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# KEY HIGHLIGHTS OF ECONOMIC SURVEY 2016-17 FOR UPSC ASPIRANTS

KEY-HIGHLIGHTS OF ALL THE 14 CHAPTERS OF ECONOMIC SURVEY 2016-17 DONE IN A COMPREHENSIVE MANNER TO HELP UPSC CIVIL SERVICES ASPIRANT IN THEIR PREPARATION OF BOTH PRELIMS AND MAINS EXAMINATION

# Highlights of Economic Survey 2016-17

# Compilation of 14 Chapters

**Here are the 10 highlights of Economic Survey 2017 relevant for UPSC aspirants**:

1. The Economic survey 2016-17 pegs the economy to grow in the range of 6.75% to 7.25% in the post demonetization year.
2. Universal Basic Income scheme projected as an alternative to the plethora of state subsidies for poverty alleviation and social welfare. But the idea is not ready for implementation yet.
3. Demonetization to affect the growth rate by 0.25% - 0.50%, but expected to have long term benefits. This can be achieved through fast, demand driven re-monetization, tax reforms including GST.
4. Twin balance sheet syndrome of leveraged companies and bad loan encumbered banks has continued.
5. Demographic dividend to peak within the next 5 years and need to stress more on developing apparel and leather industries.
6. Economic survey 2017 also explains how 'Fiscal Activism' embraced by advanced economies (AEs) is not relevant for India.
7. Swachh Bharat Mission to promote a broader fundamental right to privacy for women.
8. Growth of farm sector to improve (4.1% this fiscal), industrial sector to moderate (5.2%) and services sector to continue the success story (8.9%).
9. Fiscal windfall is expected from Pradhan Mantri Garib Kalyan Yojana and low oil prices, while the benefits of GST will take time to realize.
10. The Economic survey also points out that the capacity of the State in delivering essential services such as health and education is weak due to low capacity, high levels of corruption, clientelism, rules and red tape.

Being an UPSC aspirant, you must be aware of the economic Outlook of the country and the challenges faced by the country in various sectors of the Economy. As an annual document, Economic Survey 2016-17 will help you to revise the happenings in the Economic sector of our country round the year.

***Chapter wise analysis of Economic Survey 2016 - 17 for UPSC Aspirants***

Chapter wise analysis of Economic Survey 2016 - 17 is given below. It provides you the key highlights of all the 14 Chapter to make your UPSC Civil Services Preparation easier. We welcome your valuable suggestions & comments.

# Chapter 01- Economic Outlook and Policy Challenges - Highlights of Economic Survey 2016-17



## Economic Outlook and Policy Challenges

Briefly on the chapter:

The Economic Survey of 2014-15 spoke about the **sweet spot** for the Indian economy that could launch India onto a trajectory of sustained growth of 8-10 percent.

The "**Sweet Spot**" mentioned in 2014-15 aroused out of the following factors:

- A Strong Political Mandate the Modi government received in the elections held in 2014
- Favourable external environment arising out of the fall in oil prices

Now, the Survey in the first chapter, admits that there requires a policy shift as the external environment is rapidly fluctuating. The rise in oil prices, the not so celebrated "Brexit" and the U.S presidential elections and the possible shift in policies all may lead to the soon fading out of the **Sweet Spot**, we had in the previous two years.

This first chapter articulates briefly on all that important points which played vital role in shaping the government policies on Indian Economy. So to say, this chapter will serve as the guideline to all other chapters.

The year was marked by two major domestic policy developments:

- the passage of the 101th Constitutional Amendment Act, Goods and Services Tax (GST)
- the action to demonetise the two highest denomination notes.

**What GST unfolds for the Indian Economy?**

- a common Indian market
- improve tax compliance and governance
- boost investment and growth
- a bold new experiment in the governance of India's cooperative federalism.

## Important points to remember in chapter 1 of Economic survey 2016-17 for Civil Services Examination.

The first key focus of the Survey is in discussing the aftermath of demonetisation drive.

Termed as a "radical governance-cum-social engineering measure" the demonetisation principally was one among many actions taken by the Government in **curbing black money**.

### What were the aims of the demonetisation?

According the Economic Survey 2016-17 the aim behind the demonetization of two high valued currencies was fourfold:

- To curb corruption
- counterfeiting,
- the use of high denomination notes for terrorist activities,
- and especially the accumulation of "black money", generated by income that has not been declared to the tax authorities.

