **Reverse Repo rate** is the rate at which banks park their funds with the RBI. These rates are used by the RBI to send signals to the financial system to adjust lending and borrowing operations.

Qualitative Measure: Qualitative measures are employed to direct the credit flows towards the desired sectors and segments of the economy/population. These include:

- **Margin requirement:** These refer to differences between the securities offered and the amount borrowed by the banks.
- **RBI's Direct Action:** RBI issues oral, written statements, warnings etc. to the banks in certain situations when there is a disconnect between bank operation and RBI's guidelines.
- **Rationing of credits:** The RBI controls the credit granted/ allocated by commercial banks. RBI also makes credit flow to certain priority or weaker sectors by charging concessional rates of interest.

- **Moral Suasion:** RBI persuades and requests the commercial banks to refrain from giving loans for speculative and non-essential purposes. On the other hand, to counter deflation RBI persuades the banks to extend credit for agriculture, education etc.

Over the decades, it has been proven that the credit supply in the economy can be controlled better with the coordination of both Quantitative and Qualitative methods rather than implementing them individually in the economy.

5. What do you understand by Balance of Payments (BoP)? Highlight its different components. Also, discuss the implications of BoP deficit.

Approach:

- Introduce by briefly defining the Balance of Payments (BoP).
- Bring out the different components of BoP.
- Explain the implications of deficit in Balance of Payments.
- Conclude accordingly.

Answer:

Balance of Payments (**BoP**) of a country is a systematic record of all economic transactions between the residents of one country and the rest of the world during a given period of time. These transactions consist of imports and exports of goods, services and capital, as well as transfer payments such as foreign aid and remittances.

Following are the components of Balance of Payments:

- **Current Account:** It records exports and imports in goods and services, and transfer payments.
  - **Balance of trade (BoT):** It shows the balance of imports and exports of **visible goods** i.e., the merchandise portion of BoP.
  - **Balance of invisibles:**
    - ✓ **Trade in services:** It includes both **factor income** [net income from compensation of employees and net investment income (interest, profit and dividend)] and net **non-factor income** (shipping, banking, insurance, tourism, software services, etc.).
    - ✓ **Transfer Payments:** These are receipts, which the residents of a country receive **'for free',** without having to make any present or future payments in return. They consist of **remittances, gifts, and grants.** They could be official or private.
- **Capital Account:** It records all international purchases and sales of assets such as money, stocks, bonds, etc.
  - **Balance of capital transfer:** This accounts for FDI, FPI, borrowing and lending from abroad, NRI deposits, external assistance, Rupee debt service, Bank balances [FCNR(B), NRO, NRE], etc.
  - **Official Reserve Account:** It accounts for gold, foreign currencies, SDRs, reserve positions in the IMF, etc.
- **Errors and Omissions:** It constitutes the third element in the BoP (apart from the current and capital accounts), which is the 'balancing item' reflecting the inability to record all international transactions accurately.

In terms of accounting, the current and capital accounts remain in balance, such that there will be no deficits and surpluses in aggregate BOP. It means, if a country has a deficit in its current account (spending more abroad than it receives from sales to the rest of the world), it is **financing the deficit by selling assets or by borrowing abroad or by running down its reserves of foreign exchange.** Such BOP crises have the following implications:

- An increased external debt burden would mean that the **country is postponing its current liabilities to the future**.
- Borrowing money from organizations like the IMF comes with **terms and conditions impacting economic decision making** of the country.
- It can cause **fluctuations in the exchange rate** leading to depreciation or weakening of the domestic currency. For a country like India,

- Depreciation **increases the value of import** (e.g., oil), and hence causes inflation.
- Depreciation makes **loan repayment costlier**, as most of the external debt is denominated in foreign currency.

- The **economy is perceived weak and unattractive for the foreign investors**, leading to flight of capital.

The 1991 Indian economic crisis resulted from a balance of payments deficit due to excess reliance on imports and other external factors. To deal with the deficit, the government had to pledge 47 tonnes of gold reserves to England and Japan as collateral and had to liberalise its economy as conditions set by the IMF and the World Bank.

6. Explain the concept of gender budgeting and discuss how it can be implemented effectively in India.

Approach:

- Explain the concept of gender budgeting.
- Briefly describe the issues in gender budgeting in India.
- Discuss the steps that can be taken for it to be implemented effectively in India.
- Give a brief conclusion.

Answer:

The gender budget is an exercise that applies a gendered lens to the allocation and tracking of public funds. It is a tool to achieve gender mainstreaming so as to ensure that the benefits of development reach women as much as men.

India has started releasing a **Gender Budget Statement (GBS)** along with its Union budget since 2005. The GBS is comprised of two parts:

- Part A, which encompasses **schemes that allot 100% of the funds** for women.
- Part B, which consists of **schemes that allocate at least 30% of funds** for women.

Limitations faced by Gender Budgeting in India:

- Since its inception, Part B of the GBS has been given 60%-80% of the weightage. It implies **wholly-women-specific schemes do not form the majority** of the gender budget.
- Present segregation does not explain how funds are allocated in **schemes, which earmark less than 30 percent of their funds** for women.
- The quantum of India's gender Budget remains in the range of **4-6% of the total expenditure and less than 1% of its GDP.**
- Almost **90% of the gender Budget** remained concentrated in five key Ministries and Departments. Areas such as **digital literacy, skill training, and prevention of domestic violence against women received only 2% of the budget.**
- Lack of tracking **gender disaggregated data** to determine who is benefiting from government schemes.

In this context, the following steps can be taken to implement it effectively in India:

- **Collecting gender disaggregated data**: Cabinet Secretariat can facilitate Gender Budgeting by making it mandatory to include sex-disaggregated targets and indicators in the **Results Framework Documents** of Ministries and Departments. This would help in analysing the distributional impacts of public expenditure across gender.
- **Capacity building of personnel:** Administrations across the country must train personnel on gender sensitivity, resources that facilitate income generation, and allocation of funds.
- **Participation of women:** More women should be included in planning and budgeting processes. They should be treated as equal partners in decision-making and implementation rather than only as beneficiaries.
- **Spatial mapping:** It shows deviations from norms and spatial variations while implementing programs and schemes. It can be used to determine and rectify discrimination against women, to

bridge existing gaps or plan new interventions. Spatial mapping may also encourage regional imbalances to be corrected within states and districts.

