

VISION IAS

www.visionias.in

ECONOMIC SURVEY SUMMARY 2016-17

Copyright © by Vision IAS

All rights are reserved. No part of this document may be reproduced, stored in a retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without prior permission of Vision IAS.

TABLE OF CONTENTS

CHAPTER 1: ECONOMIC OUTLOOK AND POLICY CHALLENGES	3
CHAPTER 2: THE ECONOMIC VISION FOR PRECOCIOUS, CLEAVAGED INDIA	5
CHAPTER 3: DEMONETISATION: TO DEIFY OR DEMONIZE?	8
CHAPTER 4: THE FESTERING TWIN BALANCE SHEET PROBLEM	13
CHAPTER 5: FISCAL FRAMEWORK - INDIA IS CHANGING, SHOULD INDIA CHANGE TOO	16
CHAPTER 6: FISCAL RULES: LESSONS FROM THE STATES	17
CHAPTER 7: CLOTHES AND SHOES: CAN INDIA RECLAIM LOW SKILL MANUFACTURING?	19
CHAPTER 8: REVIEW OF ECONOMIC DEVELOPMENT	21
CHAPTER 9: UNIVERSAL BASIC INCOME: A CONVERSATION WITH AND WITHIN THE MAHATMA	28
CHAPTER 10: INCOME, HEALTH, AND FERTILITY: CONVERGENCE PUZZLES	31
CHAPTER 11: ONE ECONOMIC INDIA: FOR GOODS AND IN THE EYES OF THE CONSTITUTION	33
CHAPTER 12: INDIA ON THE MOVE AND CHURNING- NEW EVIDENCE	36
CHAPTER 13: THE 'OTHER INDIAS': TWO ANALYTICAL NARRATIVES (REDISTRIBUTIVE AND NATURAL RESOURCES) ON STATES' DEVELOPMENT	38
CHAPTER 14: FROM COMPETITIVE FEDERALISM TO COMPETITIVE SUB-FEDERALISM: CITIES AS DYNAMOS	41



**Do not get strayed when every second is precious.
To achieve your target take steps in the right direction
before time runs out.**

Open Mock Tests
ALL INDIA GS PRELIMS TEST

- Test available in ONLINE mode ONLY
- All India ranking and detailed comparison with other students
- Vision IAS Post Test Analysis™ for corrective measures & continuous performance improvement
- Available in ENGLISH/HINDI
- Closely aligned to UPSC pattern
- Complete coverage of UPSC civil services prelims syllabus

Register @ www.visionias.in/opentest
Besides appearing for All India Open Tests you can also attempt previous year's UPSC Civil Services Prelims papers on VisionIAS Open Test Platform

CHAPTER 1: ECONOMIC OUTLOOK AND POLICY CHALLENGES

Ensuring Women's Privacy

- Women face **disproportionate burden** due to deficiencies in sanitation facilities i.e. “**gender-based sanitation insecurity.**”
- This burden can take several forms:
 - threat to life and safety while going out for open defecation,
 - reduction in food and water intake practices to minimize the need to exit the home to use toilets,
 - polluted water leading to women and children dying from childbirth-related infections,
 - host of other impacts
- As per census 2011, more than half of the country's population defecated in the open. More recent data shows that about 60 percent of rural households and 89 per cent of urban households have access to toilets.
- A rapid study conducted in 2016 by WASH Institute and Sambodhi revealed that on getting access to sanitation women exhibit **better defecation behaviour** and could help in Swachh Bharat's objective of creating defecation free communities, by nudging men and boys of the household to change their behaviour.
- The first step to tackling this issue is to generate more information on access to sanitation as it is socially considered taboo or ignored.
- Next step would be to recognizing the positive behavioural patterns that women demonstrate upon obtaining access to sanitation service.

****Note:** Many important points of the chapter 1 are subsumed under subsequent chapters. Only additional information is provided here.

India's soon-To-Recede Demographic Dividend

- 2016 was the first time since 1950 that the combined working age (WA) population (15-59) of the advanced countries declined.
- Over the next three decades, the United Nations (UN) projects that China and Russia will each see their WA populations fall by over 20 per cent.
- India, however, have its working-age population projected to grow by a third over the same period. But, it should be always remembered that demography **provides potential and is not destiny.**
- For an economy, younger populations are
 - More entrepreneurial thus adding to productivity growth;
 - Tend to save more, which may also lead to favorable competitiveness effects;
 - And have a larger fiscal base because of economic growth and because there are fewer dependents (children and elderly) for the economy and government to support.

Distinctive Indian Demography

- India's demographic cycle is about **10-30 years behind** that of the Brazil, Korea and China, indicating that the next few decades present an opportunity for India to catch up to their per capita income levels.
- India's working age (WA) to non-working age (NWA) ratio is likely to peak at 1.7, a much lower level than Brazil and China, both of which sustained a ratio greater than 1.7 for at least 25 years. India will remain close to its peak for a much longer period than other countries. This has **following growth consequence:**
 - India should not expect to see growth surges or growth decelerations of the magnitudes experienced by the East Asian countries on account of the demographic dividend only.
 - At the same time, India might be able to sustain high levels of growth (on account of the demographic dividend) for a longer time.
- There is a **clear divide** between **peninsular India** (West Bengal, Kerala, Karnataka, Tamil Nadu and Andhra Pradesh) and the **hinterland states** (MP, Rajasthan, UP and Bihar). The peninsular states exhibit a pattern that is closer to China and Korea, with sharp rises and declines in the working age population.
- This divide in the WA/NWA ratio of the peninsular and the hinterland states can be traced to the difference in their levels of TFR.
- The **peak of the demographic dividend** for India will be reached in the **early 2020s** for India as a whole; around 2020 for the peninsular India while hinterland India will peak later around 2040.
- Thus, demographically, there are **two Indias**, with **different policy concerns:**
 - A soon-to-begin-ageing India where the elderly and their needs will require greater attention;
 - A young India where providing education, skills, and employment opportunities must be the focus.

- Although, heterogeneity within India offers the advantage of addressing some of these concerns via greater labour mobility, which would in effect reduce this demographic imbalance.

Trade Policy

- The environment for global trade policy has probably undergone a **paradigm shift** in the aftermath of Brexit and the US elections.
- At a time of a possible resurgence of **protectionist pressures** and India's needs open markets abroad, it is increasingly clear that India and other emerging market economies **must play a more proactive role** in ensuring open global markets.
- Two specific opportunities arise.
 - First, India could more proactively seek to negotiate free trade agreements with the UK and Europe. The potential gains for export and employment growth are substantial.
 - At the same time, with the likely **US retreat from regional initiatives** such as the Trans-Pacific Partnership (TPP) in Asia and the Trans-Atlantic Trade and Investment Partnership (TTIP) with the EU, the relevance of the World Trade Organization might increase. So, reviving the WTO and multilateralism more broadly could be proactively pursued by India.

Exchange Rate Policy

- Post the Global Financial Crisis, Eurozone crisis, and the China scare of 2015, international trading opportunities are becoming scarcer. Given India's need for exports to sustain a healthy growth rate, it is important to track India's competitiveness.
- The rise of countries such as Vietnam, Bangladesh, and the Philippines that compete with India across a range of manufacturing and services.
- **The policy implication** is that if India is concerned about competitiveness and the rise of exporters in Asia, it should monitor an exchange rate index that gives more weight to the currencies of these countries

Climate Change and India

- The increase in petrol tax has been over 150 percent in India. As a result, India now outperforms all the countries except those in Europe in terms of tax on petroleum and diesel.
- So far, and for the conceivable future, India's reliance on fossil fuels remains well below China (the most relevant comparator) but also below the US, UK and Europe at comparable stages of development. Going forward, India needs to bend the curve to ensure that its reliance on fossil fuels declines and keeping it below the level of other countries so that its good global citizenship on climate change can continue.

English Medium
Starts: **3rd April**

हिन्दी माध्यम
Starts: **10th April**

- 📖 Specific content targeted towards Prelims exam
- 📖 Complete coverage of current affairs of One Year
- 📖 Option to take exams in Classroom or Online along with regular practice tests on Current Affairs
- 📖 Support sessions by faculty on topics like test taking strategy and stress management.
- 📖 **LIVE** and **ONLINE** recorded classes for anytime anywhere access by students.

PT 365
One year Current Affairs in 60 hours

CHAPTER 2: THE ECONOMIC VISION FOR PRECOCIOUS, CLEAVAGED INDIA

Theme: Since about 1980, backed by policy reforms, India's growth performance has been robust. Yet, there are serious challenges that might impede further rapid progress emanating in part from the fact that India started out as a poor democracy with deep social fissures (a "precocious, cleavaged" democracy). The chapter first talks the policy reforms and then identifies the challenges which might impede further progress.

Introduction

- After independence, the guiding principle for Indian Economy was nationalism and protectionism. This framework was rejected after 1991.
- In 1991, India effectively embarked upon the path resembling **Washington Consensus** for its economy: *open trade, open capital, and reliance on the private sector*.
- This is essentially the same development model that has been tried and proven successful in most countries of Eastern Asia.

Measuring Country's progress

- Following **four standard measures** indicate India's progress which is both qualitative and measurable:
 - **Openness to trade:** Larger countries tend to trade more within its boundaries because of presence of large internal markets. But, India's trade-to-GDP ratio has also been rising very sharply and has now surpassed China.
 - **Open to foreign capital:** Despite significant capital controls, India's net inflows are at par with other emerging economies. India's FDI has risen sharply over time and in the most recent year; India received FDI of \$75 billion, close to what China was receiving in mid-2000s.
 - **Public sector enterprises:** Even though there has not been much exit of PSUs, India has seen increasing share of private sector. India's PSU spending as a share of GNI lies in the middle of emerging market economies.
 - **The share of government expenditure in overall spending:** On plotting government expenditure against per capita GDP, it has been observed that India spends as much as can be expected given its level of development.
- In sum, the standard measures suggest that India is now a "normal" emerging market. It is open to foreign trade and foreign capital, government is not overbearing, either in a micro, entrepreneurship sense or in a micro, fiscal sense.
- Further, India has grown at about 4.5 percent per capita for thirty seven years. This is good considering that it was always a democracy. The only other countries that have grown as rapidly and been democratic for a comparable proportion of the boom are Italy, Japan, Israel, and Ireland.

Reforms adopted by the government in line with Washington consensus in last two years.

- Government has institutionalized a commitment to low inflation in the new monetary policy framework agreement.
- There has also been a great effort to reduce the costs of doing business and create an environment friendly to investment, both domestic and foreign.
- Government has secured passage of major measures such as the Aadhaar Bill, the Bankruptcy Code, and the GST constitutional amendment.

The Road to be traversed

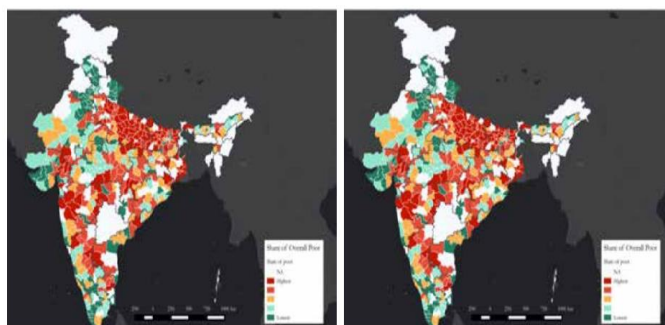
In spite of above evidences showing India's reformist and market oriented credentials, there remains a doubt that India is still not following standard development model mainly due to following **three features**:

- **Ambivalence about Private Sector and Property Rights:** There has been a hesitancy to embrace the private sector and to unambiguously protect property rights, combined with continued reliance on the state to undertake activities that are more appropriately left to the private sector.
 - It appears that India has distinctly anti-market beliefs as compared to peers with similarly low initial GDP per capita levels. This ambivalence manifest in multiple ways. The difficulty of privatizing public enterprises e.g. - In the civil aviation sector, policy reform in the sector has been animated as much by an interventionist as liberalizing spirit, reflected for example in restrictions on pricing.
 - In banking sector, debate in disinvestment of government's majority share is another example.

- In the fertilizer sector, public policy continues to rehabilitate public sector plants rather than facilitating the exit of egregiously inefficient ones.
- Agriculture sector continues to be entwined with regulation with APMC Act and Essential Commodities Act exacerbating the problem.
- **Circumscribing property rights** - Initially, the right to property was inscribed as a “fundamental right” in the Constitution, but the 44th Amendment made it a “legal right”. The ramifications of this decision continue to be felt to this day, in such issues as retrospective taxation, which remain mired in litigation.
- Problem of twin balance sheet continues to persist as its resolution may be seen as favouring private sector, a problem which will necessarily arise in cases where some private sector debts have to be forgiven.
- **State Capacity:** State capacity has remained weak as can be seen from poor delivery of essential services.
 - The Indian state has low capacity, with high levels of corruption, clientelism, rules and red tape leading to inefficiency and ineffectiveness especially in delivering essential services such as health and education.
 - Unlike most emerging markets which witnessed improvement of state capacity, often at an even faster rate than the overall economy, India did not see satisfactory improvement in state capacity which is manifested in following problems:
 - **Inefficient Service Delivery:** The competitive federalism, that acted as a powerful agent in relation to attracting investment and talent e.g. in case of Tata Nano car plant case, did not have any such impact in relation to essential service delivery. Rather at state level, competitive populism is more evident than competitive service delivery. However there are some important exceptions also:
 - ✓ Improvement of the PDS in Chhattisgarh and Bihar,
 - ✓ The incentivizing of agriculture in Madhya Pradesh,
 - ✓ The kerosene-free drive in Haryana,
 - ✓ Power sector reforms in Gujarat which improved delivery and cost-recovery
 - ✓ The efficiency of social programs in Tamil Nadu.
 - **Weak Policy Making:** This is seen in following two ways-
 - ✓ **Adherence to strict rules** which may not necessarily be optimal public policy. For example auctions of all public assets. In some cases, it may be socially optimal to sell spectrum at lower-than-auction prices because of the sizable externalities stemming from increased spread of telecommunications services.
 - ✓ **Abundant caution in decision making** leading to status quo. For example- In case of twin balance sheet problem, officers are reluctant to take decisions for fear of being seen as favouring private sector and hence becoming the target of the referee institutions, the so called “4 Cs”: courts, CVC, CBI and CAG. This favours evergreening of loans.
- **Inefficient Redistribution:**
 - Redistribution has been simultaneously extensive and inefficient.
 - The welfare spending also suffers from considerable misallocation: the districts with the most poor (shaded in red in figure 7a) suffer from the greatest shortfall of funds (also shaded in red in figure 7b). This leads to-
 - ✓ **exclusion errors** (the deserving poor not receiving benefits),
 - ✓ **inclusion errors** (the non-poor receiving a large share of benefits), and
 - ✓ **Leakages** (with benefits being siphoned off due to corruption and inefficiency).

Figure 7. Misallocation: Poorer districts get lower share of spending/allocation on schemes

7a. Share of Overall Poor 7b. Shortfall in Allocation to Poor



Possible Explanations to these three distinctive features

Normally, there are two pathways to economic success mentioned below:

1. Advanced economies which developed gradually but steadily over two centuries from limited voting rights, and limited initial demands on state capacity during the period when their capacity was weak and then slowly expanding burden on the state. It helped in their fiscal and economic development.

2. The second set consists of mostly East Asian nations which began as explicit or de facto authoritarian (Korea, China, Singapore, Thailand, Taiwan), and gave way to political transformation only after a degree of economic success was achieved.

India, however, followed a unique pathway

- It granted universal franchise from the very beginning. Thus India comes amongst a handful of countries which are perennial democracies.
- India was the poorest democracy at the time of independence.
- India was also a **highly cleaved society** with many more axes of cleavage than other countries: language and scripts, religion, region, caste, gender, and class.
- Added to this was the tilt towards socialism without completely abolishing the private sector. This was due to failure of private sector under colonial rule on one hand and rapid development of Soviet Union under state control on the other.

Implications of such a pathway

- A **precocious, cleaved democracy** that starts out poor will almost **certainly distrust the private sector**.
- Further, controlling private businesses through licensing and permits also discredited the private sector as they were seen as thriving because of those very controls.
- When confronted with the pressure to redistribute, India had to necessarily redistribute inefficiently, using blunt and leaky instruments. The luxury of effectively targeted programs was not an option in 1950 or 1960 or even 1990.
- Finally, given the pressing need to redistribute, India did not invest sufficiently in human capital. For instance, public spending on health was unusually low 0.22 per cent of the GDP in 1950-51.
- Though, now it has risen to around 1.4 per cent, it still remains well below the world average of 5.99 per cent.