The others measures aimed at curbing such illicit activities include:

- creation of the Special Investigation Team (SIT) (2014 budget);
- The Black Money Act, 2015;
- The Benami Transactions Act of 2016;
- The information exchange agreement with Switzerland;
- Changes in the tax treaties with Mauritius and Cyprus;
- The Income Disclosure Scheme.

This unprecedented demonetisation policy move have landed government in public debate . The public debate on demonetisation was primarily revolving on 3 questions:

- Management :design and implementation of the initiative.
- Economic Impact : Short & Long term
- Broader vision as to implication on future economic policy

An analysis of debates leads to a broad conclusion that it "create short-term costs and provide the basis for long run benefits".

### What are the short term costs of demonetization as per the Survey?

Inconvenience and hardship, especially those in the informal and cash-intensive sectors of the economy who have lost income and employment.

(This is less reflected in the GDP, because national income accounts estimate informal activity on the basis of formal sector indicators, which have not suffered to the same extent.)

### What are the long term gains of demonetization as per the Economic Survey 2016-17?

- Reduced corruption,
- Greater digitalization of the economy,
- Increased flows of financial savings,
- Greater formalization of the economy

All the above factors could eventually lead to higher GDP growth, better tax compliance and greater tax revenues.

## What are the actions to be taken to reduce the pain and increase the gains of demonetization?

The following actions are to be taken:

1. Re-monetizing the economy expeditiously by supplying as much cash as necessary, especially in lower denomination notes;
2. Complementing demonetisation with more incentive-compatible actions such as: bringing land and real estate into the GST,
3. reducing taxes and stamp duties,
4. ensuring that the follow-up to demonetisation does not lead to over-zealous tax administration.

## Broad vision as to Implication of future economic policy:

The question of broader vision is critical to shaping the medium term trajectory of the economy. Towards this, the government had taken the following steps:

1. **The GST bill**, which will create a common Indian market, improve tax compliance, boost investment and growth – and improve governance;
2. **New bankruptcy laws** to end the "exit" problem that pervades the Indian economy--that has caused deleterious consequences highlighted in last year's Survey.
3. **Monetary Policy Agreement** between the Government and RBi -to consolidate the gains from macroeconomic stability by ensuring that inflation control will be less susceptible to the whims of individuals and the caprice of governments
4. **Legal Basis for Aadhar** : to realise the long-term gains from the JAM trifecta (Jan Dhan-Aadhaar-Mobile), as quantified in last year's Survey.
5. The government enacted a package of **measures to assist the clothing sector** that by virtue of being export-oriented and labor intensive could provide a boost to employment, especially female employment.
6. **Unified Payments Interface (UPI)** platform has been finalised by National Payments Corporation of India (NPCI) :By facilitating inter-operability it will unleash the power of mobile phones in achieving digitalization of payments and financial inclusion, and making the "M" an integral part of the government's flagship "JAM"-Jan Dhan, Aadhaar, Mobile-- initiative.
7. **FDI reform measures** were implemented, allowing India to become one of the world's largest recipients of foreign direct investment.

With the above said measures taken by the government , India is not only among the world's fastest growing major economies, underpinned by a stable macro-economy with declining inflation and improving fiscal and external balances.

Yet there is a gap between this reality of macro-economic stability and rapid growth, on the one hand, and the perception of the ratings agencies on the other. In India's aim to realize its ambitions on growth, employment and social justice, India faces challenges which needs to be addressed.

## Challenges identified by the Economic Survey 2016-17 in the Indian economy

Broader societal shifts are required in ideas and narratives to address three major challenges:

**Reducing "inefficient redistribution,"**

The central government alone runs about 950 central sector and centrally sponsored schemes and sub-schemes which cost about 5 percent of GDP. But many have intrinsic limitations as to targeting the beneficiaries. Aadhar law is a life saver in the case.

**Strengthening state capacity in delivering essential services and regulating markets,**

On state capacity, delivery of essential services such as health and education, which are predominantly the preserve of state governments, remains impaired.

Competitive populism needs a counterpart in competitive service delivery.

Some successful examples in service delivery as quoted in the Survey are,

1. the improvement of the public distribution system (PDS) in Chhattisgarh,
2. the incentivization of agriculture in Madhya Pradesh,
3. reforms in the power sector in Gujarat which improved delivery and cost recovery,
4. the efficiency of social programs in Tamil Nadu,
5. the recent use of technology to help make Haryana kerosene free.