- **Reforms at state level:** Within states, the gender focal point should be pursued through the forum of the State Planning Board, Annual Plan of respective states should be evaluated, and a **Gender Task Force** should be formulated at the state, district, block, village/Urban Local Bodies levels.
- **Reforms in budgetary process:** A Budget Office in Parliament, the use of Gender Equity Certificates, Pre-budget consultation paper or Budget Framework Papers are some useful tools in engendering the budget process.

The success of gender budgeting initiatives depends on the broader political context. Gender budgeting needs strong alliances of key stakeholders, such as legislature, NGOs, civil society, academics, and media. Each category brings skills and visions to the budgeting process. The role of the Ministry of Finance is immense in opening up the budget process so that representatives and citizens can participate more fully in shaping budgets. Moreover, there is a need to strengthen the Gender Budgeting Cells to ensure systematic process of engendering of their policies, programs and schemes.

7. ***Highlighting the current status of Non-Performing Assets (NPAs) in India, discuss the major steps taken to resolve the NPA crisis.***

Approach:

- Start with the definition of NPA and the recent RBI report on it.
- Highlight the current status of NPAs.
- Discuss the steps taken.
- Conclude accordingly.

Answer:

A Non-performing asset (NPA) is a loan or advance for which the principal or interest payment remained overdue for a period of 90 days. As per **the Financial Stability Report of RBI,** banks **gross NPA** continued to decline and stood at a **seven-year low of 5%** in 2022-23 from the peak of 9% in 2017-18. The **net NPA stood at a ten-year low of 1.3%** under which private bankers' net NPA was below 1%.

Decline in Gross NPAs is evident due to:

- **Drop in slippage ratio of Scheduled Commercial Banks:** The slippage ratio indicates fresh accretion of NPAs in a year. It is arrived at by dividing fresh NPAs by standard advances at the beginning of the period. The slippage ratio is around 2% in September 2022 for SCBs, which is the lowest since 2015.
- **Asset Quality**: Due to the easing of legacy NPAs, the asset quality has seen an improvement in terms of transparency in asset recognition and write-offs.
- **Credit Growth**: Credit growth in the banks has been enhancing profitability from the 2014-15 levels. This has accelerated the incomes and lowered the interest expenditures.

The Asset Quality Review (AQR) initiated by the RBI in 2015 revealed high incidence of non-performing assets (NPAs) in banks. Thereafter, the government brought several banks under Prompt Corrective Action (PCA) framework and implemented a comprehensive 4R's strategy of Recognising NPAs transparently, Resolution and recovery, Recapitalizing PSBs, and Reforms in the financial ecosystem.

Consequently, following steps have been taken:

- **Recapitalisation of Public Sector Banks:** The government infused capital in successive budgets (e.g., Rs 20,000 crore in 2021-22) to help PSBs in achieving capital adequacy requirements.
- **Mission Indradhanush**: To tackle the challenges faced by PSBs, institutional reforms were brought through Mission Indradhanush which included seven elements like Accountability framework, De-stressing, Governance Reforms, etc.

- **National Asset Reconstruction Companies:** A specialized financial institution was created that buys the Non-Performing Assets (NPAs) from banks and financial institutions so that they can clean up their balance sheets.
  - **India Debt Resolution Company Ltd (IDRCL):** To manage the asset and engage market professionals and turnaround experts. Public Sector Banks (PSBs) and Public FIs will hold a maximum of 49% stake in IDRCL, while the remaining stake will be with the private sector lenders.
- **Insolvency and Bankruptcy Code (IBC)**: It was brought in 2016 for a time-bound, market mechanism for reorganization and insolvency resolution of corporate loans in financial stress.
  - It empowers operational creditors by allowing them to make applications for the Corporate Insolvency Resolution Process (CIRP).
  - IBC is further amended to introduce Pre-Packaged Insolvency Resolution Process (PPIRP), an alternate and speedier resolution mechanism for MSMEs.
- **EASE Reforms**: Enhanced Access and Service Excellence (EASE) Reforms for PSBs aimed at institutionalizing clean and smart banking.

Going forward, it is imperative that banks ensure due diligence and robust credit appraisal to limit credit risk. The uncertainties characterising fast-changing macro-economic scenarios amidst formidable global headwinds during 2022-23 can pose new challenges to the banking sector.

8. Despite the benefits of Conclusive Land Titling, there are several challenges that remain in implementing it in India. Discuss.

Approach:

- Introduce by writing about Conclusive land titling.
- Mention the benefits of Conclusive Land Titling.
- Discuss the challenges that remain in implementing it in India.
- Conclude accordingly.

Answer:

Conclusive land titling is when the state provides guarantee on land titles and also includes provisions for compensation in case of any dispute. When compared to the currently followed system of presumptive land titling, conclusive titling has the following benefits:

- **Reduces Ambiguity:** Currently, as land titles are based on transactions, it becomes necessary to keep the entire chain of transaction records, and a dispute on any link in that chain causes ambiguity in ownership.
  - However, under a conclusive land titling system, land records designate actual ownership, thus reducing ambiguity over ownership of land.
- **Lower Litigation:** According to a **World Bank** study on '**Land Policies for growth and poverty reduction**', land-related disputes accounted for two-thirds of all pending court cases in India and the average time taken for land related dispute resolution is 20 years.
  - Conclusive land titling can considerably lower this due to state guarantee for their correctness and compensation provision in case of any disputes.
- **Ease of Doing Business**: Under conclusive titling, investors who want to purchase land for business activities will be able to do so without facing the ownership and investment risk. Due to this, land acquisition for investors and its registration will become faster.
- **Infrastructure Development**: Land disputes and unclear titling create hurdles for infrastructure development and housing construction, leading to costly delays and inefficiency. Conclusive land titling will remove these hurdles leading to efficiency and cost savings.
- **Curbing Benami Transactions**: Ambiguity in ownership results in a black market for land transactions, which deprives the government of taxes. By reducing ambiguity, conclusive land titling will reduce such black or benami transactions.