Conclusion

- However, such inefficient redistribution continues to persist. A partial explanation is the difficulty of exit. This also leads to another problem- middle class exiting from the state with fewer taxpayers being one of the signs.
- The legitimacy to redistribute is earned through a demonstrated record of effectiveness in delivering essential services. The history of Europe and the US suggests that typically, states provide essential services (physical security, health, education, infrastructure, etc.) first before they take on their redistribution role.
- That sequencing is not accidental. If the state's role is predominantly redistribution, like in the case of India, the middle class will seek to exit from the state.
- A state that is forced into inefficient redistribution, risks being trapped in a self-sustaining spiral of inefficient redistribution, reduced legitimacy, reduced resources, poor human capital investments, weak capacity and so on.

Way forward

India has come a long way in terms of economic performance and reforms. But there is still a journey ahead to achieve both dynamism and social justice. One tentative conclusion is that completing this journey will require a further evolution in the underlying economic vision across the political spectrum. Further reforms are not just a matter of overcoming vested interests that obstruct them. Broader societal shifts in underlying ideas and vision will be critical.

CHAPTER 3: DEMONETISATION: TO DEIFY OR DEMONIZE?

Theme: The chapter talks about Demonetisation, when on November 8, 2016, the two largest denomination (500 and 1000) notes ceased to be legal tender. The chapter analyses the motivation, benefits and costs of demonetisation. It then suggests certain follow-up actions and certain complementary actions in order to minimize the costs and maximise the benefits of demonetisation.

The aim of the action was fourfold:

- To curb corruption;
- Counterfeiting;
- The use of high denomination notes for terrorist activities; and
- Accumulation of “black money”, generated by income that has not been declared to the tax authorities.

The public debate on demonetisation has raised 3 sets of questions.

- First, broader aspects of management, as reflected in the design and implementation of the initiative.
- Second, its economic impact in the short and medium run.
- And, third, its implications for the broader vision underlying the future conduct of economic policy.

The economic survey discusses the second aspect i.e., economic impact in the short and medium run.

Significance of Demonetisation Move

- In effect, the tax on all illicit activities, as well as legal activities that were not disclosed to the tax authorities, was sought to be permanently and punitively increased.
- Demonetisation was aimed at signaling a regime change, emphasizing the government’s determination to penalize illicit activities.
- India’s demonetisation is unprecedented in international economic history, in that it combined secrecy and suddenness amidst normal economic and political conditions.
- Also India’s action is not unprecedented in its own national history (for ex: 1946 and 1978), But the recent action had large, albeit temporary, currency consequences.

Demonetisation followed a series of earlier efforts to curb illicit activities. They are

- Creation of the Special Investigative Team (SIT) in the 2014 budget;
- The Black Money and Imposition of Tax Act 2015;
- Benami Transactions Act 2016;
- Information exchange agreement with Switzerland;
- Changes in the tax treaties with Mauritius, Cyprus and Singapore; and
- The Income Disclosure Scheme.

Motivation behind the action

- Dual dimensions of cash (table 1)
- Value of high denomination notes (INR 500 and INR 1000) relative to GDP has also increased in line with rising living standards.
- High value notes are associated with corruption because they are easier to store and carry, compared to smaller denominations or other stores of value such as gold.
- India’s economy is relatively cash-dependent.

India’s level is somewhat higher than other countries in its income group and as measured by transparency international higher the amount of cash in circulation, the greater the amount of corruption.

- Amount of black money calculated using ‘soiled notes’ (notes returned to Central Bank because they are too damaged) has been found to be substantial, as it represents about 2 percent of GDP.

Table 1. Dual Dimensions of Cash

Function	Origin/nature	
	White	Black
Transactions	Company pays employee salary in cash; payment and receipt are declared to tax authorities	Small enterprise pays for input in cash; neither declares the transaction to tax authorities
Store of value	Household keeps savings in cash for emergencies	Businessman hoards undeclared cash, with a view to distributing it to his candidate during elections

Table 2. Impact of Demonetisation

Sector	Impact	Likely longer-term effect
<i>Money/interest rates</i>	Effect through end-December	
	Cash declined sharply	Cash will recover but settle at a lower level
	Bank deposits increased sharply	Deposits will decline, but probably settle at a slightly higher level
Financial System Savings	RBI's balance sheet largely unchanged: return of currency reduced the central bank's cash liabilities but increased its deposit liabilities to commercial banks	RBI's balance sheet will shrink, after the deadline for redeeming outstanding notes
	Interest rates on deposits, loans, and government securities declined; implicit rate on cash increased	Loan rates could fall further, if much of the deposit increase proves durable
	Increased	Increase, to the extent that the cash-deposit ratio falls permanently
<i>Corruption (underlying illicit activities)</i>		Could decline, if incentives for compliance improve
<i>Unaccounted income/black money (underlying activity may or may not be illicit)</i>	Stock of black money fell, as some holders came into the tax net	Formalization should reduce the flow of unaccounted income
<i>Private Wealth</i>	Private sector wealth declined, since some high denomination notes were not returned and real estate prices fell	Wealth could fall further, if real estate prices continue to decline
<i>Public Sector Wealth</i>	No effect.	Government/RBI's wealth will increase when unreturned cash is extinguished, reducing liabilities
<i>Formalization/digitisation</i>	Digital transactions amongst new users (RuPay/ AEPS) increased sharply; existing users' transactions increased in line with historical trend	Some return to cash as supply normalises, but the now-launched digital revolution will continue
<i>Real estate</i>	Prices declined, as wealth fell while cash shortages impeded transactions	Prices could fall further as investing undeclared income in real estate becomes more difficult; but tax component could rise, especially if GST imposed on real estate
<i>Broader economy</i>	Job losses, decline in farm incomes, social disruption, especially in cash-intensive sectors	Should gradually stabilize as the economy is remonetized
<i>GDP</i>	Growth slowed, as demonetisation reduced demand (cash, private wealth), supply (reduced liquidity and working capital, and disrupted supply chains), and increased uncertainty	Could be beneficial in the long run if formalization increases and corruption falls
	Cash-intensive sectors (agriculture, real estate, jewellery) were affected more	Informal output could decline but recorded GDP would increase as the economy becomes more formalized
	Recorded GDP will understate impact on informal sector because informal manufacturing is estimated using formal sector indicators (Index of Industrial Production). But over time as the economy becomes more formalized the underestimation will decline.	
	Recorded GDP will also be overstated because banking sector value added is based (<i>inter alia</i>) on deposits which have surged temporarily	
<i>Tax collection</i>	Income taxes rose because of increased disclosure	Indirect and corporate taxes could decline, to the extent growth slows
	Payments to local bodies and discoms increased because demonetised notes remained legal tender for tax payments/clearances of arrears	Over long run, taxes should increase as formalization expands and compliance improves
<i>Uncertainty/Credibility</i>	Uncertainty increased, as firms and households were unsure of the economic impact and implications for future policy	Credibility will be strengthened if demonetisation is accompanied by complementary measures. Early and full remonetisation essential. Tax arbitrariness and harassment could attenuate credibility
	Investment decisions and durable goods purchases postponed	

Benefits

- **Tax on black money: in 3 different ways**

- ✓ Declare unaccounted wealth and pay taxes at a penalty rate;
- ✓ Continue to hide it, not converting their old notes and thereby suffering a tax rate of 100 percent;
- ✓ Launder their black money, paying 'conversion fees' for converting the money into white.
 - Black money holders paid a percentage to private intermediaries as a price for converting it into white. For ex: Jan Dhan accounts witnessed a surge in deposits during the 50-day window between November 8 and December 30
 - Also For ex: '**re-time**'-ing by constructing receipts that made it seem as if the black money had just been earned in the period immediately before November 8th, 2016. But this requires income to be reported and taxes paid on it. In this way, demonetisation would have brought black money into the tax net.

- **Tax compliance:**

- ✓ **Financial penalty:** state's resolve to crack down on black money, shows that tax evasion will no longer be tolerated
- ✓ **Social condemnation:** action has commanded support amongst the population showing that black money will no longer be tolerated by the wider public.
- ✓ So, evaders might decide in the years to come that it would be better to pay a moderate regular tax, rather than risk having to pay a sudden penal tax.
- ✓ Demonetisation **will aid tax administration**, by shifting transactions out of the cash economy and into the formal payments system.

- **Tax on informal savings:**

- ✓ Demonetisation will channel savings into the formal financial system creating a tax on informal savings.
- ✓ Also some new deposits will surely remain in the banks, where they will provide a base for banks to provide more loans, at lower interest rates.

- **Unreturned money**

- ✓ Increased net worth of RBI, as December 30, 2016 Ordinance will make these unreturned notes no longer valid. That is, it has effected a transfer of wealth from holders of illicit black money to the public sector, which can then be redeployed in various productive ways.

Potential – Long-term Benefits: Early Evidence

- **Digitalization**

The early signs are encouraging:

- ✓ The impact on the digitally excluded category can be gleaned via transactions in the Aadhaar-Enabled Payments System (AEPS). We find that total AEPS transactions have been steadily rising before November 8, 2016 but have accelerated thereafter.
- ✓ The impact on the middle category of digitally connected can be gleaned via RuPay transactions. Here, (NPCI) data shows that RuPay-based electronic transactions increased by about Rs. 13,000 crore in case of POS transactions and about Rs. 2,000 crore in e-commerce, an increase of over 300-400 percent.
- ✓ The impact on the digital-haves can be known from credit card and debit card transactions. A sharp increase of about 21 percent after November 8, 2016 is noted.

Watal Committee has recently estimated that cash accounts for about 78 percent of all consumer payments. This is because:

Cash has many advantages:

- It is convenient,
- Accepted everywhere, and
- Its use is costless
- Cash transactions are also anonymous, helping to preserve privacy

Digital transactions face significant impediments. They require:

- special equipment, cell phones for customers
- and Point-Of-Sale (POS) machines for merchants,
- internet connectivity
- costly to users, since e-payment firms need to recoup their costs
- Inter-operability of the payments system- the decline rate for transactions was nearly 56 per cent in cases where the transactions were carried out between two different banks, almost double the rate in case of intra-bank transactions.

Digital transactions help bring people into:

- ✓ The modern "wired" era.
- ✓ People into the formal economy, thereby increasing financial saving,
- ✓ Reducing tax evasion, and levelling the playing field between tax-compliant and tax-evading firms (and individuals).

- **Real Estate:**

- ✓ In the past, much of the black money accumulated was ultimately used to evade taxes on property sales.
- ✓ As the financial transactions increasingly take place through electronic means, this type of tax evasion will also diminish.

- **Short Term Effects/Impacts**

Demonetization represents a large structural shock so that underlying behavioral parameters of the past will be imperfect indicators of future behavior and hence outcomes.

- **Impact on supply of cash/money:** (Economic Survey has used 2 scenarios explained in box)

- ✓ In other words, the true extent of the cash reduction was much smaller than commonly perceived, and the true peak of the monetary – as opposed to the psychological – shock occurred in December.
- ✓ The shortfall is now narrowing rapidly. At end-December 2016, effective currency was only about 65 percent of estimated demand.

- **Impact on GDP: Based on “quantity theory of money”:** Impact on GDP would be

- ✓ On nominal GDP, the impact would be lower growth between ¼ percentage points and 1 percentage point relative to the baseline of 11¼ per cent.
- ✓ On real GDP the impact would be between ¼ percentage points and ½ percentage points relative to the baseline of 7 per cent.
- ✓ Over the medium run, the implementation of GST, follow-up to demonetization and other structural reform measures should take the trend rate of growth of the economy to the 8-10 percent range that India needs.

Steps to facilitate and incentivize the move to a digital economy:

- ✓ Launch of the BHIM (Bharat Interface For Money) app for smartphones and BHIM USSD 2.0 for phone users
- ✓ Launch of Aadhaar Merchant Pay, aimed at the 350 million who do not have phones.
- ✓ Reductions in fees (Merchant Discount Rate) paid on digital transactions and transactions that use the UPI.
- ✓ Encouraging the adoption of point of sale (POS) devices through tariff reductions.

Demonetisation is potentially:

An aggregate demand shock, because it reduces the supply of money and affects private wealth.

- **Impact on informal economy:** informal economy depends heavily on bank notes for its transactions and there have been reports of job losses, declines in farm incomes, and social disruption.
- **Impact on formal economy:** little direct impact on the formal economy, which depends instead on the banking system, where liquidity has actually improved.

An aggregate supply shock to the extent that cash is a necessary input for economic activity (for example if agricultural producers require cash to pay labour)

- If cash and other forms are substitutable, the impact will be relatively muted;
- If cash is not substitutable the impact will be greater.

An uncertainty shock because economic agents face uncertainty in decision making:

- Uncertainty caused consumers to postpone purchases and firms to put off investments in the third quarter.
- There was clearly a wealth shock in the initial months, as cash assets were turned into the banks.

- **Redistribution to the Government**

- Demonetisation will also redistribute resources. For example, black money holders have paid ‘conversion fee’ to launder their money by employing people to stand in queues.
 - ✓ Here it could be a positive wealth effect because cash would go from agents with a low propensity to spend to those with a greater propensity to spend.
- Also it will shift resources from the private sector to the government.
- Demonetisation will affect the fiscal accounts in the following ways.
 - ✓ **Positively**, in majorly 3 ways:
 - a) Wealth gain: The RBI/government may receive some gains from the unreturned cash.
 - b) Short-term flow impact: Income taxes could go up as black money was deposited in bank accounts
 - c) Increases in tax payments at state government levels and accelerated payments to discoms.
 - ✓ **Negatively**, in majorly 3 ways:
 - a) Costs of printing new notes over and above normal replacement.

- b) The costs of sterilizing the surge in liquidity into the banking system via issuance of Market Stabilization Scheme bonds.
- c) If nominal GDP growth declines, corporate and indirect tax revenues of the centre could decline but so far there is no clear evidence.

Markers of Success – How to identify success

- **Firstly**, changes in the use of digital payment methods across the three categories of digital access namely, smart phone users, regular phone users and the phoneless, respectively. Early signs are encouraging.
- **Secondly, Cash-GDP ratio**: which should decline as more saving is channeled through the formal financial system and black money falls. On one estimate of black money, the cash-GDP ratio could decline permanently by about 2 percentage points.
- **Thirdly, Taxes**: The number of new income tax payers as well as the magnitude of reported and taxable income should go up over time.
- **Lastly, Compliance**: demonetisation has also raised the costs of non-compliance with indirect taxes, we should also expect to see an increase in registration under the service and excise taxes and under the states' VATs. These should drift up steadily in the future.

Maximizing Long-Term Benefits, Minimizing Short-Term Costs:

- **Follow up Actions**: A number of follow-up actions would minimize the costs and maximize the benefits of demonetisation. These include:
 - ✓ Fast, demand-driven, remonetisation: Supply of currency should follow actual demand and not be dictated by official estimates of “desirable demand” to re-establish internal convertibility.
 - ✓ Inter-convertibility of cash:
 - There should be no penalties on cash withdrawals, which would only encourage cash hoarding.
 - Internal convertibility is a bedrock of every single financial system in the world, for some very practical reasons. Unless people have confidence that money deposited in bank accounts is freely convertible into cash, and vice versa, they will be reluctant to deposit their cash.
 - ✓ The proportion of low denomination notes should certainly rise at the expense of higher ones. But there should not be any restrictions on aggregate supply.
 - ✓ The government windfall arising from unreturned notes should be deployed toward capital-type expenditures.
 - ✓ **Digitalization**:
 - Public policy must balance benefits and costs of both forms of payments.
 - The transition to digitalization must be gradual; take full account of the digitally deprived; respect rather than dictate choice.
 - The cost of incentivizing digitization must be borne by government.
 - Cyber security systems must be strengthened considerably.
- **Complementary Actions**: A five-pronged strategy could be adopted:
 - ✓ A GST with broad coverage to include activities that are sources of black money creation—land and other immovable property—should be implemented;
 - ✓ Individual income tax rates and real estate stamp duties could be reduced;
 - ✓ The income tax net could be widened gradually and, consistent with constitutional arrangements, could progressively encompass all high incomes. (After all, black money does not make fine sectoral distinctions);
 - ✓ The timetable for reducing the corporate tax rate could be accelerated; and
 - ✓ Tax administration could be improved to reduce discretion and improve accountability. Action need to be taken to allay anxieties about over-zealous tax administration.