**Dispelling the ambivalence about protecting property rights and embracing the private sector.**

The issues in the lack of ambivalence towards private sector are manifested in the following issues:

1. the difficulties in advancing strategic disinvestment;
2. persistence of the twin balance sheet problem—over-indebtedness in the corporate and banking sectors.
3. the legacy issues of retroactive taxation
4. agriculture, where the protection of intellectual property rights, for example in seeds, remains a challenge;
5. reform in the civil aviation sector, which has been animated as much by an interventionist as liberalizing spirit;
6. in the fertilizer sector, where it is proving easier to rehabilitate unviable plants in the public sector rather than facilitate the exit of egregiously inefficient ones;
7. frequent recourse to stock limits and controls on trade in agriculture, which draws upon the antiquated Essential Commodities Act, and creates uncertainty for farmers

Reestablishing private investment and exports as the predominant and durable sources of growth is the proximate macro-economic challenge.

## Global Context and Indian Economy

"R*isk unleashing paradigmatic shifts in the direction of isolationism and nativism*" - this sentence in the Survey explains the evolving global environment.

**The three main global developments are as follows:**

1. US elections and the implied change in expectations of US fiscal and monetary policy with high expectations of fiscal stimulus and unwavering exit from unconventional monetary policies.
2. "political carrying capacity for globalisation" have changed. In the short run a strong dollar and declining competitiveness might exacerbate the lure of protectionist policies.
3. The rise in dollar and implications for China's currency and currency policy.

**What is "political carrying capacity for globalisation" ?**

If asT.S. Eliot said that "*humankind cannot bear too much reality*", recent events suggest that the world cannot bear too much globalisation either.

- There were two phases of globalisation (1870-1914, 1945-1985),
- one phase of **hyper globalisation** between 1985-2008, and one phase of **deglobalisation** in the interwar period.

The question today is what is likely to happen going forward

- Further globalisation?
- Deglobalisation?
- or stagnation?

The answer to these questions will have potentially important consequences for Indian exports and growth.

## Review of Developments in 2016-17

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# GDP

Real GDP: 7.2 % [First Half of Year]. 7.6 % [second half of 2015-16.]

**Boon :**

Increased govt consumption with implementation of 7th Pay Commission recommendations & export recovery as demand in advanced countries began to accelerate.

**Bane :**

Corporate firms balance sheet crisis

# INFLATION

- Consumer Price Index (CPI)-New Series : avg of 4.9% [April-December 2016] 3.4 % [December Last]
- WPI Inflation : (-)5.1 percent in August 2015 to 3.4 percent at end-December 2016
- Core inflation : 4.5 percent to 5 percent round the year

The outlook for the year as a whole is for CPI inflation to be below the RBI's target of 5 percent, a trend likely to be assisted by demonetisation.

# EXTERNAL SECTOR

- CAD: 0.3 percent of GDP in the first half of FY2017.
- Foreign exchange reserves : US$350 billion at end-January 2016 to US$ 360 billion at end-December 2016 ;well above standard norms for reserve adequacy.
- Net FDI inflows : 1.7 percent of GDP in FY2016 to 3.2 percent of GDP in the second quarter of FY2017,
- The trade deficit declined by 23.5 per cent in April-December 2016 in comparison with previous year. [Reason : the main factor was the contraction in imports, which was far steeper than the fall in exports]
- October-December, both exports and imports started a long-awaited recovery, growing at an average rate of more than 5 per cent .[ Reasons : improvements in the world economy, led by better growth in the US and Germany]
- The net services surplus declined in the first half, as software service exports slowed and financial service exports declined.
- Net private remittances declined by $4.5 bn in the first half of 2016- 17 compared to the same period of 2015-16, weighed down by the lagged effects of the oil price decline, which affected inflows from the Gulf region.

## Outlook for 2016-17

**Demonetisation affects the economy through three different channels.**

1. **An aggregate demand shock -** because it reduces the supply of money and affects private wealth, especially of those holding unaccounted money;
2. **An aggregate supply shock -** to the extent that economic activity relies on cash as an input.
    - For example, agricultural production might be affected since sowing requires the use of labour traditionally paid in cash;
3. **An uncertainty shock -** because economic agents face imponderables related to the magnitude and duration of the cash shortage and the policy responses (perhaps causing consumers to defer or reduce discretionary consumption and firms to scale back investments).