Considering these benefits, **NITI Aayog,** recently, published the **Model Conclusive Land Titling Act.** However, there are several **challenges** that remain in implementing it in India which are given below:

- **Records are in a bad shape**: Many title transfers are unrecorded and changes on the land often go undocumented.
- **Different scripts and languages**: Existing records are fragmented and are maintained in different scripts and languages in different states making land titling difficult.
- **State Finances**: States have low fiscal capacity to actually underwrite buyers of land and property in case the title is not clear.
- **Burden on the legal system**: The Courts are already overburdened by disputes due to the poor quality of land records. Adding disputes around claims to have the government compensate buyers defrauded by incorrect titles will add another burden on to an already stretched legal system.
- **Low accountability of state**: The **Title Registration Officer** so appointed can also be a non-state official, i.e., a private person, and this could jeopardize accountability and can lay the entire procedure vulnerable to manipulations by private interests.

India will need a lot of political will to first improve the state of its poor land records before it can plan to overhaul the presumptive titling system. With an aspirational goal of India becoming a $5-trillion economy by 2025, the imperative need is to unleash the power of land and reap fruits by bringing about the much-needed Land Reforms.

9. Though the GDP is the most widely used indicator for comparing well-being across countries, it has certain limitations. Discuss.

Approach:

- Define GDP in the introduction.
- Highlight why it is a widely used indicator across countries.
- Discuss its limitations.
- Conclude accordingly.

Answer:

Gross domestic product (GDP) refers to the total market value of all the final goods and services produced in an economy in a given period of time. In other words, it measures the value of final goods and services produced within a geographic boundary regardless of the nationality of the individual or firm.

It is the most widely used indicator for **comparing well-being across countries** due to following reasons:

- GDP gives **information about the size of the economy** and how an economy is performing. The growth rate of real GDP is often used as an indicator of the general health of the economy.
- GDP is a standardized measure that is calculated in a consistent manner across countries, making it **easy to compare** & analyze data of different countries and **track changes over time**.
- GDP is often used to **equate a country's standard of living**. This is because a high GDP per capita is generally associated with higher levels of consumption, income, and employment opportunities, which can improve people's well-being.
- Moreover, GDP growth (as a measure of economic growth) leads to increased capacity of the State, which **contributes to welfare** and other measures of development such as literacy, healthcare provision and environmental development.

However, it is important to note that GDP has some limitations as an indicator of well-being:

- **Economic inequality**: GDP does not reveal the economic inequality in a country, which is created as a side effect of economic growth. Inequality in earnings has doubled in India over the last two decades, which were incidentally the years of highest GDP growth as well.
- **Negative Externalities**: GDP does not consider the social and environmental costs of economic growth, such as pollution or resource depletion.
- **Unpaid work not accounted**: GDP does not account for unpaid work such as caring for children or the elderly and volunteering, which can have a significant impact on people's well-being.

- **Other intangibles not measured**: Does not value intangibles like leisure, quality of life etc. since quality of life is measured by many other intangibles except the materialistic things provided by economic growth.

For the reasons mentioned above, several economists have tried to create alternatives for GDP, which try to address the aforementioned limitations of GDP. Some of these indices include Human Development Index (HDI), HPI (human poverty Index), GNH (Gross National Happiness Index), Green GDP etc.

10. *While various initiatives have been taken to improve the fiscal health of states in India, there still remain various issues that need to be addressed. Elaborate.*

Approach:

- In the introduction, give the context of fiscal health of states citing relevant data and facts.
- Highlight various initiatives taken to improve it.
- Mention various issues that need to be addressed as well.
- Conclude accordingly.

Answer:

The fiscal health of the states in India has been a matter of concern for a long time especially during the pandemic years. For instance, States' gross fiscal deficit (GFD) was 4.1% of GDP and Debt to GDP ratio was 31.1% in 2020-21 way higher vis-à-vis recommended by the Fiscal Responsibility and Budget Management (FRBM) review committee (Debt to GDP ratio of 20% for states).

Recent initiatives to improve State's fiscal health:

- **Scheme for "Special Assistance to states for Capital Investment"** providing ₹1,00,000 crores interest free loan for 50-years.
- Reform-linked additional borrowing space to state government, allowing **additional borrowing of 0.5% GSDP** for power sector reforms.
- **Inclusion of off-budget borrowings** in state debt positions, i.e., the borrowings taken by state government entities, special purpose vehicles etc. bypassing the net borrowing ceiling fixed for states in a fiscal year.

Due to above initiatives, States' GFD is budgeted to decline to 3.4% in 2022-23 and debt is budgeted to ease to 29.5% of GDP in 2022-23. Although improved, it is still higher as per recommendations of FRBM Review Committee. There are still some issues that need to be addressed:

- **Increasing share of Cess and surcharge in Centre's tax revenue:** The share of Cess and surcharges in gross tax revenue has increased from around 8 percent in 2011-12 to around 28 percent in 2021-22, thus impacting the tax devolution from Centre to states.
- **Dominance of Committed Expenditures**: A larger proportion of state budget allocated for committed expenditure like payment of salaries, pensions, and interest payments crowds out other developmental expenditure. For ex., in 2022-23, states on an aggregate have budgeted to spend 54% of their revenue receipts as committed expenditure.
- **Lower States own revenue**: Most states have lower own revenues due to losses of State PSUs, weak financial position of discoms, lack of proper user charges etc. Moreover, there is no significant increase in states' own tax revenue due to issues such as inaccurate forecasts, high administrative costs, lack of innovation, economic shocks etc.
- **High Revenue Expenditure**: The share of revenue expenditure in total expenditure of states varies in the range of 80-90%, thus impacting capital expenditure by states.
- **Other issues**: Populist programs such as farm loan waivers, Old Pension schemes etc. launched by a number of state governments contribute to the fiscal stress.