Way forward: It is imperative that the effort to collect taxes on newly disclosed (and undisclosed) wealth does not lead to tax harassment by officials. There must be a shift to greater use of data through greater information sharing between direct and indirect tax departments, smarter evidence-based scrutiny and audit, greater reliance on on-line assessments with correspondingly less interaction between tax payers and tax officials.

CHAPTER 4: THE FESTERING TWIN BALANCE SHEET PROBLEM

Theme: The chapter talks about the India's Twin Balance Sheet problem (overleveraged companies and bad-loan-encumbered banks) and how despite successive attempts at reforms, the problem continues to persist. It then calls for considering a different approach- a centralized Public Sector Asset Rehabilitation Agency that could make politically tough decisions required to solve the problem.

Introduction

A balance sheet summarizes the asset and liabilities of any individual/institution at any time. The **Twin Balance sheet (TBS) problem** is a twofold problem:

Interest coverage Ratio

- It determines the debtors' capacity to pay interests on their loans.
- If it is less than 1, then debtor is unable to pay its interests. Such companies are also called "IC1 companies".

1. **Overleveraged companies** - A company carrying too much debt and unable to pay interest payments from loans.
2. **Bad loan with banks:** Loan repayments to banks are 'past due' their time, turning to Non-performing assets (NPA). India's NPA problem is also unique in some ways –
 - Ideally NPAs occur in an economic crisis but India's GDP growth was one of the fastest when NPAs built up.
 - Nearly 80% of the NPAs are concentrated with Public Sector Banks (PSBs). 13 PSBs own 40% of the severely stressed loans.
 - India's NPAs are higher as compared to other emerging markets.

Reasons of India's TBS problem

- During the mid-2000s, with high growth rates of the economy:
 - Nonfood bank credit had doubled.
 - Investment-GDP ratio was at an all-time high (38% in 2007).
 - Overseas funding was about 9% of GDP by 2007.**All this increased the debt of the companies.**
- Environmental and land clearances were difficult to get, causing delays. This made debt go bad.
- Global Financial Crisis (GFC) 2007-2008 reduced growth rates and thus the revenues from investments.
- RBI increased interest rates to avoid inflation, increasing the financing costs sharply.

Balance Sheet syndrome with Indian Characteristics

- In an ideal scenario, corporations expand in an economic boom. They add up liabilities making the companies overleveraged. This also leaves banks with NPAs.
- India also followed this ideal path but consequence of TBS in India was different than others.
 - **TBS in India co-existed with high aggregated demands and high growth rates.**
- Reasons of this are –
 - India has had infrastructure shortages. So, **although the infrastructure created became financially unviable, it allowed for Indian economy to grow.** In contrast, US housing boom did not prove useful to its infrastructural needs leading to recession.
 - In India, the creditors gave the debtors more time to pay loans and 'ever greened' their loans. In contrast, creditors in other countries declared bankruptcies.

Is Indian model of TBS sustainable?

- It can be sustainable under two scenarios –
 - **Phoenix scenario** - Economy grows with improvement in cash flows to stressed companies so that they can service debts.
 - **Containment scenario** – NPAs are limited to a small proportion of the GDP and GDP growth is increased. In this way problem is not solved but fades in importance.
- But both the scenarios are failing as per recent data.

Loan ever greening

In this, the banks lend money to the firms to pay their interest obligations until their conditions improve.

Eg. In the power sector, low tariffs have decreased its cash flows.

Eg. In the telecom sector, entry of new players has led to price cutting thus lowering cash flows.

- Economy is not able to grow in the first place because of low investments and low bank lending.
- Banks NPAs are also increasing because of higher interests on more loans they gave to debtors.

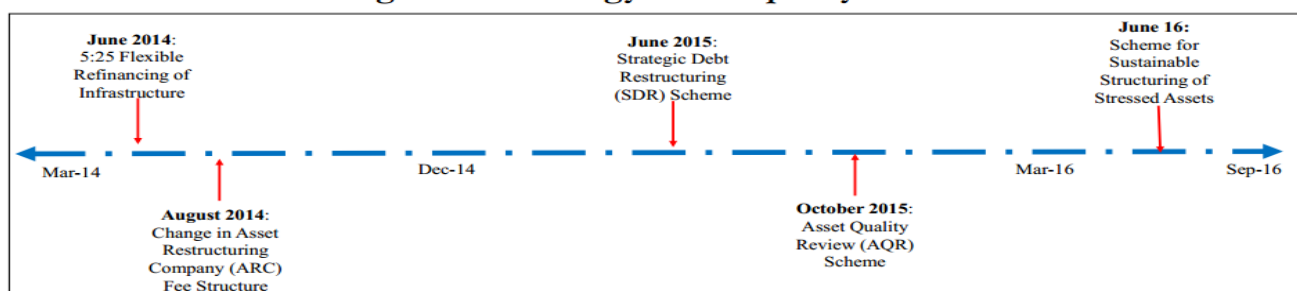
Challenges in the Indian economy due to TBS

- In 2016, 80% of the NPAs came from mid-size companies and MSMEs. Therefore **stress in the corporate sector is not only deepening but also widening**.
- **Bank lending is tightening** - Although household credit and agricultural credit are continuing at a good pace, the credit to corporate and MSMEs have been hit.
- **Disintermediation of banking sector** – With tightening of bank credit, borrowers are switching to other alternatives like capital markets. This can have two consequences –
 - **Disintermediation of banks** with banks losing their borrowers and their markets.
 - MSMEs losing their funding because MSMEs still do not have affinity to capital markets.

Why hasn't TBS grown into an economic crisis in India?

- The NPAs are mostly with the PSBs ultimately backed by the government. So, creditors still retain confidence in the government.

Figure. Chronology of RBI policy actions



Limitations of the current solutions

- Initially the focus was on **rescheduling amortizations (5/25 scheme)** –
 - It was for infrastructure sector and eight core industry sectors.
 - It extended loan periods by 25 years and adjusted interest rates every 5 years so as to match the funding period with the long gestation and productive life of these projects.
- Now RBI has focused on three mechanisms –
 - Encouraging **private Asset reconstruction companies (ARC)** –
 - ✓ They were introduced under SARAFAESI Act 2002.
 - ✓ This lets bank focus on its core activities and ARC solving debt problems.
 - ✓ But ARCs have only been able to buy 5% of the total NPAs over 2014-2015. They have found it difficult to recover from the debtors.
 - **Strategic Debt Restructuring scheme (SDR) (2015)** - Under this the banks can take over firms and sell them to new owner.
 - **Sustainable Structuring of Stressed Assets (2016):**
 - ✓ An independent agency hired by banks decides how much unsustainable debt can be converted to equity.
 - ✓ Unlike SDR it does not have change of company's ownership.
- **Success of the schemes have been limited due to the following reasons** –
 - The schemes are still new and financial negotiations takes time.
 - **Loss recognition** - Banks do not recognize stressed assets and continue to evergreen loans. They also neglect RBI's Asset Quality review (AQR).

Asset Quality Review

- It is a financial inspection conducted by RBI in 2015-16. It checks whether the banks have classified assets correctly according to loan repayment.
- Its loan sample size was larger than an annual financial investigation conducted by RBI.

- **Lack of coordination** - RBI's **Joint Lender's Forum**, where decisions can be taken by 75% creditors by value and 60% creditors by number, has been less successful because -
 - ✓ Different banks have different degrees of credit exposure and incentives. So, banks with large exposures may be reluctant to accept losses.
- **Lack of incentives** – Banks see a threat of attracting **attention of investigative agencies and public** if they give concessions to debtors.
 - ✓ To address this problem, the Bank Board Bureau (BBB) has created an **Oversight Committee** which vets and certifies write-down proposals. But it remains open whether it can change bankers' incentives.
- **Lack of capital** – Rs 70000 crores for capitalization under the Indradhanush scheme are far from sufficient.
- **The new bankruptcy system is not yet fully established.**

Required Solution: Till now, the solution was based on decentralized approach i.e. banks resolving NPAs themselves. The economic survey suggests a centralized approach where **Public Sector Asset Rehabilitation Agency (PARA)** should be formed. It would recognize losses, help in coordination and provide incentives to solve TBS problem.

About PARA

- **Why is PARA needed?**
 - It will resolve bad debts on sound economic principles.
 - Stressed debt is concentrated in larger companies. Bigger cases are difficult to resolve and needs an independent agency.
 - Banks have difficulty in solving these cases due to lack of coordination, capital etc. Even private ARCs have failed. International practice has shown PARA like organization to be viable to solve TBS problem. E.g. Post East Asian crisis
 - Immediate step is needed because delays are increasing the problem.
- It would purchase loans from banks and adopt value maximizing strategy to solve them. E.g. Converting loan (debt) to equity etc. Then the government can recapitalize PSBs.
- In this process, losses would have to be paid to the creditors. The bulk of this burden will fall on government as PSBs are major creditors. The government can finance this capital by –
 - Issuing Government Securities.
 - Capital markets – Private sector can take equity floated by PARA. Government can sell its holdings in PSBs too.
 - RBI is one of the most highly capitalized banks in the world. Therefore, its excess capital like securities can be transferred to PARA.
- PARA is not a panacea. Issues that need to be resolved to make PARA work are –
 - There is a need to **confront the losses and accept the political consequences.**
 - PARA should be highly professional with the sole objective of maximizing recovery value. It should be an **independent agency staffed by banking experts.**
 - Although difficult and time consuming, **market pricing of the distressed loans** should be done to minimize losses.

Conclusion

Economic Survey 2016 required 4Rs to address the stressed assets problem:

- **Reform:** Here, the least amount of progress has occurred. Recurrence of NPA problem highlights the need for structural reforms. Serious consideration must also be given to issue of government majority ownership in the public sector banks (PSBs).
- **Recognition:** it is the area where there has been the most progress. following the RBI's AQR, banks have recognized a growing number of loans as non-performing.
- **Recapitalization:** With rising NPAs banks will need to be recapitalized most of which will need to be funded by government for PSBs. However, it is not the need of the hour.
- **Resolution:** For speeding up resolution, India can follow the approach of East Asian Countries by adopting a centralized strategy (post 1990s economic crisis) instead of decentralized approach currently adopted.

CHAPTER 5: FISCAL FRAMEWORK - INDIA IS CHANGING, SHOULD INDIA CHANGE TOO

Introduction

- A **commitment towards fiscal consolidation** is seen in recent times. Eg. Steady decline in the fiscal deficit (FD) from 4.5% of GDP in 2013-14 to 3.5% in 2016-17.
- Post **Global Financial Crises (GFC)** in 2008-09, the monetary policy (MP) has seen a paradigm shift in Advanced Economies (AEs):
 - **Near Zero Interest Rates or even negative interest rates** to increase market liquidity.
 - **Promoting Quantitative Easing (QE)** to increase credit in the economy.
- Despite such monetary easing, **the AEs have not recovered** as expected. Therefore **focus is shifting to fiscal policy (FP) to recover economies**. And here too there has been a paradigm shift as
 - Fiscal policy can legitimately be used for a countercyclical policy.
 - It is particularly effective when monetary policy is at the zero lower bound, because at that point multipliers are large.
 - It is effective in increasing the GDP and thus will lead to significant increase in tax revenues.
 - So, the FP is now promoting fiscal deficits (FD) rather than being concerned about debts thus moving towards Fiscal Activism.

Quantitative Easing

- It is an unconventional MP where a central bank purchases securities from the market to lower interest rates.
- It floods financial institutions with capital to increase liquidity.

Countercyclical policy

- A countercyclical policy is a FP where the government **promotes spending during downturns and tightens credit during the inflationary periods**.

India and the World Flows/Deficits

- India has a Twin Balance Sheet problem (TBS) with overleveraged companies and stressed assets in banks. So **India needs a countercyclical policy like AEs**.
- But India's conditions are different from AEs:
 - **Both its growth rates and inflation are substantially higher than AEs**. Therefore
 - ✓ Higher fiscal spending to boost growth is presently not needed.
 - ✓ A countercyclical policy could trigger higher inflation.
 - **Past experiences of 1991 and 2013** have not been good for the economy.
 - ✓ High FD in 1991 led to Balance of Payment problem.
 - ✓ High FD in 2013 led to a **financial currency 'near crisis'** because of surge in government spending during boom years of 2004-05 and post Global financial crisis.
 - ✓ Only difference between 1991 and 2013 was that in 1991 the exchange rate was fixed while in 2013 it was floating.

Therefore India's fiscal stance has in-built bias towards higher deficit with higher spending during growth surge. This creates **Fiscal Fragility**.

India and the World Stocks/Debts

- India also has a higher debt to GDP ratio than other emerging markets (EMEs). Still India is also unique in its debt management because –
 - Despite inflation, India has never defaulted on its domestic debt unlike other EMEs in Latin America.
 - It has consistently met its debt service obligation despite debts scaling to 83% of GDP.
 - Gold from the RBI was flown to fulfill external debt obligations in 1991 default.
- India also runs a primary deficit that puts pressure on India's debts.

Conclusion

- India is converging toward the AEs with one fundamental difference - India has higher growth rates than AEs especially after GFC.
- India's experience shows a **need for rules to contain FD and FRBM Act 2003 is a welcome step** towards it. India should not over rely on countercyclical policies like AEs.
- The new committee to reform FRBM should reform FRBM considering these present and future conditions.

CHAPTER 6: FISCAL RULES: LESSONS FROM THE STATES

Theme: The chapter analyses the impressive fiscal performance of the states after the introduction of Fiscal Responsibility Legislation (FRL). It identifies reasons, other than FRL itself, responsible for the impressive fiscal performance. It then talks about the mounting fiscal challenges for the states and also provides suggestions how fiscal performance can be kept on track.

Introduction

- India embarked in the mid-2000s on an ambitious project of fiscal consolidation, adopting fiscal rules aimed at curbing fiscal deficits i.e. Fiscal Responsibility and Budget Management (FRBM) Act, adopted by the centre in 2003.
- This Act was mirrored by Fiscal Responsibility Legislation (FRL) adopted in the states.

State's fiscal position after FRL

- The financial position of the states improved considerably after 2005, based on any measure.
- States essentially achieved the fiscal targets right away, years in advance of the target year of FY 2008 (extended to 2009/10 due to the financial crisis).
- Within the first two years, states on average lowered their deficits to target levels – while the primary balance shifted into surplus
- Comparing the 11 years before FRL to the 10 years afterwards
 - ✓ Fiscal deficits fell by almost half- from an average of 4.1 percent of GSDP on average to 2.4 percent of GSDP.
 - ✓ Revenue deficits also fell sharply from 2.1 percent of GSDP on average to -0.3 percent of GSDP after the FRL.
- States kept a tight rein on wage and salary expenditure. Instead, they expanded more discretionary spending, which would be easier to scale back if needed to achieve the deficit targets.
- The average debt to GSDP ratio accordingly fell by 10 percentage points to a mere 22 percent of GSDP in 2013.
- Off-budget spending (Explicit guarantees by state government and borrowing by state PSUs), which can undermine the power of fiscal rules, also came down.

Other the exogenous factors the deficit reduction owes to:

- Acceleration of nominal GDP growth (of 6 percentage points on average) helped boost states' revenues by about 1 percent of GSDP;
 - ✓ Own tax revenues as a percent of GSDP increase by 1 percentage point,
- Increased transfers from the centre of about 0.9 percent of GSDP because of the 13th Finance Commission recommendations and the surge in central government revenues;
 - ✓ This is more than half of the reduction in the fiscal deficit and about half the change in revenue deficit.
- Reduced interest payments of about 0.9 percent of GSDP on account of the debt restructuring package offered by the centre; and
 - ✓ Centre provided a conditional debt restructuring window, the Debt Consolidation and Restructuring Facility (DCRF).
 - ✓ So states could substantially lower their interest payments in the same year that they adopted the FRL.

What did FRL do?