## Impact on supply of cash and money and interest rates

1. It has reduced sharply - cash—while increasing almost to the same extent another type of money—demand deposits.
2. The decline in interest rates on the lending rate (based on the marginal cost of funds) by 90 basis points since November 9; on deposits (by about 25 basis points); and on g-secs on the other (by about 32 basis points)
3. India's stock market had declined by 0.93 percent

## Impact on GDP

To explain the impact on GDP, the Survey has taken 5 broad indicators

1. **Agricultural (rabi) sowing; -** Wheat and pulses sowing has exceeding last year's planting figures.But the increase in production depends upon whether farmers' access to inputs—fertilizer, credit, and labour—was affected by the cash shortage.
2. Indirect tax revenue, as a broad gauge of production and sales.
    - Passenger car sales and excise taxes bear little imprint of demonetisation.
    - Auto sales, as a measure of discretionary consumer spending and two-wheelers, as the best indicator of both rural and less affluent demand;
    - Sales of two wheelers has come down.
3. Real credit growth - Credit was already looking weak before demonetisation, and that pre-existing trend was reinforced.
4. Real estate prices : it has fallen in cities.

Recorded GDP growth in the second half of FY2017 will understate the overall impact because the most affected parts of the economy—informal and cash-based— are either not captured in the national income accounts or to the extent they are, their measurement is based on formal sector indicators.

## Outlook for 2017-18

Real GDP

1. India's exports appear to be recovering, based on an uptick in global economic activity. This is expected to continue in the aftermath of the US elections and expectations of a fiscal stimulus.
2. Private consumption will be affected by rising international oil prices, but is expected to receive a boost from two sources: catch-up after the demonetisation-induced reduction and cheaper borrowing costs.
3. Since no clear progress is yet visible in tackling the twin balance sheet problem, private investment is unlikely to recover significantly from the levels of FY2017.

Thus the Economic Survey expect real GDP growth to be in the 6¾ to 7½ percent range in FY2018. Even under this forecast, India would remain the fastest growing major economy in the world.

### There are three main downside risks to the above forecast.

1. **Effects of demonetisation could linger into next year**, especially if uncertainty remains on the policy response. Currency shortages also affect supplies of certain agricultural products, especially milk (where procurement has been low), sugar etc. It is essential to prevent "another pulses episode" with respect to agricultural products.
2. **Geopolitics** could take oil prices up further than forecast. It will eat into our import bills resulting reduced consumption; less room for public investment; and lower corporate margins, further denting private investment.
3. **Risks from the possible eruption of trade tensions** amongst the major countries, triggered by geo-politics or currency movements. This could reduce global growth and trigger capital flight from emerging markets.

### Fiscal outlook

1. The **increase in the tax to GDP ratio of about 0.5 percentage points** in each of the last two years **will disappear** due to increase in oil prices.
2. There will be a **fiscal windfall** both from the high denomination notes that are not returned to the RBI and from higher tax collections as a result of increased disclosure under the Pradhan Mantri Garib Kalyan Yojana (PMGKY).
3. A third factor will be the **implementation of the GST**. The transition to the GST is so complicated from an administrative and technology perspective that revenue collection will take some time to reach full potential.

**How to use the 'fiscal windfall' [comprising the unreturned cash and additional receipts under the PMGKY] as per the Economic Survey 2016-17?**

Since the windfall is not an income gain, it should be deployed to strengthening the government's balance sheet rather than being used for government consumption, especially in the form of programs that create permanent entitlements.

In this light, the best use of the windfall would be

- to create a public sector asset reconstruction company so that the twin balance sheet problem can be addressed, facilitating credit and investment revival;
- or toward the compensation fund for the GST that would allow the rates to be lowered and simplified;
- or toward debt reduction.

## The macroeconomic policy stance for 2017-18

An economy recovering from demonetisation will need policy support. Since the central government fiscal deficit started declining from 4.5 percent of GDP in 2013- 14 to 4.1 percent, 3.9 percent, and 3.5 percent in the following three years, fiscal policy needs to balance the cyclical imperatives caused by demonetisation.