Debt consolidation should be a priority for state governments. Also, in order to attract private investment, state governments should focus on creating a favourable environment for the private sector to operate and grow. Moreover, states also need to encourage and facilitate higher inter-state trade and commerce to realize the full benefit of spillover effects of state capex across the country.

11. *The internationalisation of rupee has its own benefits for the economy, but it is not free from certain risks. Discuss.*

Approach:

- Introduce by explaining the term internationalization of rupee.
- Discuss the advantages and risks associated with internationalization of the rupee.
- Conclude by giving a way forward.

Answer:

An international currency is one, which adopts full capital and current account convertibility. It involves an increasing use of the local currency in cross-border transactions. As of now, the Indian rupee is fully convertible in the current account and partially convertible in the capital account, implying that there are certain caps on overseas investment into Indian markets.

The central bank is striving towards internationalization of the Indian rupee given its various **advantages,** which are as follows:

- **Mitigation of currency risks:** Cross-border transaction in Indian rupee mitigates currency risks of Indian businesses, thus aiding them in sustaining global business adversities.
- **Better bargaining power for Indian businesses:** Protection from currency volatility not only reduces cost of doing business but also enables better growth of business, thereby improving the chance of Indian businesses to grow globally.
- **Ease foreign trade:** Cross-border transactions in domestic currency will eliminate the chances of dictation from advanced economies and would allow India to make favourable trade decisions.
- **Preventing loss of income:** Holding foreign reserves accrue some cost on the economy in the form transfer of income from India to advanced economies. Internationalization of rupee will ultimately reduce the need for holding foreign reserves.
- **Improve savings and investment**: It will allow global capital to move freely. This will allow India to access more money for investments. **This, in turn, helps improve savings and investments within the country** and thus accelerate growth.

However, there are certain **risks** associated with internationalization of rupee, which include:

- **Heightened vulnerability to external shocks:** India is a capital-deficient country, and needs foreign capital to fund its growth. If a substantial portion of its trade is in rupee, non-residents would hold rupee balances in India which would be used to acquire Indian assets. Large holdings of such financial assets could heighten vulnerability to external shocks.
- **Challenges to the monetary policy:** Internationalization can potentially limit the ability of the central bank to control domestic money supply and influence interest rates as per domestic macroeconomic conditions. Thus, macroeconomic policy would need to measure up to such risks. Further, more effective policy tools will be needed to manage large holdings of financial assets in domestic currency, which will come from increased dealings in rupees.
- **Reduce reserve accretion**: A reduced role for convertible currencies in external transactions could lead to reduced reserve accretion.
- **Increased volatility in the domestic market:** Non-resident holdings of rupees could exacerbate pass-through of external stimulus to domestic financial markets thereby increasing volatility.
- **Uncontrolled capital inflows and outflows**: Complete internationalization of currency may lead to unrestricted inflow and outflow of rupee leading to volatility and expand the risk of hot currency (highly prone to sudden outflows) to capital assets. For instance, a global risk-off phase could lead non-residents to convert their rupee holdings and move out of India.

The risks posed by internationalization of the rupee are real, thus we need to calibrate our moves to the evolving size of our economy as internationalization would make domestic monetary policy more challenging. However, the alternative of compromising on growth by playing it safe is not an optimal choice. Thus, internationalization of rupee should be considered after a careful analysis of the advantages and risks involved.

12. ***Highlighting the factors inhibiting the export competitiveness of India, bring out the measures needed to enhance the contribution of exports in India's economic growth.***

Approach:

- Introduce the answer with India's export contribution and potential.
- Highlight the factors that hinder the export performance of India.
- Suggest measures that can further propel the export preparedness and competitiveness of the country.
- Conclude accordingly.

Answer:

Strong exports have proven to be crucial drivers of development, as seen from the examples of Japan, South Korea, China, Thailand, etc. **Though India contributes around 3.1% of the world's GDP, its export contribution to the world has been a mere 1.6% only.** The recent record rise in exports amounting to **$418 billion in FY 2021-22** is certainly an achievement but there exists a huge difference in India's exports potential and actual exports in many sectors.

The factors that inhibit the export competitiveness of India include:

- **Higher tariff on intermediate goods:** Almost 70% of all anti-dumping duties are levied on intermediate goods, which are critical inputs for finished export products. This has a cascading effect on the pricing of downstream industries as it increases production costs, which hampers our exports.
- **Traditional export basket:** India's exports do not comprise cutting-edge products. As much as 70% of India's exports target 30% of world trade comprising items with a declining global share.
- **Higher logistics cost:** The logistics cost is approximately 16 percent of India's GDP, which is very high as compared to around 10 percent in China and 8 percent in America and Europe.
- **Limiting the business ecosystem:** The complexities of trade and business are accentuated by red tape, complex taxation laws, cross-subsidisation of power, constraining labour laws and high non-tariff barriers such as administrative fees, labelling requirements, etc.
- **One-size-fits-all approach:** India's export preparedness lacks sector-specific and market-specific approach in order to fully capitalise on exports across sectors.