- Fiscal targets were established, which were the same for all states:
 - the overall deficit was not allowed to exceed 3 percent of GSDP at any point (relaxed to 4 percent of GSDP in 2009/10 due to 2008 crisis),
 - revenue deficit was to be eliminated by 2008/9
- The 12th Finance Commission allowed states to borrow directly from the market, in the hope that investors would also exercise some discipline, by pushing up interest rates on states whose fiscal position had not improved.
- New reporting requirements: publish annual Medium-Term Fiscal Policy reports

Significance of FRL on Budgeting Process: to meet FRL targets:

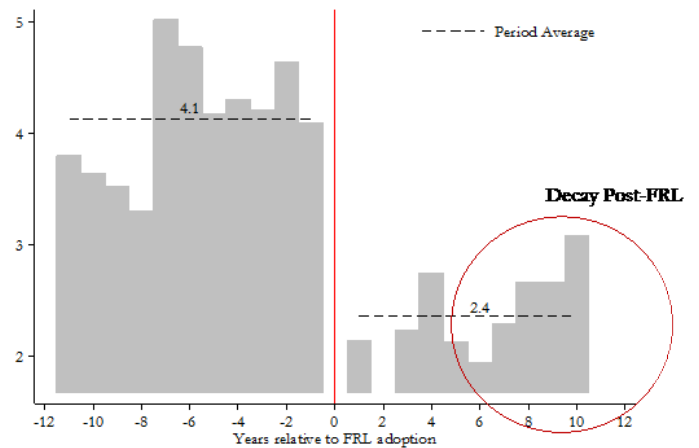
- States tried to generate accurate forecasts of revenues and expenditures, so they would not be forced to make large spending adjustments at the end of the year to meet their deficit targets.
- As states have become increasingly dependent on central transfers, which can be delayed or arrive in lumpy amounts. So states have tried to smooth their expenditures by holding large cash balances or holding intermediate treasury bills (ITBs).

- **Reduced need for spending by the states:** as the centre took on a number of major social sector expenditures under the Centrally Sponsored Schemes (CSS)

Further, rather than encouraging states to tighten their belts, the role of the FRL has been to prevent them from spending all of their windfall. This is suggested by the quick “decay” post FRL. That is, a few years after the FRL, all indicators of fiscal performance—deficits, expenditures, and especially off-budget activities—started deteriorating. **Survey also suggests** the possibility of Centre exercising **Article 293(3)** of the Constitution to prevent this deterioration.

What are the lessons for future fiscal rules?

On the fiscal scene, new challenges such as: implementing Pay Commission recommendations, slowing growth, and mounting payments from the UDAY bonds etc., are mounting.



There is need to review how fiscal performance can be kept on track.

- Need to incentivise good fiscal performance:
 - ✓ **13th FC’s recommendation** of allocating resources across states (the so-called “horizontal” criteria) based on states’ own fiscal performance (which had 17% weightage) can be brought in again.
 - ✓ **14th FC’s attempted** to shift towards incentive by relaxing some of the FRL limits for better performing states, but there was some element of tension in its recommendations.
- Need for greater market-based discipline on state government finances: At present, this is missing, as reflected in the complete lack of correlation between the spread on state government bonds and their debt or deficit positions.
 - ✓ There is a flat relationship between the spread and the indebtedness of states – states are neither rewarded nor penalized for their debt performance.
 - ✓ Similarly, there is no relationship between the coupon rate and the fiscal deficit of states.
- Incentivizing good performance by the states will require the centre to be an exemplar of sound fiscal management itself.

LIVE / ONLINE
Classes Available

- ✦ Access to recorded classroom videos at your personal student platform
- ✦ Comprehensive, relevant & updated HARD Copy study material for prelims syllabus. (for online students, it will be dispatched through post)

Fast Track
Course
for
GS
PRELIMS
2017

- ✦ Classroom MCQ based tests & access to ONLINE PT 365 Course
- ✦ Access to All India Prelims Test Series

DURATION
65 classes

CHAPTER 7: CLOTHES AND SHOES: CAN INDIA RECLAIM LOW SKILL MANUFACTURING?

Theme: The chapter is based on the challenge of job creation and identifies apparel and leather sector for addressing this challenge. The chapter analyses the potential, opportunities and challenges in front of this sector. The chapter also suggests some policy responses and not cede the space to its competitors.

Introduction: Creating jobs is India's central challenge. Critical elements of this policy response are

- Generating rapid economic growth
- Nurturing an enabling environment for investment
- Targeted action in certain labour intensive sectors

The apparel and leather and footwear sectors meet many or all of the above criteria and hence are eminently suitable candidates for targeting.

Why these sectors should be targeted?

- **Mimicking East Asian growth story**
 - ✓ Every successful economic growth take-off in post-war history in East Asia has been associated with rapid expansion in clothing and footwear exports in the early stages
 - ✓ In its take-off phase of growth, India has underperformed relative to the East Asia
- **Jobs**
 - ✓ Jobs per unit of investment- Apparels are 80-fold more labour-intensive than autos and 240-fold than steel.
 - The comparable numbers for leather goods are 33 and 100, respectively.
 - ✓ High employment elasticity- due to this, rapid export growth could generate about half a million additional direct jobs every year.
- **Women and Social transformation**
 - ✓ Female labour intensity for apparel and leather industry is very high when compared to major manufacturing sectors
 - ✓ Opportunity for women means that these could be vehicles for social transformation
 - ✓ In Bangladesh, female education, total fertility rates, and women's labour force participation improved due to the expansion of apparel sector.
- **Opportunity to replace China-** grabbed by others and not India
 - ✓ China stabilizing or losing market share- because of rising wage levels in China
 - ✓ The space vacated is being taken over by Bangladesh and Vietnam in case of apparels; Vietnam and Indonesia in case of leather and footwear.

What can targeted action in these sectors signify?

- They can generate jobs that are formal and productive,
- They provide bang-for-buck in terms of jobs created relative to investment,
- They have the potential for broader social transformation as they employ women,
- They can generate exports and growth.

Labour Intensity: Jobs per unit of investment. Ex – Apparels – 23.9 jobs per lakh investment, while in Food processing 2.4

Employment elasticity: Percentage change in employment with 1% change in economic growth.

Indian apparel and leather firms are relocating to Bangladesh, Vietnam, Myanmar, and even Ethiopia. The window of opportunity is narrowing and India needs to act fast if it is to regain competitiveness and market share in these sectors. Hence, the urgency.

Challenges

Common Challenges for both sectors	Solutions
Labor regulations <ul style="list-style-type: none"> • High minimum wages and overtime pay • Low Wage Employees receive only 55% of their salary because rest goes to statutory deductions like EPF, ESI etc. which act like de-facto 45% taxes • Lack of flexibility in part-time work All this makes Labor costs, India's source of comparative advantage in this sector a disadvantage.	For mandatory deductions – offer employees (not employers) three choices: <ul style="list-style-type: none"> • 12% employee contribution to be deducted or not • Whether this 12% goes to EPF or NPS • Whether health insurance premiums go to ESI or a private health insurance of the employee's choice. (ESI – Employee State Insurance, 1.75% from employee's salary and 4.75% from employer)

Also it makes Indian apparel and leather firms smaller compared to firms in China, Bangladesh and Vietnam.	(EPF - Employee Provident Fund, 12% from employee's salary and 12% from employer)
<p>Tax and tariff policies</p> <ul style="list-style-type: none"> High tariffs on yarn and fiber import Domestic taxes are higher for man-made fibers than cotton based production. Similarly, for non-leather against leather. These policies are impeding competitiveness in man-made fibers and Non-Leather footwear and favor cotton-based exports and Leather Footwear instead. But world markets are shifting away from latter. 	<ul style="list-style-type: none"> Apparel exporters will be provided relief to offset the impact of state taxes imbedded in exports, which could be as high as about 5% of exports. A subsidy for increasing employment – 12% contribution to EPF GST to rationalize domestic indirect taxes so that they do not discriminate in the case of apparels against the production of clothing that uses man-made fibers; and in the case of footwear against the production of non-leather based footwear
<p>Logistics:</p> <ul style="list-style-type: none"> costs and time involved in getting goods from factory to destination are greater than those for other countries few very large capacity containers (VLCC) come to Indian ports. They have to be transhipped through Colombo which adds to travel costs 	<ul style="list-style-type: none"> Simplified permits and single portal clearances Identification and development of freight networks Address bottlenecks concerning trucking industry and increase in logistics efficiency <p>Also look up <i>WORLD BANK'S LOGISTICS PERFORMANCE INDEX (July 2016 VISION Current Affairs)</i></p>
<p>Discrimination in export markets</p> <p>Competitor exporting nations have better market access by way of zero or at least lower tariffs in the two major importing markets, USA and EU.</p>	Free Trade Agreements (FTAs), such as, with the European Union (EU) and the United Kingdom (UK).

Specific challenge for leather and footwear sector:

- The leather and footwear industry uses raw hides and skins of a number of animals like cattle, buffalo etc. Leather made from cattle hides has greater global demand owing to its strength, durability and superior quality.
- However, despite having a large cattle population, India's share of global cattle population and exports of cattle hides is low and declining due to limited availability of cattle for slaughter despite a large cattle population.

"You are as strong as your foundation"

FOUNDATION COURSE

GS PRELIM cum MAINS 2018

Approach is to build fundamental concepts and analytical ability in students to enable them to answer questions of Preliminary as well as Mains examination

Regular | Weekend

DELHI | 10th April

PUNE | JAIPUR | HYDERABAD | 15th May

- ↳ Includes comprehensive coverage of all the topics for all the four papers of GS mains , GS Prelims & Essay
- ↳ Access to LIVE as well as Recorded Classes on your personal student platform
- ↳ Includes All India GS Mains, GS Prelims, CSAT & Essay Test Series
- ↳ Our Comprehensive Current Affairs classes of PT 365 and Mains 365 of year 2018 (Online Classes only)
- ↳ Includes comprehensive, relevant & updated study material

NOTE - Students can watch LIVE video classes of our COURSE on their ONLINE PLATFORM at their homes. The students can ask their doubts and subject queries during the class through LIVE Chat Option. They can also note down their doubts & questions and convey to our classroom mentor at Delhi center and we will respond to the queries through phone/mail. Post processed videos are uploaded on student's online platform within 24-48 hours of the live class.

ONLINE Students

CHAPTER 8: REVIEW OF ECONOMIC DEVELOPMENT

Introduction

The first Advanced Estimates (AE) released by the CSO has pegged the GDP growth rate of 7.1 per cent in 2016-17. The first AE largely mirror the economic situation during the first seven to eight (pre demonetization) months of the financial year.

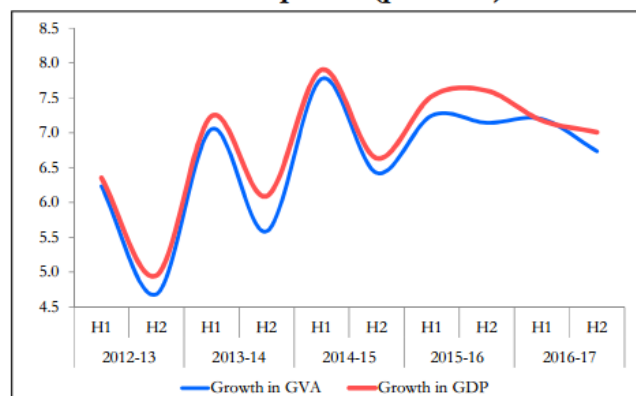
Trends at Sectoral Level

- The growth of agriculture & allied sectors improved significantly in 2016-17, following the normal monsoon, increase in rabi sowing so far and the first AE for kharif crop production.
- The growth in industrial sector, comprising mining & quarrying, manufacturing, electricity, gas & water supply, and construction sectors moderated in 2016-17.
- Manufacturing also registered moderation mostly on account of a steep contraction in capital goods, and consumer non-durable segments of IIP.
- The contraction in mining and quarrying largely reflects slowdown in the production of crude oil and natural gas.
- Fixed investment (gross fixed capital formation (GFCF)) to GDP ratio (at current prices) is estimated to be lower in 2016-17 vis-a-vis 2015-16.
- It is the 23.8 per cent growth in government final consumption expenditure that is the major driver of GDP growth in the current year from the demand side (Table 2).
- Decline in trade deficit was witnessed in the first half of 2016-17 because of steeper contraction in imports, compared to exports. Despite slowing services exports, the decline in merchandise trade deficit helped improve the position of net exports.

Fiscal Developments

- **Fiscal consolidation:**
 - Fiscal deficit is projected at 3.5 per cent of GDP for the year, down from 3.9 percent in 2015-16.
 - This was sought to be achieved through an 11.9 per cent increase in the gross tax revenue (over 2015-16 PA) and significant strides in non-tax revenue and non-debt capital receipts.
 - Also, this is despite upside compulsions on the expenditure side due to the implementation of the recommendations of the Seventh Pay Commission.
- **Tax Collection:** On the whole, tax collections, especially union excise duties and service tax, have been buoyant in the current year till Nov 2016.
- **Revenue expenditure:** The growth in revenue expenditure which prima facie seems very high, may be viewed against-

Figure 1. Growth in GDP and GVA at constant prices (per cent)



Source: CSO

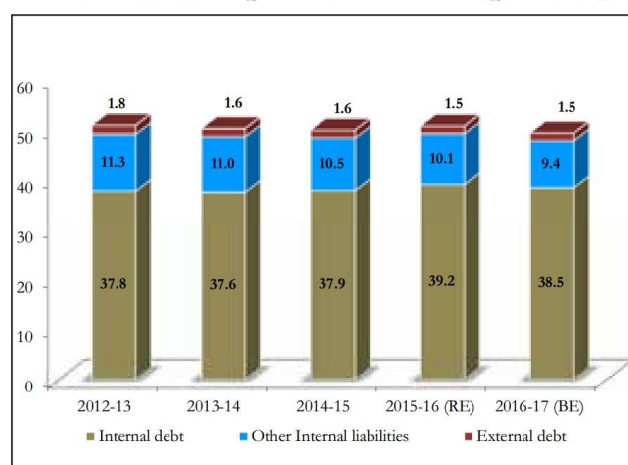
Table 2. Growth Rate of GDP at constant Prices and its components (per cent)

Component	2012-13 ^a	2013-14 ^a	2014-15 ^b	2015-16 ^c	2016-17 ^d	2016-17	
						H1	H2
Government final consumption	0.5	0.4	12.8	2.2	23.8	16.9	32.4
Private final consumption	5.3	6.8	6.2	7.4	6.5	7.1	6.0
Gross fixed capital formation	4.9	3.4	4.9	3.9	-0.2	-4.4	4.2
Change in stocks	-3.8	-18.6	20.3	5.5	5.2	5.9	4.6
Valuables	2.6	-42.2	15.4	0.3	-33.5	-47.9	-19.3
Exports of goods and services	6.7	7.8	1.7	-5.2	2.2	1.7	2.6
Imports of goods and services	6.0	-8.2	0.8	-2.8	-3.8	-7.5	-0.1
GDP	5.6	6.6	7.2	7.6	7.1	7.2	7.0

Source: CSO

Note: a=second revised estimate; b=first revised estimate c=provisional estimate; d= first advance estimate

Figure 5. Outstanding liabilities of the Union Government as per cent of GDP (per cent)



- The salary component of revenue expenditure increased by 23.2%.
- Major subsidy increased by 5.0 per cent because of 21.6 per cent surge in food subsidy.
- An increase of 39.5 per cent in the grants for creation of capital assets (GCCA). All grants given to the State Governments and Union Territories are treated as revenue expenditure, but a part of these grants are used for creation of capital assets which should be subtracted.
- **Liabilities:** The **total outstanding liabilities** of Central Government are composed of external debt, internal debt and other internal liabilities like provident funds, small savings, etc. and external.

Prices

Inflation:

- The headline inflation as measured by the Consumer Price Index (CPI) remained under control for the third successive financial year. The average CPI inflation declined to 4.9 per cent in 2015-16 from 5.9 per cent in 2014-15.
- The WPI inflation stood at 3.4 per cent in December 2016 and the average inflation was 2.9 per cent during April- December 2016.
- **CPI based Core inflation** does not take food and fuel inflations into account while **Headline inflation** consists of these two groups.
- While the headline inflation has dropped sharply in the recent months, the CPI based core inflation has remained a cause of concern so far during this fiscal year.

Food Inflation

Pulse continued to be the major contributor of food inflation. However, since July 2016, pulse prices except gram dal prices have declined because of near normal monsoon, increase in the Rabi pulse sowing and buffer build up by the government.

- The food inflation is likely to remain subdued in the light of
 - higher Rabi sowing acreage,
 - projected increase in the production of pulses and key agri-products globally
 - Astute food management and price monitoring by the Government.

Monetary Management and Financial Intermediation

- As per revised monetary policy framework, the Government has fixed inflation target in consultation with the Reserve Bank.
- The monetary policy is now managed by the Monetary Policy Committee as provided in the amended Reserve Bank of India Act, 1934.
- As per the revised monetary policy framework, the Government has fixed the inflation target of 4 per cent with tolerance level of +/- 2 per cent for the period beginning from 5th August, 2016 to March 31, 2021.