*Labour Reforms*

A move towards affording greater choice to workers which would foster competition amongst service providers. Choices would relate to:

- whether they want to make their own contribution to the Employees' Provident Fund Organisation (EPFO);
- whether the employers' contribution should go to the EPFO or the National Pension Scheme;
- whether to contribute to the Employee State Insurance (ESI) or an alternative medical insurance program;

Also there could be a gradual move to ensure that at least compliance with the central labour laws is made paperless, presenceless, and cashless.

## Other Issues

1. **Redistribution: Universal Basic Income (UBI)** as a radical new vision.

This misallocation of funds has consequences:

1. It **results in exclusion** of the deserving poor from access to government welfare benefits,
2. **Leakages to non-poor** and benefits to corrupt local actors.

One of the key problems with many programs is that the take-up and effectiveness of targeting will be correlated with a state's institutional and implementation capacity.

Thus the Economic Survey moots new idea of a **universal basic income** as a more effective way of achieving Mahatma Gandhi's objectives of "*wiping every tear from every eye*."

*Understanding UBI*

A UBI will not necessarily be driven by take-up capability from below but given from above to all the deserving. In that sense, it is less likely to be prone to exclusion errors. And by directly transferring money to bank accounts, and circumventing multiple layers of bureaucracy, the scope for out-of system leakages (a feature of PDS schemes) is low.

2. **Exchange rate policy: Vigilance and new ways of monitoring**

Given India's need for exports to sustain a healthy growth rate, it is important to track India's competitiveness.

A second reason to review India's competitiveness is 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

3. **Trade Policy**

*Aftermath of Brexit and the US elections.* - These are likely to be exacerbated by macro-economic developments in the United States.

## Two specific opportunities arise.

1. **More proactively seek to negotiate free trade agreements with the UK and Europe** (given the need to promote labor-intensive exports).

The potential gains for export and employment growth are substantial.

2. 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.

It is possible that the relevance of the World Trade Organization might increase. As a major stakeholder and given the geo-political shifts under way, reviving the WTO and multilateralism more broadly could be proactively pursued by India.

4. **Climate Change and India**

The Paris Agreement on climate change in December 2015 has been one of the shining recent examples of successful international cooperation. The focus will now shift to implementing the agreements.

The increase in petrol tax has been over 150 percent in India. In contrast, the governments of most advanced countries have simply passed on the benefits to consumers, setting back the cause of curbing climate change.

5. **Ensuring Women's Privacy**

In FY2015, it highlighted the violence against women related to coercive family planning methods.

In FY2016, the Survey featured a chapter on “Mother and Child,” emphasizing the importance of government interventions to ensure long term well-being of women and children.

Women’s personal hygiene is important not just for better health outcomes but also for the intrinsic value in conferring freedom that comes from having control over their bodies, a kind of basic right to physical privacy. Put differently, impeded access may well be creating “gender-based sanitation insecurity.”

## The Disproportionate Burden on Women

1. Households without toilets : 33 percent of the women have reported facing privacy concerns and assault while going out in the open.
2. Household with toilets: In rural households, the proportion of regular use by women was 56 percent (men, 43 percent); and in urban households, 75 percent of women reported exclusive usage (men, 72 percent). What this pattern of usage suggests is that women and girl-children could take a key leadership role to play in Swachh Bharat’s objective of creating defecation free communities, by nudging men and boys of the household to change their own defecation behaviors.

*What Economic Survey suggests as a solution?*

- **Acknowledge the problem**.

This means generating more information on a topic that is socially considered taboo or ignored.

- **Recognizing the positive behavioral patterns** that women demonstrate upon obtaining access to sanitation services is critical. Equally, when these services are denied, they face considerable insecurity and nutritional risks. For this reason, ensuring safe and adequate sanitation, water security and hygiene—the objectives of Swachh Bharat—as part of a broader fundamental right to privacy is becoming a serious policy issue.

6. **India’s Soon-to-Recede Demographic Dividend**

2016 was a turning point in global demographic trends. It was the first time since 1950 that the **combined working age (WA) population (15-59) of the advanced countries declined** (Ip(2015)).

Over the next three decades, the United Nations (UN) projects that China and Russia will each see their WA populations fall by over 20 percent.

India, however, seems to be in a **demographic sweet spot with its working-age population projected to grow by a third over the same period**; always remembering that demography provides potential and is not destiny.

**Younger populations are more entrepreneurial** (adding to productivity growth); tend to save more, which may also lead to favourable competitiveness effects.