To further accelerate the annual growth rate of India's exports which was a little over 1 percent between 2011 to 2020, the **following measures are needed**:

- **Decentralised export strategy:** India's export policy has to be **more decentralized and state-specific** to actively strategize respective industrial policies. NITI Aayog's recent report on **Export Preparedness Index (EPI)** needs to be utilized to enhance a sense of competition between states and to encourage them to adopt export promotion policies.
- **Aggressive bid for global value chains (GVCs):** India has to aggressively increase its participation in GVCs and engage its working-age population in labour-intensive manufacturing for the next couple of decades to capitalise on the labour-intensive assembly of network products.
- **Enhance the export ecosystem**: India needs to efficiently implement its initiatives involving trade facilitation such as Remission of Duties or Taxes on Export Products, PM Gati Shakti, Trade Infrastructure for Export Scheme (TIES), recently implemented four Labour Codes, Market Access Initiative by the Export Promotion Councils, etc.
- **Enhance domestic capacity:** Domestic manufacturing industry can be promoted through steps like **lowering the corporate tax rate**, introduction of **PLI schemes** in several key sectors, etc.
- **Move away from protectionism:** India must be open to forging preferential trade agreements and regional trading arrangements. The country must reorient its trade policy to take advantage of the increasingly popular China-plus-one strategy.

The above-mentioned measures will help India achieve the targets of **$1 trillion in merchandise exports by 2027-28 and $1 trillion in services exports by 2030, which will help achieve the $-5 trillion** economy goal sooner.

13. Farm prosperity in India hinges largely on the unfinished task of land reforms. Discuss.

Approach:

- Give a brief background of land reforms in India and state their outcome.
- Mention the various land reforms that have remained unaddressed for farm prosperity.
- Discuss how land reforms alone will not solve the problem.
- Conclude on the basis of the above points.

Answer:

India is the country with the 2nd largest arable land in the world (around 159.7 million hectares) after the USA. Because land was the basis of major economic activities, land reforms and policies formed the basic agrarian reforms initiated post-independence.

Despite the key land reforms including **abolition of the intermediaries, tenancy reforms, fixing ceilings on landholdings and consolidation of landholdings**, their impact and implementation remained non-uniform. Today, landless, marginal, and small farmers together constitute **93.7% of the total agricultural workforce** in India. Further, **the Socio-Economic and Caste Census 2011,** shows that **56% of households in rural India do not own any agricultural land,** despite the high dependence of rural workforce on agriculture.

Though land reforms as part of agrarian reforms drove India to self-sufficiency in food grains and gave an impetus to farm exports, **but for achieving farm prosperity, the unfinished task of land reforms is crucial to a large extent, as follows:**

- **Since land is a 'state subject'** (under the 7th Schedule of the Constitution), it has resulted in only a few states implementing the land reforms like West Bengal and Kerala. Some argue that **land reforms should be a 'central subject', while agriculture can remain a 'state subject'.**
- **Innovative land-leasing and/or farmer-friendly contract farming arrangements** can enable consolidation at scale where the security of tenure and size of land holding remains a structural constraint. A basic minimum income from rent for the land can be chalked out for the farmers.
- There is need for **redistribution of ceiling surplus land, downward revision of the ceiling limits in irrigated areas and distribution of Bhoodan lands,** which are still not properly recorded and distributed.
- There can be **allotment of homestead land for homeless persons in rural and urban areas, and recognition of rights of communities over "commons", including pastures, grazing lands and water bodies** and stoppage of transfers of such land to private and external agencies.
- There is a need to **reinforce the rights of people to forestland and other forest resources** including a transformation in laws and practices which **recognise women's ownership, control, and use of land.**
- **Land titling and modernisation of land records through digitization** across states should be upscaled to prevent further fragmentation of land holdings along with awareness campaigns for the farmers.
- A **progressive land tax,** based on the size of the ownership, could incentivise the sale of some of the larger land possessions.
- **The National Council for Land Reforms** needs to be empowered with mandatory powers for better implementation of land policies and for navigating associated issues.

Though land reforms have played a great role in the rural agrarian economy that is dominated by land and agriculture, farm prosperity is not an outcome of land reforms alone. Other agrarian reforms must complement them such as marketing reforms in the Agricultural Produce Market Committees (APMCs), better storage facilities, modern farm infrastructure, pricing mechanisms, timely procurement of low-cost inputs, credit management and timely disbursal of farm insurance policies.

14. Discuss the significance of green accounting and the challenges in its implementation in India.

Approach:

- Define green accounting in the introduction.
- Discuss the significance of green accounting.

- Highlight the issues in the implementation of green accounting in India.
- Conclude accordingly with a way forward.

Answer:

Green accounting is a type of accounting that attempts to factor environmental costs into the financial results of operations. It has been argued that gross domestic product ignores the environment and therefore policymakers need a revised model that incorporates green accounting.

Significance of green accounting:

- **Better policy-making and sustainable growth:** Green accounting facilitates more informed rules, regulations and policies and helps policy makers recognise the trade-off between pursuing high growth economic policies against the extensive impact they could have on India's natural capital.
- **Biodiversity conservation:** Green accounting systems reflect the biodiversity and ecosystem services that have a bearing on human well-being and help in balancing economic development with environmental conservation.
- **Promotes innovation:** The governments and companies are encouraged to develop and adopt technologies that can lead them towards a low carbon footprint path and are also environment-friendly.
- **Improved quality of life:** By promoting sustainable practices, reduction of environmental pollution as well as enhanced public awareness, green accounting can improve public health and lifestyle leading to a more productive workforce.
- **Enhanced corporate social responsibility:** Green accounting can help ensure that businesses are complying with environmental regulations, which can help prevent environmental disasters and other costly events that can harm the economy.
- **Access to capital:** Green accounting can help businesses demonstrate their environmental performance and commitment to sustainability, which can help them access capital and attract investors.

Challenges in its implementation in India:

- **Developmental imperatives:** Given India's huge population and multidimensional poverty, it is difficult to prioritise environmental conservation over economic growth.
- **Lack of reliable and accurate data:** It is difficult to quantify the ecosystem services provided by natural resources such as land, forests, and water.
- **Absence of multisectoral accounting:** Green accounting standards are only developed for a few resources such as land and water in India and other important resources and sectors are yet to be analysed.
  - Moreover, there is no well-accepted international accounting standard for environmental accounting.
- **Additional costs**: Environmental accounting and reporting will require extra manpower and cost. Many enterprises, unless otherwise compelled, may not be willing to incur such costs.
- **Lack of accountability:** Green accounting has not been made compulsory for all the industries in the country by the Ministry of Environment, Forest and Climate Change. This coupled with inadequate public awareness and insufficient data have led to absence of accountability.