Measures to Strengthen Corporate Bond Market

The RBI accepted many of the recommendations of the **Khan Committee** to boost investor participation and market liquidity in the corporate bond market. They include:

- Permitting commercial banks to issue rupee-denominated bonds overseas (masala bonds) for their capital requirements and for financing infrastructure and affordable housing
- Brokers registered with the SEBI and authorized as market makers in corporate bond market permitted to undertake repo / reverse repo contracts in corporate debt securities
- Banks allowed to increase the partial credit enhancement they provide for corporate bonds to 50 per cent from 20 per cent.
- Permitting primary dealers to act as market makers for government bonds, to give further boost to government securities by making them more accessible to retail investors
- Simplified procedures to ease access to the foreign exchange market for hedging in over the counter (OTC) and exchange-traded currency derivatives up to a limit of US\$30 million at any given time.
- For the first time since 2008 crisis, **Net Foreign Portfolio Investments** turned negative because of higher returns in advanced economies.

India's Merchandise Trade

- In line with subdued global growth and trade, India's exports declined by 1.3 per cent and 15.5 per cent in 2014-15 and 2015-16 respectively.
- The trend of negative growth was reversed somewhat during 2016-17 (April-December), with exports registering a growth of 0.7 per cent to about US\$ 200 billion.
- USA followed by UAE and Hong Kong were the **top export destinations**.
- Value of imports declined from US\$ 448 billion in 2014-15 to US\$ 381 billion in 2015-16, mainly on account of decline in crude oil prices resulting in lower levels of POL imports.
- Top **three import destinations** of India were China, UAE and USA in 2016-17 (April-November).
- **Trade Deficit**
 - In 2015-16, India's trade deficit declined by 13.8 per cent (vis-à-vis 2014-15) to US\$ 118.7 billion.
 - Furthermore, it declined by 23.5 per cent to US\$ 76.5 billion in 2016-17 (April-December) as compared to US\$ 100.1 billion in the corresponding period of previous year.

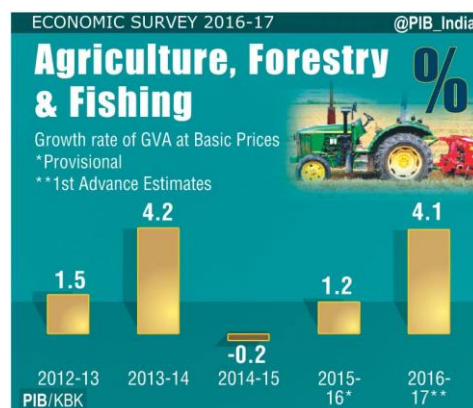
Balance of Payments

- **Current Account:** current account deficit (CAD) progressively contracted from 4.8 per cent of GDP in 2012-13 to 1.1 per cent of GDP in 2015-16.
- Positive factors helping narrowing of CAD:
 - Sharp contraction in trade deficit outweighed the decline in net invisible earnings.
 - Decline in oil import bill due to low prices by around 18 per cent
 - Sharp decline in gold imports led to a reduction in India's overall imports.
- **Capital/finance account:** Net capital flows remained higher than the CAD leading to net accretion to India's foreign exchange reserves.
- **External Debt:**
 - India's external debt stock stood at US\$ 484.3 billion, recording a decline of US\$ 0.8 billion over the level at end-March 2016, mainly due to a reduction in commercial borrowings and short term external debt.
 - The shares of Government (Sovereign) and non-Government debt in the total external debt were 20.1 per cent and 79.9 per cent respectively at end-September 2016.
 - 'International Debt Statistics 2017', published by World Bank, indicates that India continues to be among the less vulnerable countries.

Agriculture and Food Management

Price Policy of Agriculture Produce

- The price policy seeks to
 - ensure remunerative prices to the farmers to encourage higher investment and production,
 - To safeguard the interest of consumers by making available supplies at reasonable prices.
- Measures to check **volatility of price of pulses**
 - To increase productivity of pulses, a new extra early maturing, high yielding variety of Arhar (Pusa Arhar-16) has been developed to be made available for farmers in the next Kharif season.
 - MSP for pulses were raised to substantially to incentivize farmers to cultivate pulses.
 - Also, the government constituted a committee under Dr. Arvind Subramanian which suggested various measures to arrest volatility of prices of pulses in its report.



Recommendation of Dr. Arvind Subramanian Committee

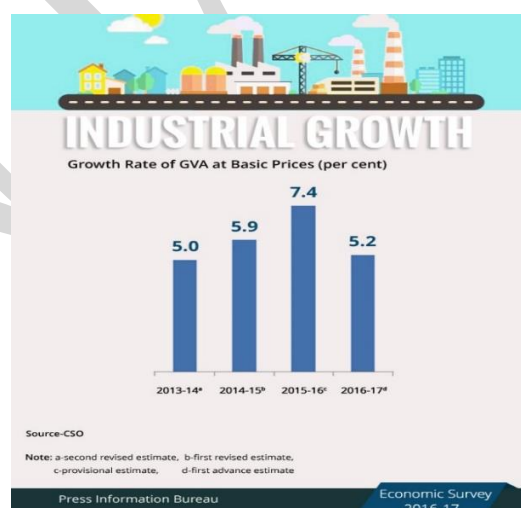
- Government procurement machinery should be prepared to ensure the procurement of 29 Kharif pulses at this season's announced MSP.
- To ensure effective procurement, a High Level Committee comprising Ministers of Finance, Agriculture, and Consumer Affairs and Principal Secretary to PM should be constituted.
- Build up gradually but opportunistically 2 million tons of pulses stock with targets for individual pulses, especially tur (3.5 lakh tonnes) and urad (2 lakh tonnes).
- Eliminate export ban on pulses and stock limits which coupled with weak procurement forces farmers to sell most of

their output at market prices that are well below MSP; at the very least limits on wholesalers should be eliminated.

- Encourage states to delist pulses from their APMC.
- Review Essential Commodities Act, 1955 and futures trading of agricultural commodities.
- Create a new institution as a Public Private Partnership (PPP) to compete with and complement existing institutions to procure stock and dispose pulses
- Encourage development of GM technologies and grant expeditious approval to indigenously developed new varieties of pulses.

Industrial, corporate and Infrastructure sectors

- During April-November 2016-17, a modest growth of 0.4 per cent has been observed in the Index of Industrial Production (IIP).
- The eight core infrastructure supportive industries, viz. **coal, crude oil, natural gas, refinery products, fertilizers, steel, cement and electricity** that have a total weight of nearly 38 per cent in the IIP.
- **FDI Policy:**
 - The Government has liberalized and simplified the foreign direct investment (FDI) policy in sectors like defence, railway infrastructure, construction and pharmaceuticals, etc.
 - Sectors like services sector, construction development, computer software & hardware and telecommunications have attracted highest FDI equity inflows.
- Measures to **incentivize investment include** Make-in-India, Invest India, Start Up India and e-biz Mission Mode Project under the National e-Governance Plan.
- Measures to **facilitate ease of doing business include**
 - online application for Industrial License and Industrial Entrepreneur Memorandum through the e-Biz website 24x7 for entrepreneurs;
 - limiting documents required for export and import to three;
 - Setting up of Investor Facilitation Cell under Invest India to guide, assist and handhold investors during the entire life-cycle of the business.



Social Infrastructure, Employment and Human Development

Social Expenditure Trend:

- As per the RBI data, expenditure of social services by Centre and state as a proportion of GDP was 7.0 percent.

Employment Scenario

- Survey (Fig 20.) shows that overall employment increased by 135 thousand (Dec-2014 to Dec 2015).
- The All India LFPR of females is much lower than that for males. The North Eastern and Southern States, in general, display high female LFPR as compared to low levels in Northern States.

Table 13. Trends in social sector expenditure

Items	2009-10	2013-14	2014-15	2015-16 RE	2016-17 BE
As percentage to GDP					
Total Expenditure	28.6	26.6	25.1	28.2	28.4
Expenditure on Social Services	6.9	6.6	5.7	6.9	7.0
<i>of which:</i>					
Education	3.0	3.1	2.6	2.9	2.9
Health	1.4	1.2	1.1	1.3	1.4
Others	2.5	2.3	2.0	2.7	2.7

Source: Reserve Bank of India.

- There is a clear shift in employment to secondary and tertiary sectors from the primary sector.
 - This reflects increase in both casual labour and contract workers which has adverse implications on the level of wages, stability of employment, social security of employees owing to the 'temporary' nature of employment.
 - It also indicates preference by employers away from regular/formal employment to circumvent labour laws.

- The multiplicity of labour laws and the difficulty in their compliance have been an impediment to the industrial development and employment generation. At present, there are 39 Central labour laws which have been broadly proposed to be grouped into four or five Labour Codes on functional basis with the enactment of special laws for small manufacturing units.
- The Government has put forth a set of labour reform measures for bringing compliance in the system, catalysing the need of job creation and to ensure ease of doing business while ensuring safety, health and social security of every worker.

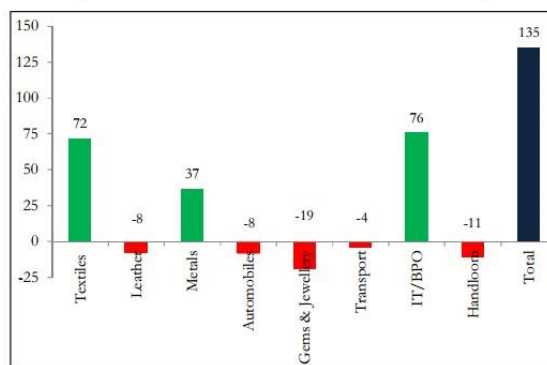
Education sector: Addressing learning outcomes

- There have been improvements in access and retention, the **learning outcomes** for a majority of children is still a cause of serious concern.
- Though the share of teacher component in total Sarva Shiksha Abhiyan (SSA) budget has been increasing over the years from 35 per cent in 2011-12 to 59 per cent in 2014-15, teacher **absenteeism** and the shortage of **professionally qualified** teachers remain an issue to be addressed.
- **Suggestions:**
 - Biometric attendance of all teachers in primary schools should be taken, regularly monitored by local communities and parents and should also be put in public domain.
 - Apart from this, adequate teaching aids, recorded lectures, etc. should be used to fill in for absentee teachers.
 - The implementation should leave for local flexibility so the same do not end up as top driven 'Model Schools'.
 - The pilot of biometric attendance of teachers should be accompanied with an evaluation of learning outcomes.

Health for all

- India's health policy aims at an integrated approach which will provide accessible, affordable and equitable quality health care to the marginalized and vulnerable sections.
- **SDG 3** "Ensure healthy lives and promote well-being for all at all ages" should be synchronized with India's domestic targets to reap the benefits of the 'demographic dividend'.
- **Achievements**
 - Life expectancy has doubled and infant mortality and crude death rates have reduced sharply.
 - Total fertility rate (TFR) has been steadily declining and was 2.3 during 2014.
 - Infant Mortality Rate (IMR) has declined to 37 per 1000 live births in 2015 from 44 in 2011.
 - The Maternal Mortality Ratio (MMR) declined from 301 maternal deaths per 100,000 live births during 2001-03 to 167 maternal deaths per 100,000 live births during 2011-13.
- The challenge lies in addressing the huge gap between IMR in rural (41 per 1000 live births) and urban (25 per 1000 live births) areas.

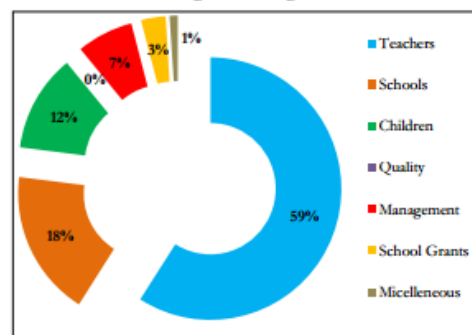
Figure 20. Estimated change in Employment in Eight Selected Sectors (in 000)
(December 2015 over December 2014)



Source: Labour Bureau.

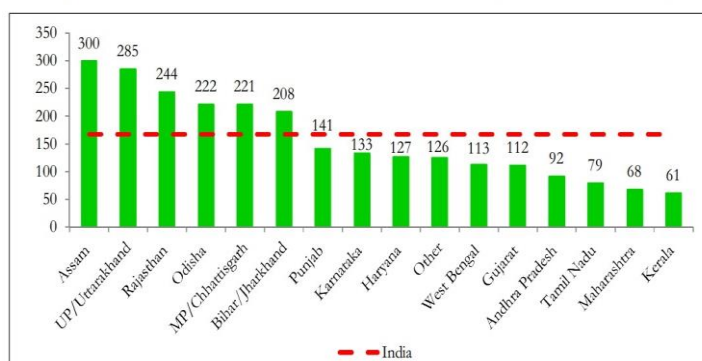
Labour force participation rate (LFPR) is defined as the section of working population in the age group of 16-64 in the economy currently employed or seeking employment.

Figure 23. Per cent share of components in SSA Budget during 2014-15



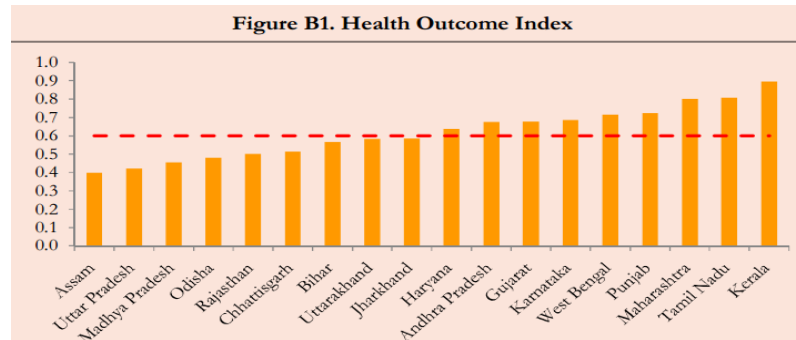
Source: SSA Portal, ASER portal.

Figure 24. Maternal Mortality Ratio by States, 2011-13 (per 100000 live births)



Source: MMR Bulletin, 2011-13, Ministry of Health and Family Welfare.

- **MMR:**
 - There are wide regional disparities in MMR (Figure 24). Therefore, in addition to reducing the all India MMR there is need to focus on States with MMR higher than the national average.
 - The high levels of anaemia prevalent among women in the age group 15-49 have a direct correlation with high levels of MMR. To address this Under the National Health Mission, Government provides health and nutrition education to promote dietary diversification, inclusion of iron foliate rich food as well as food items that promote iron absorption.
- **Experimental Health Outcome Index (Fig B1)**
 - It has been computed using Life Expectancy at age 1 year (LE1), IMR and MMR as indicators.
 - As per the data, Assam has the lowest health outcome index whereas Kerala has the highest.



Inclusive Policies of the Government

- An inclusive society is that in which equal opportunities are provided for the growth and development of all sections of the population including the marginalised, vulnerable and weaker sections to lead productive, safe and dignified lives.

- **The Accessible India Campaign:**
 - For achieving universal accessibility for Persons with Disabilities with a focus on three verticals: Built Environment, Public Transportation and Information & Communication Technologies.
 - Under this first-of-its-kind '**Inclusiveness and Accessibility Index**' is launched that helps the industries and corporates to participate in the Accessible India Campaign (AIC) by voluntarily evaluating their readiness for making the workplace accessible for PwDs.
 - Further, the "**Rights of Persons with Disabilities Bill – 2016**" passed by the Parliament aims at securing and enhancing the rights and entitlements of PwDs.
- '**Nai roshni**' scheme for leadership development of minority women.
- '**Padho Pardesh**', a scheme of interest subsidy on educational loans for overseas studies for minority communities
- '**Seekho Aur Kamao**' (Learn & Earn) and Upgrading Skill and Training in Traditional Arts/Crafts for Development (USTTAD) for skill development and economic empowerment of minorities
- '**Nai Manzil**'- a scheme to provide education and skill training to the youth from minority communities are in operation.

Climate Change

COP 22- Marrakech, Morocco

- The main thrust of COP 22 was on developing rules and action framework for operationalizing the Paris Agreement and advance work on pre-2020 Actions.
- At COP 22, Parties agreed to a deadline of 2018 for the rule book.
- The key decision adopted at COP 22 was "**Marrakech Action Proclamation for our Climate and Sustainable Development**".
 - It captured the sense of urgency to take action on climate change.
 - It also emphasized the need to strengthen and support efforts to eradicate poverty, ensure food security and enhance resilience of agriculture.
 - The pre 2020 action including mobilization of USD 100 billion per year was a key element of the Proclamation.