There is a clear divide between peninsular India (West Bengal, Kerala, Karnataka, Tamil Nadu and Andhra Pradesh) and the hinterland states (Madhya Pradesh, Rajasthan, Uttar Pradesh, 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.

Demographically speaking, therefore, there are two Indias, with different policy concerns: a soon-to-begin-ageing India where the elderly and their needs will require greater attention; and a young India where providing education, skills, and employment opportunities must be the focus. Of course, heterogeneity within India offers the advantage of addressing some of these concerns via greater labour mobility, which would in effect reduce this demographic imbalance.

The growth boost from the demographic dividend is likely to peak within the next five years, as India's share of working-age population plateaus.

# Chapter 02 - The Economic Vision for Precocious, Cleavaged India - Highlights of Economic Survey 2016-17

The Chapter 02 of Economic Survey 2016-17 briefly discusses the growth performance of the nation over decades, focuses up on serious challenges that impede further rapid progress and concludes by providing a possible explanation to these challenges.

Important points to remember in chapter 2 of economic survey 2016-17 for Civil Services Examination

**Economic Survey 2016-17 categorises India's growth performance into two phases:**

1. Nearly half a century of socialism, where the guiding principles were economic nationalism and protectionism.
2. After 1991: when India's transformation into an "open economy".

The repudiation of socialism into the latter has been justified as something resembling the "Washington Consensus" - A STANDARD DEVELOPMENT MODEL, which in simple terms mean: open trade, open capital, and reliance on the private sector. This is particularly evident with the type of reforms introduced since then and till date including the efforts to ease doing business, create investment friendly environment and passing of following Bills such as Aadhaar Bill, The Bankruptcy Code, and the GST constitutional amendment.

**The result of all these reforms over the past 25 years:**

"A remarkable transformation of India from a largely closed and listless economy to the open and thriving economy."

How is this progress measured?

The author uses the following standard measures to quantify the development of Indian economy over the past quarter century.

- Openness of Indian economy to trade
- Openness to foreign capital
- Extent to which public sector enterprises dominate commercial activities;
- The share of government expenditure in overall spending.

**The openness of Indian economy to trade:**

India is equally competent in world trade as is the case with domestic trade.

**Openness to foreign capital:**

- India's foreign capital flows as a share of GDP reveals that despite significant capital controls, India's net inflows are, in fact, quite normal compared with other emerging economies.
- India's FDI has risen sharply over time. In fact, in the most recent year, FDI is running at an annual rate of $75 billion, which is not far short of the amounts that China was receiving at the height of its growth boom in the mid-2000s.

**The extent to which public sector enterprises dominate commercial activities:**

- Compared to other countries, India's public sector undertakings (PSU) are exceptionally large. That may have been true in the past.
- India has allowed the private sector entry into, amongst others, civil aviation, telecommunications, and financial services. These have all served to reduce the share of the public sector even if there has not been many exits of the PSU enterprises themselves. India is now squarely in the middle of the emerging market pack.

**The share of Government expenditure in overall spending:**

On the basis of per capita GDP, India is understood to spend as much as can be expected given its level of development.

These standard measures suggest that India is now a "normal" emerging market, following the "**STANDARD DEVELOPMENT MODEL".**

**However, this progress is faced with new challenges as mentioned below :**

- Ambivalence about property rights and the private sector
- Deficiencies in state capacity, especially in delivering essential services.
- Inefficient redistribution.

**Ambivalence about private sector and property rights.**

"The ambivalence in India seems greater than elsewhere", especially with regard to the private sector -whose objective is - maximising profits. The symptoms of this ambivalence toward the private sector manifest in multiple ways:

- Difficulty of privatizing public enterprises, even for firms where economists have made strong arguments that they belong in the private sector. Eg: Civil Aviation sector, disinvesting the government's majority stake in the public sector banks,fertilizer sector.
- Initially, the right to property was inscribed as a "fundamental right" in the Constitution. But during the socialist era, the 44th Amendment removed Articles 19 (1) (f) and Article 31 and replaced them with Article 300-A, thereby downgrading property to that of a "legal right".

**Deficiencies in state capacity, especially in delivering essential services.**

- The weakness of state capacity, especially in delivering essential services such as health and education.
- At the level of the states, competitive populism (with few goods and services deemed unworthy of being handed out free) is more in evidence than competitive service delivery.

The above weakness in State's capacity has heavily hindered the decision-making process of the government.