India is rich in biodiversity and natural resources. However, these resources are exhaustible in nature. To ensure sustainable development and a quality life for the future generations, it is critical that efforts at the government, corporate, and civil society levels are made to put in place effective policies and incentives to move towards a universal green accounting system in India.

15. What is a Non-Banking Financial Company (NBFC) and how is it different from a commercial bank? Discuss the significance of NBFCs in India.

Approach:

- Introduce with the definition of a Non-Banking Financial Company (NBFC) and briefly highlight its salient features.

- Elaborate on the difference between banks and NBFCs.
- Discuss its significance in India.
- Conclude appropriately.

Answer:

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 engaged in the **business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities** issued by the government or local authority or other marketable securities.

Its salient features include the following:

- **It does not include** any institution whose principal business is that of **agriculture activity, industrial activity, purchase or sale of any goods** (other than securities) or providing any services and sale/purchase/construction of immovable property.
- A non-banking institution, which is a company and has the principal business of **receiving deposits under any scheme or arrangement in one lump sum or in installments** by way of contributions or in any other manner is also an NBFC.
- The companies **obtain NBFC license from the RBI**, but, they are regulated by different agencies based on the role they play.

Differences between NBFCs and commercial banks:

- NBFCs **cannot accept demand deposits** (but some can accept time deposits and such NBFCs are called deposit-taking NBFCs) while banks accept demand deposits.
- Unlike banks, NBFCs **do not form part of the payment and settlement system** and cannot issue cheques drawn on themselves.
- **Deposit insurance facility is not available to depositors** of NBFCs while it is available in case of banks.
- Unlike banks, **CRR does not apply on any NBFC** while a lower SLR of 15% applies only to a deposit-taking NBFC.
- **NBFCs get a license under the Companies Act, 1956** while banks under the Banking Regulation Act, 1949.

Significance of NBFCs in India:

- **Growth of microfinance in India**: NBFCs have reached out to rural, semi-urban, and metro areas where access to formal credit is often limited, thus, increasing the width and depth of credit availability.
- **Complement the mainstream banking system**: Given the nature of the business models (cost of borrowing) of the NBFCs, they cater to the market, which is inherently considered a higher risk by larger banks and financial Institutions.
- **Role in financial inclusion:** Major customers of NBFCs are people who have never borrowed in the past. Banks are cautious regarding the credit worthiness of these customers. However, with digital solutions and nuanced underwriting models, the NBFCs are bridging this gap.
- **Employment generation:** The sector employs a large number of people, particularly in rural and semi-urban areas, where there is a high demand for financial services.
- **Support to Small and Medium Enterprises (SMEs):** NBFCs provide financial assistance to SMEs, which are the backbone of the Indian economy. They help in **promoting entrepreneurship and self-employment** by providing loans and other financial services to small businesses.
- **Benefits to customers**: Customers reach out to NBFCs on account of their quicker decision-making, minimal documentation, prompt services, and flexibility.

NBFCs form an integral part of the Indian financial system and play a key role in the development of infrastructure, which is the lifeline of our economy. Additionally, they innovate products in consonance with the needs of their clients.

16. Bring out the role of Outcome Budgeting in contributing to the efficient allocation of resources and the achievement of government's socio-economic objectives in India.

Approach:

- Explain Outcome Budgeting in the introduction.
- Discuss the role of Outcome Budgeting in efficient allocation of resources and the achievement of the government's socio-economic objectives.
- Conclude appropriately.

Answer:

An **Outcome Budget (OB**) is a method of budgeting that measures the progress of each department and Ministry and what they have done with their allocated budget. It aims to look at the **performance of various Ministries handling development programmes** and seeks to link budgetary outlays to specific outputs and outcomes.

Role of Outcome Budgeting in efficient allocation of resources:

- **Better conceptualization:** Conventional budget does not focus much on the efficient use of allocated resources to achieve certain agreed results. In comparison, an Outcome Budget converts outlays into outcomes by planning the expenditure, fixing appropriate targets, quantifying deliverables in each scheme and bringing to the knowledge of all the outcomes for each scheme/programme.
- **Defined outputs and outcomes**: As an Outcome Budget gives significance to clearly defined outputs and outcomes, it helps in **better planning and allocation of resources to achieve the desired outcomes.**
- **Reduce costs**: This method helps to reduce costs by identifying budgets that do not contribute enough to outcomes and redirecting focus to priority areas where investments can be more effective.
- **Addressing certain weaknesses in the performance budget:** Outcome Budgeting addresses certain weaknesses in the performance budgeting system such as lack of a clear relationship between the financial and performance budgets and inadequate target setting for the ensuing year.

Outcome Budgeting plays a significant role in the achievement of the government's socio-economic objectives like social welfare, equality, delivery of quality services, etc. in the following ways:

- **Enhancing transparency and evaluation:** It helps in enhancing transparency, predictability and ease of understanding of the government's development agenda.
  - Schemes that fail to achieve their stated outcomes are **subjected to further review through systematic evaluations** with the intent of improving or redesigning the schemes.
- **Participation of citizens:** Engagement of citizens and sensitisation are done through a dialogue on outcomes not only about the expenditure that has been incurred but also on whether quality of life has improved.
  - This institutionalisation of **outcome thinking further complements the goal of 'minimum government, maximum governance'** by rationalising and redirecting resources to solutions that work.
- **Better targeting:** It enables Ministries to keep track of the scheme objectives and work towards the development goals set by them. **For instance:**
  - **Financial inclusion:** PM KISAN targets to improve payment facilitation and outcome of assured income support to all landholding farmers with cultivable land.
  - **Agriculture: Pradhan Mantri Fasal Bima Yojana** has targets like timely processing and settlement of claims, efficient claims assessment through technology and claim settlement mechanisms, etc.