Paris Agreement

- It was adopted on 12th December, 2015.
- It brings all nations into a common cause to undertake ambitious efforts to combat climate change and unleash actions and investment towards a low carbon, resilient and sustainable future.
- It sets the path for the post-2020 actions based on the Nationally Determined Contributions (NDCs) of the Parties.
- The Paris Agreement entered into force on 4th November 2016.

India's green actions

- India ratified the Paris Agreement on 2nd October 2016 under which its NDC include:
 - Lower the emissions intensity of GDP by 33 to 35 per cent by 2030 from 2005 levels.
 - To increase the share of non-fossil fuels based power generation capacity to 40 per cent of installed electric power capacity by 2030.

- To create an additional (cumulative) carbon sink of 2.5–3 GtCO₂e through additional forest and tree cover by 2030.
- India has set a target of 175GW of renewable energy capacity to be reached by 2022.
- **Major programs/schemes** to achieve the above target include: **Solar Park, Solar Defence Scheme, Solar scheme for Central Public Sector Undertakings, Solar photovoltaic (SPV) power plants on Canal Bank and Canal Tops, Solar Pump, Solar Rooftop, etc.**
- A capacity addition of 14.30 GW of renewable energy has been reported during the last two and half years under Grid Connected Renewable Power.
- In addition, 92305 Solar Pumps were installed and Rs.38, 000 crore worth of Green Energy Corridor is being set up to ensure evacuation of renewable energy.
- India attained **4th position** in global wind power installed capacity after China, USA and Germany.
- Launch of **International Solar Alliance (ISA)** which is envisaged as a coalition of solar resource-rich countries
- Government of India has established the **National Adaptation Fund for Climate Change** to assist States and Union Territories to undertake green initiatives
- The **Clean Environment Cess** has been doubled in 2016-17 budget to Rs. 400 per tonne. This is used to fund the **National Clean Environment Fund (NCEF)**.
- The **proceeds of the NCEF** are being used to finance projects under **Green Energy Corridor** for boosting up the transmission sector, **Namami Gange, Green India Mission, Jawaharlal Nehru National Solar Mission, installation of SPV lights and small capacity lights, installation of SPV water pumping systems, SPV Power Plants and Grid Connected Rooftop SPV Power Plants.**

The **National Tariff Policy** for electricity was amended in January, 2016 to provide for

- Renewable Purchase Obligation in which 8 per cent of electricity consumption excluding hydro power shall come from solar energy by March 2022
- Renewable Generation Obligation in which thermal plants to also establish/procure/purchase renewable capacity
- Bundling of renewable power with power from plants whose Power Purchase Agreements have expired or completed their useful life
- No inter-state transmission charges for solar and wind power
- Procurement of 100 per cent power produced from waste-to energy plants

PHILOSOPHY/ दर्शनशास्त्र

by

ANOOP KUMAR SINGH

Classroom Features:

- ☑ Comprehensive, Intensive & Interactive Classroom Program
- ☑ Step by Step guidance to aspirants for understanding the concepts
- ☑ Develop Analytical, Logical & Rational Approach
- ☑ Effective Answer Writing
- ☑ Printed Notes
- ☑ Revision Classes
- ☑ All India Test Series Included

Answer Writing Program for Philosophy (QIP)

Overall Quality Improvement for Philosophy Optional

Daily Tests:

- ☑ Having Simple Questions (Easier than UPSC standard)
- ☑ Focus on Concept Building & Language
- ☑ Introduction-Conclusion and overall answer format
- ☑ Doubt clearing session after every class

Mini Test:

- ☑ After certain topics, mini tests based completely on UPSC pattern
- ☑ Copies will be evaluated within one week

Classes at Jaipur & Pune

हिन्दी माध्यम में भी उपलब्ध

CHAPTER 9: UNIVERSAL BASIC INCOME: A CONVERSATION WITH AND WITHIN THE MAHATMA

Theme: This chapter examines Universal Basic Income (UBI) and how it holds the prospects of improving upon the current anti-poverty and social programs. This chapter provides some illustrative costs for a UBI and outlines a number of ideas to take UBI forward, highlighting the practical difficulties.

Introduction

- Despite making remarkable progress in bringing down poverty from about 70% at independence to 22% in 2011-12 (as per Tendulkar report), still multiple deprivations exist.
- A radical proposed **solution to this is a Universal Basic Income (UBI)**. It is a **right to basic income**. UBI would have three components –
 - **Universality** – UBI for all.
 - **Unconditionality** – UBI without any conditions.
 - **Agency** – UBI can make a citizen move away from being a subject of government welfare programme to agents of its own change.
- UBI is premised on the idea that **a just society needs to guarantee to each individual a minimum income** for a dignified life with access to basic goods.
- It is the acknowledgment of the economy as a common project and **promotes social justice**.

Basic limitations to UBI

- It **may lead to a disincentive to work and the work productivity may decrease**. But this objection is exaggerated because –
 - UBI is **only to guarantee minimum needs**. One cannot live entirely on basic income.
 - A pilot study in Madhya Pradesh shows that with a basic income several marginal farmers shifted from wage labour to own cultivation thus raising productivity.
- **Whether income be detached from employment**.
 - In a society accepting inheritance money or accepting non-work related income without employment, UBI should not be a problem. Indian society already does this, but largely for the rich and privileged.
- **UBI is proposed as unconditional without concern of people's contribution to society**.
 - UBI may be an acknowledgement of non-wage work related contributions to the society, for example, home making women contribution.
- It may promote spending on social evils like alcohol, tobacco etc.
 - NSS data of 2011-12 shows that evil/temptation goods find a smaller budget in overall rising consumption. Therefore, UBI alone will not lead to rise of temptation goods consumption.
- A counter argument can be that, it would have been easier to universalize the present in-kind transfers (for example universal food subsidy) rather than bringing UBI.

Why Universalize?

- **Misallocation of resources** – Generally government allocates resources as per state capacity. Since richer areas have better administration, so they receive more resources than the **poorer areas**.
 - **Eg.** In the top 6 welfare schemes in terms of their resources, under no scheme do the poorest districts receive more than 40% of the total resources
- **Exclusion of genuine Beneficiaries** – Because of misallocation many poor are excluded from welfare resources. Eg. States having over 50% poor got only about 33% MNREGA funds in 2015-16.
- Therefore there is a **need of universal welfare approach**. Some benefits of '**universalization**' seen in recent schemes are -
 - Eg. With food security universalization by National Food Security Act and PDS infrastructure, subsidy to bottom 40% has increased substantially since 2011-12.
 - Eg. Due to improvements in MNREGA like digitizing job cards, geotagging assets etc. there was seen **an increase in women participation**.

- If there will be '**Universal**' Basic Income, misallocation will be lesser and the exclusion of beneficiaries will reduce. The reasons are –
 - It reduces allocation errors and administrative hassles as it is 'universal'.
 - It reduces leakage because income is transferred directly to beneficiary bank account.

Arguments for and against UBI

Way forward on UBI

- According to poverty level, consumptions level, income and inflation, the Economic Survey gives out a minimum UBI of INR 7620/year for 2016-17. This is supposed to be 4.9% of GDP.
 - The survey points out that UBI should be indexed to inflation for revision.
 - There also is a need of a neutral political mechanism to consider UBI.
- Central subsidies are 2.07% GDP while state subsidies amount to 6.9% of GDP. Although a fiscal space exists to start a UBI by rolling back on some subsidies, it is politically and administratively challenging.
- Economic survey suggests **some guiding principles for a well-designed UBI** –

- **De jure universality, De facto quasi universality** –
 - ✓ It means that UBI would be universal in law but practically cover all but the non-deserving like the well off.
 - ✓ This is being suggested as giving even some money to well off would have resistance.
 - ✓ Following options have been suggested to fulfill this objective –
 - **Define the non-deserving based on ownership of key assets** such as automobiles etc.
 - **Adopt a 'Give it up' scheme** to enable well off to opt out.
 - List of UBI beneficiaries should be publicly displayed which would "**name and shame**" the rich who avail UBI.
 - **Periodic self-verification system for beneficiaries** to avail UBI may make rich opt out voluntarily as their opportunity cost of time is high. So, **poor would self-target into UBI**.
- **Gradualism** – The survey wants an incremental introduction of UBI. The options suggested are –
 - ✓ **Allow UBI as a 'Choice' in place of existing entitlements.** The advantages of this approach are –
 - Choice gives people bargaining power with administrators (**called Agency**).

Table 1. Arguments in Favour and Against UBI

Favor	Against
Poverty and vulnerability reduction Poverty and vulnerability will be reduced in one fell swoop.	Conspicuous spending Households, especially male members, may spend this additional income on wasteful activities.
Choice A UBI treats beneficiaries as agents and entrusts citizens with the responsibility of using welfare spending as they see best; this may not be the case with in-kind transfers.	Moral hazard (reduction in labour supply) A minimum guaranteed income might make people lazy and opt out of the labour market.
Better targeting of poor As all individuals are targeted, exclusion error (poor being left out) is zero though inclusion error (rich gaining access to the scheme) is 60 percent ⁵ .	Gender disparity induced by cash Gender norms may regulate the sharing of UBI within a household – men are likely to exercise control over spending of the UBI. This may not always be the case with other in-kind transfers.
Insurance against shocks This income floor will provide a safety net against health, income and other shocks.	Implementation Given the current status of financial access among the poor, a UBI may put too much stress on the banking system.
Improvement in financial inclusion Payment – transfers will encourage greater usage of bank accounts, leading to higher profits for banking correspondents (BC) and an endogenous improvement in financial inclusion. Credit – increased income will release the constraints on access to credit for those with low income levels.	Fiscal cost given political economy of exit Once introduced, it may become difficult for the government to wind up a UBI in case of failure.
Psychological benefits A guaranteed income will reduce the pressures of finding a basic living on a daily basis.	Political economy of universality – ideas for self-exclusion Opposition may arise from the provision of the transfer to rich individuals as it might seem to trump the idea of equity and state welfare for the poor.
Administrative efficiency A UBI in place of a plethora of separate government schemes will reduce the administrative burden on the state.	Exposure to market risks (cash vs. food) Unlike food subsidies that are not subject to fluctuating market prices, a cash transfer's purchasing power may severely be curtailed by market fluctuations.

- It incentivizes administrator to improvise performance otherwise beneficiaries may switch to UBI.
- The limitation of this approach is that it leaves problems of targeting and resource misallocation intact.
- ✓ **UBI for women** – It would improve status of women and children too. Challenges faced in this option are –
 - Identifying the number of children.
 - Constantly phasing out boys from the beneficiary list once they turn 18.
 - It may incentivize households to have more children.
- ✓ **Universalizing across groups** – UBI should be made universal first across easily identifiable vulnerable groups like widows, old, pregnant women etc. The challenge to this may be of absence of bank accounts with them.
- ✓ Centre can run a **pilot UBI programme** to transfer, a part of the redistributive resources to the poorer states, directly in the beneficiaries’ bank account as UBI. The challenge is of the limited capacities of these states.
- ✓ **UBI in urban areas** – Urban areas are better than rural in banking infrastructure and people having bank accounts.
- The prerequisites of fulfilling a UBI for all are –
 - **JAM trinity** – It has been observed that still 33% adults lack bank accounts. Also only 57% of Jan Dhan accounts are Aadhar seeded.
 - **Centre-State negotiations on cost sharing** in UBI would require consultations.
 - ✓ Survey suggests a **minimum UBI funded wholly by centre** and a co-contributory scheme thereafter with states.

Conclusion

UBI, when carefully analyzed and successfully implemented, can have many potential benefits. Therefore, UBI is a powerful idea, in achieving the outcomes Mahatma Gandhi so deeply cared about and fought for all his life, whose time even if not ripe for implementation is ripe for serious discussion.

“You are as strong as your foundation”

FOUNDATION COURSE
PRELIMS
2017

GS PAPER - 1

FOUNDATION COURSE
GS MAINS 2017

Approach is to build fundamental concepts and analytical ability in students to enable them to answer questions of Preliminary as well as Mains examination

Duration: 90 classes (approximately)

- Includes comprehensive coverage of all the major topics for GS Prelims
- Includes All India Prelims (CSAT I and II Paper) Test Series of 2017
- Our Comprehensive Current Affairs classes of PT 365 for 2017 (Online Classes only)
- Access to LIVE as well as Recorded Classes on your personal online student platform
- Includes comprehensive, relevant & updated study material for prelims examination
- **The uploaded Class videos can be viewed any number of times till Mains 2017 exam.**



Duration: 110 classes (approximately)

- Includes comprehensive coverage of all the four papers for GS MAINS
- Includes All India GS Mains and Essay Test Series of 2017
- Our Comprehensive Current Affairs classes of MAINS 365 for 2017 (Online Classes only)
- Access to LIVE as well as Recorded Classes on your personal online student platform
- Includes comprehensive, relevant & updated study material
- **The uploaded Class videos can be viewed any number of times till Prelims 2018 exam**

NOTE - Students can watch LIVE video classes of our COURSE on their ONLINE PLATFORM at their homes. The students can ask their doubts & subject queries during the class through LIVE Chat Option. They can also note down their doubts & questions & convey to our classroom mentor at Delhi center and we will respond to the queries through phone/mail. Post processed videos are uploaded on student’s online platform within 24-48 hours of the live class.

CHAPTER 10: INCOME, HEALTH, AND FERTILITY: CONVERGENCE PUZZLES

Theme: While economic performance has been remarkable in the aggregate, India's success as a federation depends on the progress of each of its individual states. For assessing this, the chapter analyses convergence puzzle in performance of individual states over time on two sets of indicators: **economic indicators and health/demographic indicators.**

Introduction

- India's economic performance has been remarkable in the aggregate after the era of "Hindu Growth Rate". But reasonable assessment of how well the states are doing relatively is missing.
- Economic and health/demographic indicators and their **convergence** between different states and also India compared to other nations have been used to see relative performance over time.

Convergence (or unconditional convergence):

Convergence means that a state that starts off at low performance levels on an outcome of importance, say the level of income or consumption, should see faster growth on that outcome over time, improving its performance so that it catches up with states which had better starting points.

Convergence is thus an intuitive measure of absolute and relative performance, allowing national and international comparisons.

In this chapter, focus is on two broad economic indicators—income and consumption—and three indicators of health and demographic outcomes—life expectancy, infant mortality rate and total fertility rate. Three major findings in this regard are

Income/Consumption Divergence within India

- **Income divergence:**
 - When studying real per capita GSDP over time between 1983 and 2014, there has been a clear increase in levels indicating an across-the-board improvement. For example, between 1984 and 2014, the poorest state (Tripura) increased its per capita GDP 5.6 fold; the median state (Himachal Pradesh) increased its income level 4.3 fold.
 - However, when convergence in real per capita GDP is studied for the latest decade (2004-2014), it is found that while incomes converge for provinces in China and for countries in the world, in India, they diverge.
- **Consumption divergence :**
 - **Similar trend as above** is observed within India for per capita consumption for the three time periods of 1983-1993, 1993-2004 and 2004-2011.
 - All this suggests that over time, regional income/consumption inequality in India is not narrowing despite such gaps narrowing across countries in the world and within China.

Health/demographic indicators:

- In contrast to income/consumption divergence, on health, there is strong evidence of convergence amongst the states in the 2000s.
- But here it is the international contrast that is striking. With regards to life expectancy, the Indian states are close to where they should be given their level of income. But that is not true of IMR (Infant Mortality Rate), suggesting that the "mother and child" bear the brunt of weaker delivery of health services.
- What India should really stand out in the international comparison is fertility (measured using Total Fertility Rate), where we find that for their levels of development, the Indian states have much lower levels of fertility than countries internationally.
- These unusually large declines in fertility have strong—and potentially positive—implications for India's demographic dividend going forward.

HEALTH CONVERGENCE WITHIN INDIA

There are two primary reasons to expect convergence in key health indicators – LE, IMR, etc.

- Many medical "technologies" can flow freely into areas with low health outcomes. So faster progress is expected.
- Measurement criteria: there are much clearer bounds on health indicators that would naturally lead to convergence. For instance, once a country has reduced its infant mortality to near zero, it is impossible to reduce further, while countries with high mortality rates have much more room for improvement.