**Inefficient redistribution.**

- Redistribution by the government is far from efficient in targeting the poor.
- The welfare spending suffers from considerable misallocation.

**What explains these three distinctive challenges of the Indian development model?**

According to the Economic Survey, India has followed a unique pathway to economic success, what might be called **"Precocious, Cleavaged India".** This means, and includes:

- India attempted economic development while also **granting universal franchise from the very beginning.** This is unlike other advanced economies like US and UK, were the political rights were restricted initially and after attain a certain level of economic development, the voting rights were granted to all.
- India, at independence, was one **of the poorest nations**, regardless of political system, with a per capita GDP of just $617 measured in purchasing power parity prices.
- India was also a **highly cleavaged society** regarding language and scripts, religion, region, caste, gender, and class.

Implication of India's precocious, cleavaged democracy

**Weak State capacity and early redistribution** in the development process.

**Insufficient investment in human capital**. – for instance, public spending on health was an un unusually low 0.22 per cent of the GDP in 1950-51 World average is 5.99% today, whereas India stands at ~1.3%, which is abysmally low.

**Inefficient Redistribution**, using blunt and leaky instruments.

Concluding remarks

To conclude, it is erstwhile to say that all of these features, explanations, and implications are lessons for inefficient redistribution, and the legitimacy of the private sector and the state that may prove crucial as India moves along on the next stage of its economic journey. 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 03 - Demonetization: To Deify or Demonize?- Highlights of Economic Survey 2016-17



Demonetization: To Deify or Demonize?

Union finance minister Arun Jaitley tabled the Economic Survey 2016-17 in Parliament during the first day of the budget session. Here are the major highlights from the **Chapter 3** of Economic Survey 2016-17.

The most anticipated chapter for many in the Economic Survey had to be regarding Demonetization. Chapter 3 mentions the exercise in detail, its rationale, impact, costs and future framework to supplement and complement the exercise.

**Why demonetization was conducted?**

The drive aimed to curb the following,

a) Corruption

b) Counterfeiting

c) The use of high denomination notes for terrorism activities

d) Accumulation of black money.

**What have been the earlier efforts to curb the above-mentioned illicit activities?**

a) Creation of the Special Investigative Team in 2014 budget

b) The Black Money and Imposition of Tax Act 2015;

c) Benami Transactions Act 2016;

d) The information exchange agreement with Switzerland;

e) Changes in the tax treaties with Mauritius, Cyprus and Singapore;

f) Income Disclosure Scheme.

**When was the previous demonetization exercises carried out in India?**

1946 and 1978

Moving forward, The Economic survey also introduces the concept of "Helicopter drops" and "Reverse helicopter drops"

A helicopter drop is a hypothetical, unconventional tool of monetary policy that involves printing large sums of money and distributing it to the public in order to stimulate the economy. This measure was widely followed by all countries post the Global Financial Crisis of 2008.

The Economic survey regards Demonetization as a "Reverse helicopter drop" or "Helicopter hoover" strategy, which aims to reduce the money supply instead of expanding it.

**What were the issues debated on regarding the Demonetization drive?**

- Broader aspects of management, as reflected in the design and implementation of the initiative.
- Its economic impact in the short and medium run.
- Its implications for the broader vision underlying the future conduct of economic policy.

The Economic Survey 2016-17 however does not discuss the broader welfare and other non-economic dimensions. It also admits that there have been reports of job losses, declines in farm incomes, and social disruption, especially in the informal, cash-intensive parts of the economy (EFFECTS OF DEMONETIZATION exercise in the short run) and that a systematic analysis could not be included due to paucity of macro-economic data.

The Economic Survey 2016-17 goes onto discuss the rationale for the exercise and provide background facts for the same.

**What are the functions of Money/Cash?**

a) cash can be used as a medium of exchange (for transactions)

b) a store of value like other forms of wealth such as gold and real estate.

**Evolution of India's Currency to GDP ratio:**

*Currency to GDP = Amount of cash in circulation / total GDP value.

The Economic Survey highlights that there have been two phases in the evolution

a) From 1952-53 to 1968, where the ratio declined from 12 percent to 9 percent.

b) Growing from 1970s till the Global Financial Crisis and high inflation in 2010. (The ratio showed a declining trend till 2014-15 post which it has improved)

The Economic Survey also notes that India is a highly cash dependent country (even when compared to countries in the same income group. This seemed to suggest that some of the cash holdings were used for illegitimate activities.