Outcome Budgeting has taken the institutionalization of outcomes in the government system a step further and provided a strong foundation for future efforts such as strengthening scheme divisions within Ministries and departments to capture outcomes at a regular frequency, going beyond periodic national surveys.

17. *What is the Twin Deficit problem? Discuss how it affects the Indian economy.*

Approach:

- Introduce by explaining the Twin Deficit problem.
- Discuss how the Twin Deficit problem affects the Indian economy.
- Mention steps that can be taken in this context.
- Conclude accordingly.

Answer:

Twin deficit refers to the situation when an economy suffers from both **fiscal** deficit and **current account deficit (CAD)**. Fiscal deficit is the gap between the government's expenditure requirements and its receipts. This equals the money the government needs to borrow during the year. Current account deficit signifies that the money going out of a country through imports, investment, and services is greater than the money coming into the country.

In its **'Monthly Economic Review'**, the Ministry of Finance has cautioned about the Twin Deficit problem, as it can **affect the Indian economy in the following ways:**

- **Crowding out private investment**: A higher fiscal deficit is expected to lower the resources available for private investment and borrowing leads to a higher interest rate, which in turn, will affect private investment and finally growth.
- **Weakening of the rupee**: A higher current account deficit will lead to the **weakening of the rupee,** which will further make imports costlier. Costlier imports such as crude oil and other commodities will further widen the current account deficit and also put downward pressure on the rupee.
- **Decline in forex reserves**: A costly import shall lead to higher payments in dollars and decrease in foreign reserves.
- **Debt accumulation**: When a country is not able to finance its current account deficit with foreign investment, it becomes necessary to borrow to cover the gap. This can lead to an increase in debt levels, thereby negatively impacting the economy.
- **Rise in inflation**: Costlier imports, weaker rupee, etc. due to high current account deficit lead to higher inflation and a reduction in purchasing power.
- **Impact on investments**: A very high fiscal deficit may reduce the sovereign credit rating of the country, which will make it difficult to raise funds abroad and attract investments to India.

In order to tackle the Twin Deficit problem, the following steps can be taken:

- The **Monthly Economic Review** has suggested that rationalizing non-capital expenditure is critical. It is necessary to follow the **Fiscal Responsibility and Budget Management (FRBM) Act, 2003,** which sets targets for the government to reduce fiscal deficits.
- Enhancing exports and reducing import dependency through the Aatmanirbhar Bharat initiative can play a key role in addressing the current account deficit.
- Key measures in order to reduce the fiscal deficit, such as increasing tax-based revenue, reducing subsidies, disinvestment, etc. can be adopted.

While the government has set a target of attaining a fiscal deficit of **4.5 per cent of GDP by 2025-26**, a roadmap to achieve this target should also be specified. Sound macro stabilisation requires outlining debt and deficit reduction targets for the next few years. Also, market adjustment of the rupee to rein in the current account deficit should be a part of the macro stabilisation strategy.

18. *In the post-reforms era, there was a surge in outsourcing to India. What were the factors that made India a favourite outsourcing destination? Bring out the role played by it in India's economic development.*

Approach:

- Briefly introduce the answer with the meaning of outsourcing in the context of India.
- Discuss the factors, which made India a favourite outsourcing destination.
- Highlight its impact on India's economic development.
- Conclude accordingly.

Answer:

In outsourcing, **a company hires regular service from external sources, mostly from other countries**, which was previously provided internally or from within the country. In the post-globalization era, outsourcing has intensified because of the growth of fast modes of communication, particularly the growth of Information Technology (IT) and the availability of cheap manpower.

The following are some of the factors that made India a favourite outsourcing destination:

- **Cost-effective services:** Hiring an Indian professional is more cost-effective for companies stationed outside India than hiring local professionals. One more positive aspect is that despite the low cost of services, quality standards are maintained at par with global requirements.
- **Large pool of English speaking manpower:** India is home to possibly the largest skilled talent pool. Every year almost 1.5 million engineering graduates pass out from various institutes, which include premier institutes like the IITs and NITs. With the advent of modern communication technology and apps, communication has been as smooth as direct communication, making the Indian workforce an ideal workforce.
- **State-of-the-art infrastructure:** Cities like Delhi, Gurgaon, Bangalore, Pune, Mumbai, and Hyderabad, are known to have dedicated and some of the best corporate infrastructure for world-class organisations. Two-tier cities like Bhubaneswar, Jaipur, Indore, etc. are also on the fast pace of similar developments, which are lucrative options for their great infrastructure at a lesser cost.
- **Capacitive corporate environment:** In comparison to other preferred outsourcing countries, India has the one of the most flexible work environments. The less disruptive environment provides a development model for MNCs.

Impact of outsourcing on India's economic development:

- **Large share in GDP:** Both the ITO (Information Technology Outsourcing) and BPO (Business Process Outsourcing) in India contribute to around 9.5% of the country's GDP**.** The services sector of India remains the engine of growth for India's economy and contributed around 53% to India's Gross Value Added at current prices in FY21-22 (as per advance estimates).
- **Creation of jobs:** The sector employs around 5 million people and demand for women in the workforce is among the highest in the IT/BPO (Business Process Outsourcing) industry. Also, the increased acceptance of technology has boosted the performance and effectiveness in the domestic market as a result of foreign companies shipping part of their business processes to India.
- **Growth of cities:** In 2008, a study listed 6 Indian cities of Bangalore, Chennai, Delhi-NCR, Hyderabad, Mumbai, and Pune, among the world's top 10 outsourcing destinations. Outsourcing has helped the urbanization process in India, which has had a multiplier effect on the economy.
- **Leapfrogging effect:** Growth in the services sector such as information technology has encouraged a "leapfrogging" effect in the Indian economy i.e. India puts the export-oriented sector before agricultural and manufacturing industries mainly because of the growth and development the export-oriented sector brings to the nation.