Observations for Life Expectancy (LE)

- In India: Kerala, with a life expectancy of 73.5 years in 2002, posted an increase of about 1.27 years over 11 years; UP, with an LE of 60.8 years in 2002, saw a gain of 3 years.
- Globally: In LE, there is strong evidence of international convergence. However, Indian states are making slower progress than the average.

Observations for Infant Mortality Rate (IMR)

- In India: Kerala experienced little change in its IMR of 11 while Odisha registered a 49 point decrease, moving from an IMR of 87 to 38 points.
- Globally: Nearly all the Indian states have posted larger declines in IMR than the average.

Fertility: Exceptional Performance

Perhaps one of the most striking developments over the past decade has been in fertility.

- 12 states out of reporting 23 have reached levels of fertility below the replacement rate
- Evidence of strong convergence across the states:
 - For ex. between 2002 and 2014, UP reduced TFR by 1.3 points compared with Kerala that registered an increase and Tamil Nadu which posted a very small decline.
 - High TFR states such as Bihar, UP, MP and Rajasthan are posting stronger fertility declines than the average of country.
- Globally: almost all states are performing much “better” (in the sense of more rapid fertility declines) than countries on average.

Factors that lead to convergence

- It happens through trade and mobility of factors of production.
- If a state/country is poor, the returns to capital must be high and should be able to attract capital and labor, thereby raising its productivity and enabling catch up with richer counterparts.
- For example- China: Chinese convergence dynamic has been the migration of people from farms in the interior to factories on the coast, raising productivity and wages in the poorer regions faster than in richer regions.

Puzzle: Factors that should help convergence but have not

- Flow of goods: Trade within India is quite high.
- Flow of people: Mobility of people has surged dramatically – almost doubled in the 2000s.
- Competitive federalism: successful states serve both as models (examples that become evident widely) and magnets (attracting capital, talent, and people). So a pressure on poorer states to reform their governance to become competitively attractive is expected.

Why these factors are failing?

- Governance or institutional traps: Poor governance makes the risk-adjusted returns on capital low even in capital scarce states.
 - ✓ Moreover, greater labor mobility or exodus from these areas, especially of the higher skilled, could worsen governance.
- India's pattern of development: India has relied on growth of skill-intensive sectors rather than low-skill ones
 - ✓ High skilled labour pool is already available in high-income states and cities.

The binding constraint of growth is lack of skills in poor areas. The labour productivity remains low here, and is not able to attract capital to establish new industries.

CHAPTER 11: ONE ECONOMIC INDIA: FOR GOODS AND IN THE EYES OF THE CONSTITUTION

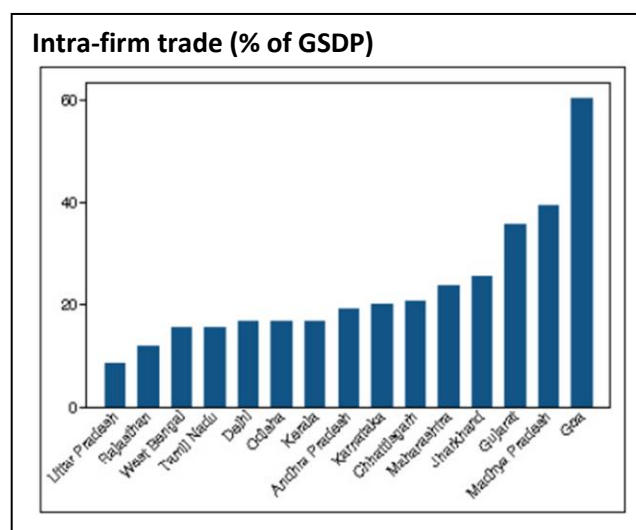
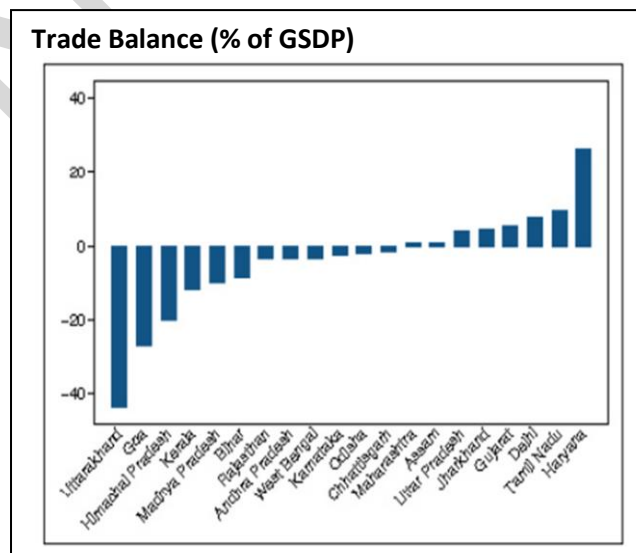
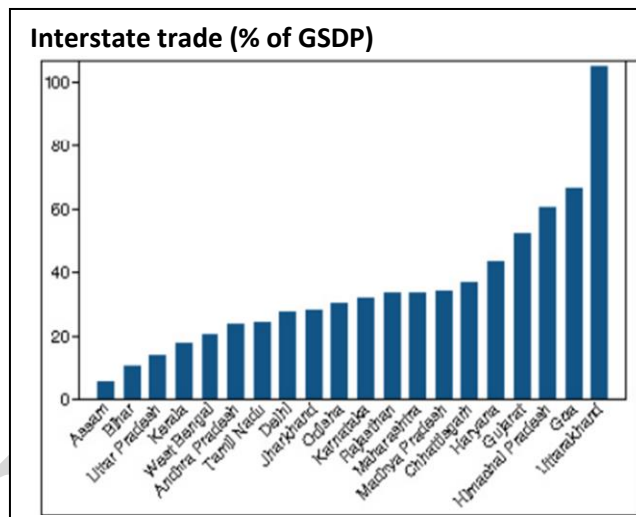
Theme: The chapter assesses the economic integration of India and documents high levels of internal trade in goods. However, the chapter suggests that this may be a consequence of the current system of indirect taxes which in some important cases perversely favours inter-state trade over intra-state trade and points out the potential of GST in ironing out these oddities. The extent to which the Constitutional provisions facilitate the creation of one economic India and comparison with other international models has also been discussed.

Introduction

- In light of recent initiative of Goods and Services Tax (GST) to make India ‘**One India, One Market and One tax**’, it is imperative that we assess the economic integration of India.
- This is done on the basis of a new “Big Data” set available from the Goods and Service Tax Network (GSTN- invoice level data on interstate movement of goods).
- Economic Survey (ES) finds out that India is highly integrated internally. Some of its findings on India’s internal economic integration are –
 - **Inter-state cross-border exchanges** are about 54% of GDP. It is lower than USA (78%) and China (74%) but greater than Canada and EU.
 - **Language does not pose a significant barrier on internal trade.**
 - **Smaller states** like Uttarakhand, Himachal Pradesh (HP), Goa etc. **trade more as a percent of state GDP (GSDP).**
 - **Manufacturing leaders are usually the net exporters** like Tamil Nadu (TN), Gujarat etc.
 - Agricultural Haryana and Uttar Pradesh (UP) also lead in internal trade mostly because of Gurugram and Noida respectively, which benefit from Delhi’s urban agglomeration.
 - Costs to move people are nearly twice than that of moving goods.
 - Current system of indirect taxes favours inter-state trade over intra-state trade.
- India’s **interstate trade 1.7 times larger than international trade** comparable to China (1.6 times) and lower than USA (2.5 times).
- It can be concluded that **large countries trade more within their borders than beyond them** due to the size of their domestic market.

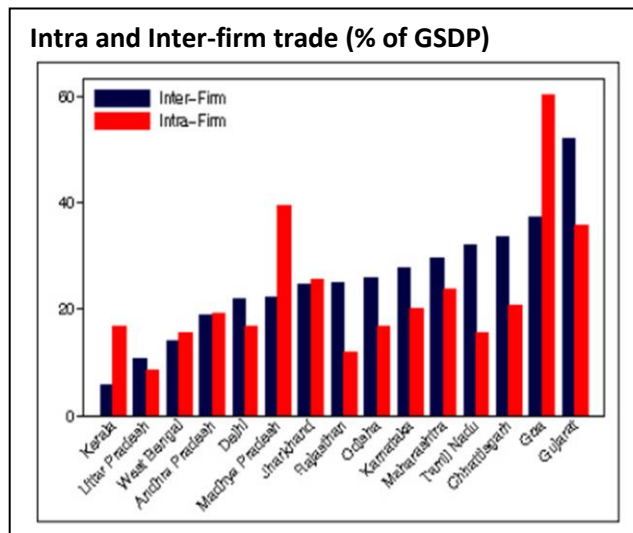
Patterns of Interstate trade in India

- Interstate trade has two elements –
 - **Arm’s length trade** – Trade in which buyers and sellers act independent of each other.
 - **Intra-Firm trade** – It means trade between parent company with its subsidiaries and affiliates.



Arm's Length Trade (Inter-Firm trade) facts

- Uttarakhand, Goa and HP are top in arm's length trade despite states like Maharashtra and TN having high GSDP.
- This shows that **Indian States have a negative correlation between the State's size and the openness to trade.**
- This means that smaller size states are showing greater trade openness. It is contrary to the structure in USA and Canada.
- **Most of this can be attributed to the domestic taxes** which may be reformed with the coming of GST.
- The smaller states with high interstate trade like Uttarakhand and HP **also have a large trade balance.**
- This may be because of **low competitive manufacturing capabilities of these states.**



Intra-Firm Trade facts

- The smaller states like Goa also have a high intra-firm trade.
- The larger states like UP and Rajasthan has a poor intra-firm trade because of the **high fixed cost to setup companies** in them.
- ES also points out that there is **no correlation between arm's length trade and intra-firm trade.**
- **Madhya Pradesh** stands out having high intra-firm trade than its inter-firm trade. This is because of its location in central India – **ideally suited for logistical supply chains.**

Determiners of India's internal trade

- **Distance** - India's **trade elasticity with respect to distance** is much lower than usual. Trade falls only 5.65% with change of distance by 10% despite a relatively poorer freight infrastructure than countries like USA.
- **State GDP coefficients** – The elasticity of trade with respect to income is positively correlated with trade flows. Trade increases by about 9% with rise of income by 10% similar to other countries.
- **Proximity coefficient** – Adjoining states in India tend to trade with each other about 90 percent more than other states.
- **Language** – Although countries with similar languages trade more worldwide, this trend is not seen in Indian states.

TINXSYS

- It is **Tax Information Exchange System.**
- To calculate the data on trade, ES used TINXSYS dataset.
- It is **administered and hosted by the Goods and Services Tax Network (GSTN).**
- It has Central Sales Tax invoices for trade between states.

Different Taxes in trade

1. **VAT** – VAT is a Value added Tax levied by the states on each stage of value addition from the production to the final sale. It is levied on **sale within the state.**
2. **CST** – Central State tax is levied by the central government **when sales of goods is across states.** It is an origin based tax.

Reasons of India's strong internal trade

- India has a pro-trade bias despite barriers like distance or language. India's current **domestic tax structure** makes it a pro trade biased economy. Some tangible reasons for this are –
 - **Area based exemptions** – Eg. **Exemption of Central Excise Duty for manufacturing** in North east states, HP, Uttarakhand etc. This incentivizes production shifts to these areas.
 - **Tax distortion** –
 - ✓ Usually when a firm is a final consumer or a manufacturer of tax exempt goods, they are **unable to get input tax credit (ITC) on VAT. This discourages intra-state trade.**
 - ✓ Due to this, **interstate trade is indirectly promoted over the intra-state trade,** as the CST is lower than VAT.

- ✓ Some states also take out a negative list on which ITC is not available. Eg. Automobile and its parts. This also promotes interstate trade.
- ✓ **GST will be a solution to tax distortion.**
- **Constitutional Provisions (PART XIII)**
 - ✓ **Article 301** (Freedom of trade, commerce and intercourse) - **Trade, commerce and intercourse throughout the territory of India shall be free** subject to some provisions in this part.
 - ✓ **Article 302** – It gives Parliament the power to restrict free trade between and within states **on grounds of public interest.**
 - ✓ **Article 303** – No law by Parliament or State legislatures can discriminate between states in terms of trade. This is a type of **Most Favoured nation (MFN) obligation.**
 - ✓ **Article 304 (a)** – State can by law impose such taxes that prevents any discrimination between goods imported and goods manufactured in the State. This is a type of **National Treatment (NT) obligation.**
 - ✓ **Article 304 (b)** – State legislature by law can impose ‘reasonable restrictions’ on freedom of trade in public interest.

Challenges to One Economic India

- The constitutional provisions give sufficient freedom to legislatures to restrict the trade. Eg. ‘Public Interest’ is not defined.
- Financial and non-financial barriers by states like motor vehicle taxes etc. have created a hindrance to trade. Even Supreme Court (SC), in various judgments has upheld such restrictions. Eg. Entry Taxes by various states has been upheld as a matter of compensation to them (Automobile Transport (Rajasthan) Ltd. Case).

Provisions in other countries

- **United States of America**
 - Even though the US Constitution vests residuary power in the states, **the states are barred from regulating interstate trade and commerce.** This helps promote USA as one economic market.
- **European Union**
 - **As per the Maastricht treaty,** countries under EU must not restrict the four freedoms of movement – **goods, services, capital and people,** apart from special circumstances.

Maastricht Treaty

It is the treaty that was **responsible for the creation of European Union** (a group of countries having a common economic and monetary union).

Recommendations for making One Economic India

- Comparing with other countries, it seems like Indian states should have lesser powers to regulate interstate trade. But some argue that India is a diverse country and states should have some flexibility.
- For a step towards One Economic India, **a model based on WTO can be used** because -
 - **WTO is also diverse like India** in terms of regimes ranging from democracies to communist countries apart from having developed to underdeveloped countries.
 - Despite the Indian Constitution gives MFN and NT like the WTO, the **WTO also gives the freedom to depart from anti-protectionism which the constitution does not.** Eg. **Article XX gives general exceptions** like protection of domestic industries, conservation of natural resources etc. for which protectionism can be used by a country.
 - ✓ The departures from common market are more **clearly and narrowly specified in WTO than Constitution’s open ended ‘public interest’ clause.**
 - ✓ WTO gives **a justified and precise power** to countries to shift away from protectionism. Constitution gives **arbitrary powers to legislatures** for the same. Eg. Burden of proof on the party evoking exceptions, strict rules to prevent unjustifiable discrimination etc.

Conclusion

At a time when India is adopting the path of cooperative federalism, it should adopt a common financial standard all over the country. GST is a right step in this direction and should be followed up by opening the economy to other spheres also like agriculture etc.

CHAPTER 12: INDIA ON THE MOVE AND CHURNING- NEW EVIDENCE

Theme: Migration of people for work and education has been a phenomenon that accompanies the structural transformation of economies, and has paved the way for the release of “surplus labour” from relatively low-productive agricultural activities to sectors enjoying higher productivity. The resulting remittance flows increase household spending in the receiving regions and further the economic development of less-developed regions.

Analysis of migration pattern in India:

- Based on the census 2001 data, it emerged that number of migrants in India is very low and not increasing. According to census -2001 data India has 33 million economic migrants, constituting around 8.1% of workforce with low urbanization rates being one of the reasons. In China, nearly 25% of workforce is migrant labour.
- However new studies- analyzing 2011 Census data (using Cohort-based Migration Metric (CMM) and gravity models) and railway passenger traffic flows data provided by the Ministry of Railways- have contradicted census data and shown that stock of migrants in India is far more.
- Major findings of the study include-
 - **Indians are increasingly on the move-** As opposed to annual average of about 3.3 million suggested by successive Censuses, new studies show that annually inter-state labour mobility averaged from 5 million to 9 million people.
 - **Migration is accelerating-** the annual rate of growth of labour migrants nearly doubled relative to the previous decade, rising to 4.5 per cent per annum in 2001-11 from 2.4 per cent in 1991-2001.
 - This acceleration has been accompanied by the surge of the economy indicating that the returns to migration might have increased sufficiently to offset the costs of moving, resulting in much greater levels of migration.
 - **Language not a barrier –**
 - Internal political borders impede the flow of people. The flow within states is four times the flows across states.
 - However, language does not seem to be a demonstrable barrier as common language between the origin and destination state is not significant in explaining the flow of the migrants.

Patterns of flow observed in the new studies consistent with popular conception-

- Less affluent states see more people migrating out while the most affluent states are the largest recipients of migrants.
- The cost of moving for people is about twice as much as it is for goods.

Limitations of Census 2001 data and earlier studies in estimating the size of Migrant Workforce in India

- Migration trends in India tends to be circular in nature both in short term and long term migration streams and are not captured properly by Census.
- Female migration for work is concealed in ‘reason-for-migration’ statistics because the principal reason given to the enumerator is ‘marriage’ or ‘moved with household.’ According to the new studies, female migration for work not only grew far more rapidly than the female workforce, but increased at nearly twice the rate of male migration.
- Commuter migration for work across the rural-urban divide is also substantial in India, exceeding 10 million people in 2009-10. Further, slow pace of Indian urbanization is rooted in the demographic divergence between rural and urban natural growth rates and not necessarily in low or stagnant rates of migration.

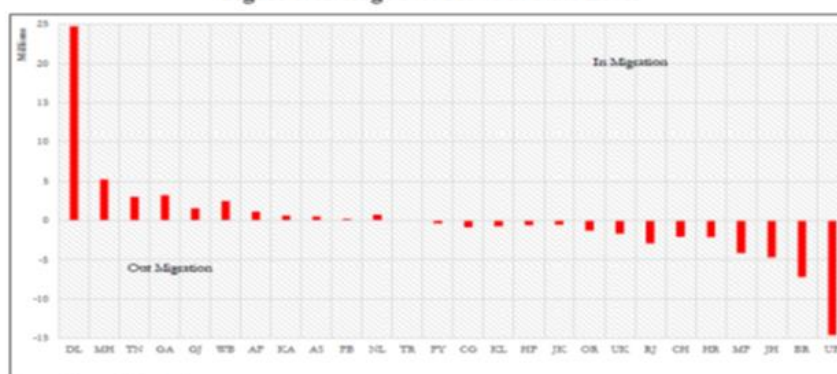
Migrant: The Census definition of a migrant is as follows: “When a person is enumerated in census at a different place than his/her place of birth, she/he is considered a migrant”.

Circular migrants: Individuals who migrate from place to place for temporary periods.

Magnitude and Pattern of migration according to new estimates:

- Recent studies place the share of migrants in the workforce to lie between 17% and 29%, much greater than 8.1% indicated by census 2001.
- Internal migration rates have dipped in Maharashtra and surged in Tamil Nadu and Kerala reflecting the growing pull of southern states in India’s migration dynamics.

Figure 6. Average Net Flows at State Level



Source: Survey Calculations

- Relatively less developed states such as Bihar and Uttar Pradesh have high net out migration. Relatively more developed states have net in migration: Goa, Delhi, Maharashtra, Gujarat, Tamil Nadu, Kerala and Karnataka.
- The largest in-migration was at Delhi region, which accounted for more than half of migration in 2015-16, while Uttar Pradesh and Bihar taken together account for half of total out-migrants.

Way forward

- This acceleration has taken place in the backdrop of discouraging incentives such as **domicile provisions for working in different states, lack of portability of benefits, legal and other entitlements upon relocation**. These policy hurdles have to be overcome.
- Portability of food security benefits, healthcare, and a basic social security framework for the migrant are crucial potentially through an interstate self-registration process.
- While there do currently exist multiple schemes that address migrant welfare, they are implemented at the state level, and hence require interstate coordination of fiscal costs of migration.
- The domestic remittances market, estimated to exceed Rs. 1.5 lakh crores, can also be leveraged to enhance financial inclusion for migrant workers and their families in the source region.

ALL INDIA TEST SERIES

Get the Benefit of Innovative Assessment System from the leader in the Test Series Program

PRELIMS

- **General Studies** (हिन्दी माध्यम में भी उपलब्ध)
- **CSAT**

> VISION IAS Post Test Analysis™
 > Flexible Timings
 > ONLINE Student Account to write tests and Performance Analysis

MAINS

- **General Studies** (हिन्दी माध्यम में भी उपलब्ध)
- **Geography**
- **Essay**
- **Philosophy**
- **Sociology**

CHAPTER 13: THE 'OTHER INDIAS': TWO ANALYTICAL NARRATIVES (REDISTRIBUTIVE AND NATURAL RESOURCES) ON STATES' DEVELOPMENT

Theme: The chapter examines whether the effects associated with the “aid curse” and the “natural resources curse” internationally are discernible in the context of the Indian States. It calculates Redistributive Resource Transfers’ (RRT) from the Centre (between 1994 and 2015) and value of natural resources for Indian States (over 1980 and 2014) and correlates these with several economic outcomes and an index of governance.

Introduction

- The Indian growth take-off since 1980 is associated with Peninsular India.
- These states—Gujarat, Maharashtra, Tamil Nadu, Karnataka, Kerala, and Andhra Pradesh are close to ocean, this is special advantage with them and thus have grown faster and advanced more rapidly economically.
- For this reason they have also been given a greater focus of policy and research attention in comparison to other states- the so called ‘Other Indias’.
- Peninsular India has offered **three different models** of development:
 - ✓ Traditional East Asian mode of escape from development **based on manufacturing** (Gujarat and Tamil Nadu)
 - ✓ **Remittance-reliant** mode of development exemplified by Kerala
 - ✓ “**Precocious India**” model based on specializing in skilled services (Karnataka, Andhra Pradesh and TN)
- In other Indian states (‘Other Indias’), including hinterland, forested, natural resources rich, and ‘Special Category’ status states, two models of development can be observed:
 - ✓ Based on “aid” or special status - most applicable to the erstwhile ‘Special Category’ states that include North-eastern states and Jammu and Kashmir
 - ✓ Based on **natural resources** - Jharkhand, Chhattisgarh, Odisha, Gujarat and Rajasthan. **Natural resources** include coal, onshore oil and natural gas, major and minor minerals but exclude forest cover.

Redistributive Resource Transfers (RRT)

- Devolution to the state adjusted for respective state’s share in aggregate gross domestic product.
- It excludes the impact these transfers have on expenditures by state governments. Any redistribution occurring directly by the Centre’s spending is also excluded.

Gross devolution to states

- A share of central taxes, as stipulated by Finance Commissions,
- Plan and non-plan grants,
- Plan and nonplan loans and advances.

Impact of Redistributive Resources

- At the time of India’s independence, most economists held that developing countries were poor because they lacked capital and creating capital was difficult, because people were too poor to save.
- Hence, two views of development for poor and developing countries emerged –
 - Foreign aid
 - Mineral resources: those with vast amount of minerals should sell them to gain capital
- India accepted aid in early years but moved on to resources to end aid dependence.
- Also, research has **not found a positive relationship** between aid and growth as
 - Aid perpetuates resource dependency: recipient countries may fail to develop their own tax bases or their institutions.
 - It may trigger ‘**Dutch disease**’: named after the impact that discovery of natural gas in the North Sea had on the economy of Netherlands.
 - The extra income spent domestically, pushed up prices of non-tradeable like services. This eroded profitability of export and import competing industries, de-industrializing the economy.
- Despite these international experiences, India has provided extensive transfers to certain poorer states in an attempt to spur their development.

Redistributive Resource Transfers (RRT): Evidence from Indian States

- The relationship between per capita RRT and per capita GSPD shows that as expected poorer states receive the highest transfers.

- Despite such flows over the past few decades, higher the RRT, the slower is growth, the smaller is the share of manufacturing in GSDP, The lower its own tax revenues and even on part of quality of governance, the RRT found negative relationship.
- This suggests that there might be an “RRT curse”.

Impact of Natural Resources

It is found that the economies with abundant natural resources have grown less rapidly than resource scarce economies. Economists term it as “resource curse”.

Three possible explanations for it:

- Exploitation of natural resources generates rents, which leads to rent-seeking and increased corruption.
- Exposes countries to commodity price volatility, which can destabilize GDP growth.
- Natural resource ownership – like foreign aid — makes countries susceptible to “Dutch Disease”

Natural Resources and Evidence from Indian States

- Taking the value of minerals as the sum total of fuels (coal, lignite, and crude petroleum onshore only and natural gas), all metallic, non-metallic as well as minor minerals, the mineral resource rich states are: Jharkhand, Chhattisgarh, Odisha, Rajasthan and Gujarat.
- The relationship between availability of resources and reduction in poverty in mineral rich states shows that they seem relatively successful. Their poverty ratio fell by around 31% over nearly two decades, compared with 28% in the other states.
- However the gains were not passed on equally to all sections of the population. In particular, ST population of the mineral-rich states, which forms the predominant population in these areas, saw only a 17% decline in poverty, smaller than the 22% fall in the other states.
- There seems to be no concrete evidence either in favour or against a “resource curse” in the context of Indian states. However, the resource rich states need to bolster efforts to counter any possible downsides of a “resource curse” that may emerge in the future.

Conclusion

It is possible that the “RRTcurse” and “natural resource curse” could be a result of poor connectivity and poor infrastructure - physical, financial, and digital that most of these states suffer from. This is clearly true of the north-east but also true of many parts of resource-rich India. Enhancing connectivity- financial and physical, on a war footing will have a moderating effect.

Policy Recommendations

RRT

- Redirecting flows to households i.e. to redirect a certain portion of RRT and channel the resources directly to households as part of a Universal Basic Income (UBI) scheme.
- Conditioning transfers on fiscal performance as recommended by 13th FC, like on the basis of tax effort of states, as higher resource flow leads states to relax their own tax effort.
- Making governance-contingent transfers: the fund transfer mechanism could explicitly include a few monitorable institutional indicators as criteria for transfers

Natural resources

- There is a need to improve governance, to ensure a more productive use of the resources.
- The present structure of revenue administration is taking royalty from mining of minerals.
- However, in the present system there is further scope to bolster citizen engagement which will act as a constraint on large scale corruption and over-exploitation of resources.
- Mines and minerals (Development and Regulation) Amendment Act, 2015 included Establishment of a trust, to be called the District Mineral Foundation (DMF) for districts affected by mining related operation,
- Considering minerals as part of the commons, owned by the state as trustee for the people including future generations, revenue from the natural resources could be saved in a **non-wasting asset - in a dedicated Permanent Fund.**

- The real income accrued by the Fund can be redistributed to citizens affected by and having a stake in the extraction.
- An alternative structure to redistribute the gains: directly into the accounts of the concerned citizens as part of a UBI.

Supreme Court of India Judgement on Goa Mining

The judgment was the culmination of a series of landmark judgements on managing natural resources in public domain. In this case, the apex court ordered a cap on mining as well as the **creation of a Goa Iron ore Permanent Fund to meet the ends of inter-generational equity and sustainable development.**

What implications does the SC judgment carry for natural resource management?

- Natural resources, including minerals, are a shared inheritance that needs to be preserved for future generations. As sub-soil minerals are largely owned by the States, and offshore minerals by the Centre, the states are the trustees on behalf of the people. The cap on mining in Goa is to ensure the availability of minerals over several generations as well as to limit the environmental damage from permitted extraction.
- The proposal for exploring the creation of a Goa Iron ore Permanent Fund is notable for being the first that has potential to be established by judicial action. Norway and several other countries have created Permanent Funds based on extracting economic rent from oil or other natural resources.

THE REAL RACE BEGINS. ARE YOU READY?

GS ADVANCED COURSE MAINS 2017

- Covers topics which are conceptually challenging
- Updated with current affairs and dynamic topics
- Approach is completely analytical and focussed on demands of the Mains examination
- Includes comprehensive, relevant and updated study material
- Includes All India GS Mains and Essay Test Series

LIVE / ONLINE CLASSES AVAILABLE

CHAPTER 14: FROM COMPETITIVE FEDERALISM TO COMPETITIVE SUB-FEDERALISM: CITIES AS DYNAMOS

Theme: The chapter highlights the problems facing the Urban Local Bodies (ULBs) and also gives certain suggestions for empowering ULBs. Further, the chapter suggests entrusting cities with responsibilities, empowered with resources, and encumbered by accountability so that they can become effective vehicles for unleashing dynamism so that to competitive federalism India can add, and rely on, competitive sub-federalism.

Introduction

- In India urbanization is rapidly on the rise. By 2011, there were about 380 million people, living in around 8,000 cities.
- Urban Indians now form about one-third of the population and they produce more than three-fifths of the country's GDP.
- The exodus of rural Indians into the cities over the coming decades will pose tremendous challenge for government, particularly urban local bodies (ULBs).
- Just as with competition between states is becoming a powerful dynamic of change and progress, that dynamic must extend to competition between states and cities, and between cities.

Background

- Contrary to perception, India's urbanization rate appears to have been similar to that in other countries.
- Generally, city with the largest population in any country is large as compared to the next-biggest. This has been shown to hold true for many countries but not so for India.
- In India large cities are usually small. Few reasons which can be attributed to this are
 - Infrastructure of the cities are overburdened.
 - India is land scarce relative to most countries, discouraging migration particularly because distorted land markets render rents unaffordable.
 - Mobility in India is limited by strong place based preferences embedded in deep social networks in India
- However, in coming years India's urbanization rate should begin to converge with those in similar emerging markets and much of this urban growth is likely to take place in the bigger cities

Recent Initiatives by Government for Urban rejuvenation

- Smart City Mission
- AMRUT
- HRIDAY
- Swachh Bharat Mission

Key challenges in front of ULBs: The primary responsibility for development of urban areas lies with the state governments and urban local bodies (ULBs). These levels of government face major and inextricably linked problems: poor governance capacities, large infrastructure deficits and inadequate finances.

- **Governance challenge**
 - Cities do not have a single city government or a local self-government, leading to functional overlap.
 - Fragmentation of responsibilities and service delivery across a gamut of institutions: municipality, state departments and parastatal agencies reporting directly to state government.
 - Transparency/accountability issues: because implementation of the e-Governance initiative has also not been uniform
- **Infrastructure deficit and inadequate finances**
 - Every Indian city faces serious challenges related to water and power supply, waste management, public transport, education, healthcare, safety, and pollution.
 - Addressing this infrastructure deficit will require resources, some of which could come from the Centre and the states. The rest of the required funds would have to come from local resources but raising sufficient resources has not proved easy.

Role of private sector in urban development: Lessons from Gurgaon and Jamshedpur experience

1. A system of proprietary, competitive cities can combine the initiatives of private development to bring innovation and best urban planning.
2. The city should be managed by single authority to tax and make initial plan, so that private sector can perform at fast pace.
3. The active role of civil society can prevent excessive exploitation of resources and reduce negative impact rapid urbanization.

- There has not been devolution of functional and financial powers to the ULBs. Some states have not even allowed the municipalities to levy property taxes.
- Even when powers have been devolved, exercising them has proved difficult. Municipal own income comes from taxes; user fees; and domestic borrowing:
 - ✓ **Property tax:** it is the most important constituent of own revenue but problems of low coverage, low rates, low collection efficiency, and lack of indexation of property values, making it a non-buoyant source of revenue.
 - ✓ ULBs by and large have not been able to levy adequate user charges to cover even the operation and maintenance costs.
 - ✓ Issuing municipal bonds has been challenging owing to the poor state of ULB finances and governance.
- According to the data and experiences across various cities in India, there is direct positive relationship between the quality of service delivery to citizens and adequate staffing in ULBs. Similar is outcome for per capita capital expenditure by ULBs and service delivery.

Way forward

- ULBs need to be empowered financially by
 - The states should empower cities to levy all feasible taxes.
 - Efficient collection of existing tax base, there is need to adopt the latest satellite based techniques to map urban properties in order to tap full potential of property tax.
- Political economy challenges need to be removed. Higher bodies (state governments) should cede power and share resources with local bodies. Finance commission can play a vital role by allocating more resources to ULBs.
- Also, data and transparency can play an important role here. Grants to ULBs by MoUD can be more tightly linked to comprehensive and updated data disclosure and transparency.
- NITI Aayog should compile comparative indices of municipalities' performance annually. This index should be based on the actual accountability and administrative capacity to deliver the core public services

“ The Secret To Getting Ahead Is Getting Started ”

ALTERNATIVE CLASSROOM PROGRAM *for*

GS PRELIMS & MAINS

2019 & 2020

- Approach is to build fundamental concepts and analytical ability in students to enable them to answer questions of Preliminary as well as Mains examination
- Includes comprehensive coverage of all the topics for all the four papers of G.S. Mains, GS Prelims & Essay
- Access to LIVE as well as Recorded Classes on your personal online student platform



- Includes comprehensive, relevant & updated study material
- Includes All India G.S. Mains, Prelim, CSAT & Essay Test Series of 2017, 2018 & 2019 (for students enrolling in 2019 program)
- Our Comprehensive Current Affairs classes of PT 365 and Mains 365 of year 2019 (Online Classes only)