India is currently the world's largest and leading offshore IT and BPO destination. Its established dominance in the segment of IT and non-voice related BPO and KPO (Knowledge Process Outsourcing) services, makes it ideally positioned to take advantage of future outsourcing trends by capitalising on its strengths.

19. Rising public debt inflicts a burden on the economy. Explain. Also, discuss how the Fiscal Responsibility and Budget Management Act, 2003 seeks to address it.

Approach:

- Introduce the answer by stating the meaning of public debt and discuss its current status.
- Explain how it imposes a burden on the economy.
- Highlight the role of the Fiscal Responsibility and Budget Management Act (FRBM Act), 2003 in addressing the issue.
- Conclude accordingly.

Answer:

Public debt is the **total amount, including total liabilities, borrowed by the government** to meet its budgetary deficits. These debts are contracted against consolidated funds. It is often expressed as a debt to Gross Domestic Product (GDP) ratio. The General Government **Debt to GDP ratio increased from 75.7% at the end-March 2020 to 89.6% at the end of the pandemic year FY21**.

The burden of public debt on the economy:

- **Burden on future generations:** By borrowing, the government transfers the burden on future generations. This is because it borrows by **issuing bonds to the people living at present** but may decide to **pay off the bonds some twenty years later by raising taxes**.
- **Increase in interest payments:** Increase in public debt **increases the amount of interest** that the government has to pay on that debt. Thus, the government has to **allocate a greater portion of its budget for interest payments**, leaving **less money for other priority areas,** such as public services or investment in infrastructure.
- **Increase in inflation:** Increased borrowing by the government may lead to a **rise in interest rates.** Also, **when the government increases spending, aggregate demand increases**. This can lead to higher inflation in the economy.
- **Crowding-out private investment:** When the government borrows issuing bonds to finance its deficits, these **bonds will compete with corporate bonds for the available supply of funds**. Thus, some **private borrowers will get 'crowded out'** as the government claims an increasing share of the economy's total savings.

In this context, the **Fiscal Responsibility and Budget Management Act (FRBM Act), 2003** is an important tool to address the issue of rising public debt. It **binds the government through an institutional framework** to pursue a prudent fiscal policy in the following ways:

- It mandates the Central government to **reduce fiscal deficit to less than 3 percent of GDP** and to **eliminate the revenue deficit** and thereafter build up adequate revenue surplus.
- The actual deficits may exceed the targets specified **only on grounds of national security or natural calamity or such other exceptional grounds** as the Central government may specify.
- The Central government shall **not borrow from the Reserve Bank of India except by way of advances** to meet temporary excess of cash disbursements over cash receipts.
- The **Reserve Bank of India must not subscribe to the primary issues** of the Central government securities.
- The Central government has to lay before both Houses of Parliament three statements – **Medium-term Fiscal Policy Statement, Fiscal Policy Strategy Statement, and Macroeconomic Framework Statement** along with the Annual Financial Statement.

Hence, the FRBM Act, 2003 aims to ensure inter-generational equity and long-term macroeconomic stability through effective public debt management by the government.

20. Discuss the monetary policy framework in India. Also, highlight the dilemmas posed by monetary management.

Approach:

- Give a brief introduction about the monetary policy framework in India.
- Mention the key components of the monetary policy framework in India.
- Discuss the dilemmas posed by monetary management.
- Conclude accordingly.

Answer:

The Monetary Policy Framework Agreement (MPFA) was signed between the Government of India and the RBI in February 2015 to **formally adopt the flexible inflation targeting (FIT) framework**. This was followed up with an amendment to the Reserve Bank of India (RBI) Act, 1934, in May 2016 to provide a statutory basis for the implementation of the FIT framework.

Key components of the monetary policy framework in India:

- **Flexible inflation targeting:** The Central government, in consultation with the RBI, **determines the inflation target** in terms of **the Consumer Price Index (CPI)**, once every five years and accordingly fixes it. The CPI inflation target is to be 4% with ± 2% tolerance band.
- **Monetary Policy Committee: Section 45ZB of the amended RBI Act, 1934,** provides for the constitution of a six-member Monetary Policy Committee (**MPC**) to determine the policy rate required to achieve the inflation target.
- **Instruments:** Instruments are tools that the central bank has control over and are used to achieve the operational target. For example, open market operations, reserve requirements, policy rate, etc.
- **Operational targets:** These are the financial variables that can be controlled to a large extent by the central bank, i.e., the RBI, through monetary policy instruments and guide the day-to-day operations of the central bank. For example, reserve money and short-term money market interest rates.
- **Goals of monetary policy:** These refer to the final objectives of the monetary policy. For example, price stability, economic growth, financial stability, and exchange rate stability.

Dilemmas posed by monetary management in India include:

- **Trade-off between growth and inflation**: There is an imperative need in developing countries to keep the inflation rate as low as possible, which will impact liquidity and may hamper growth prospects.
- **Balance of the internal and external sectors:** Even a moderate inflation rate poses a dilemma in an open economy. If the domestic inflation rate of an economy, however low it may be, is higher than the average inflation rate of its trading partners, it puts pressure on the exchange rate. In this context, the question of simultaneous balance of the internal and external sectors becomes a major issue.
- **The dilemma between the manager of public debt and monetary authority:** The market-borrowing programme of the government is determined by fiscal parameters, but the size of the government debt impacts the interest rates in the economy. It will be a dilemma for the central bank to meet the elected government priorities and keep the interest rates low amidst rising demand for money.
- **Conflict between regulator and monetary policy conductor:** The central bank, as a monetary authority, may require reducing the liquidity in the system by raising the rate of interest. But, such a rise in the rate of interest could be detrimental to the interests of the weak banks.

In light of the current global economic integration and greater possibilities of spill-over effects, the need of the hour is for consensus among the government and central bank in the form of timely revision of the monetary policy framework and maintaining credible fiscal adjustment.