This presumption is especially strong because across the globe there is a link between cash and nefarious activities: the higher the amount of cash in circulation, the greater the amount of corruption, as measured by Transparency International.

**Why high denomination notes were targeted in Demonetization?**

a) 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

b) RBI data show that in India low denomination notes have a soil rate of 33 percent per year. In contrast, the soil rate for the Rs 500 note is 22 percent, and the Rs 1000 just 11 percent. One way to estimate black money is to assume that all these notes should soil at the same rate, if they were really being used for transactions. (But as you can see, that's not the case and some money is not used for transaction)

**What is soil rate?**

"Soil rates," is the rate at which notes are considered to be too damaged to use and have been returned to the central bank.

**IMPACT OF DEMONETIZATION:**

The Economic Survey 2016-17 views demonetization as follows, a money supply contraction but only of one type of "money"—cash; a tax on unaccounted private wealth maintained in the form of cash – black money; and a tax on savings outside the formal financial system.

It can also be viewed on the following lines,

an aggregate demand shock, because it reduces the supply of money and affects private wealth (especially of those holding unaccounted money and owning real estate); 

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); 

an uncertainty shock because economic agents face imponderables related to the impact and duration of the liquidity shock as well as further policy responses. 

# IMPACT OF DEMONETISATION

| SECTOR | IMPACT: Effect through end-December | IMPACT: Likely longer-term effect |
|---|---|---|
| Money/interest rates | • Cash declined sharply<br>• Bank deposits increased sharply<br>• RBI's balance sheet largely unchanged: return of currency reduced the central bank's cash liabilities but increased its deposit liabilities to commercial banks<br>• Interest rates on deposits, loans, and government securities declined; implicit rate on cash increased | • Cash will recover but settle at a lower level<br>• Deposits will decline, but probably settle at a slightly higher level<br>• RBI's balance sheet will shrink,after the deadline for redeeming outstanding notes<br>• Loan rates could fall further, if much of the deposit increase proves durable |
| Financial System Savings | • Increased | • Increase, to the extent that the cash deposit ratio falls permanently |
| Corruption (underlying illicit activities)<br>Unaccounted income/black money (underlying activity may or may not be illicit) | • Stock of black money fell, as some holders came into the tax net | • Could decline, if incentives for compliance improve<br>• Formalization should reduce the flow of unaccounted income |
| Private Wealth | • 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 |
| Public Sector Wealth | • No effect. | • Government/RBI's wealth will increase when unreturned cash is extinguished, reducing liabilities |
| Formalization/ digitilisation | • 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 |
| Real estate | • 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 |
| Broader economy | • Job losses, decline in farm incomes, social disruption, especially in cash-intensive sectors | • Should gradually stabilize as the economy is remonetized |
| GDP | • Growth slowed, as demonetisation reduced demand (cash, private wealth), supply (reduced liquidity and working capital, and disrupted supply chains), and increased uncertainty<br>• Cash-intensive sectors (agriculture, real estate, jewellery) were affected more.<br>• 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.<br>• Recorded GDP will also be overstated because banking sector value added is based (inter alia) on deposits which have surged temporarily | • Could be beneficial in the long run if formalization increases and corruption falls<br>• Informal output could decline but recorded GDP would increase as the economy becomes more formalized |
| Tax collection | • Income taxes rose because of increased disclosure<br>• Payments to local bodies and discoms increased because demonetised notes remained legal tender for tax payments/ clearances of arrears | • Indirect and corporate taxes could decline, to the extent growth slows<br>• Over long run, taxes should increase as formalization expands and compliance improves |

**BENEFITS OF DEMONETIZATION:**

a) Tax on Black Money:

Demonetization 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 such as to retire government debt, recapitalize banks, or even redistribute back to the private sector.

b) Tax compliance:

Demonetization could aid tax administration by shifting transactions out of the cash economy and into the formal payments system. As a result, the tax-GDP ratio, as well as the size of the formal economy, could be permanently higher.

*The tax-to- GDP ratio is the ratio of tax collected compared to national gross domestic product (GDP).

c) Tax on informal savings:

Some of the new deposits will surely remain in the banks, where they will provide a base for banks to provide more loans, at lower interest rates.

**The Economic Survey 2016-17 goes onto state certain potential long-term benefits**

a) Digitization:

One intermediate objective of demonetization is to create a less-cash or cash- lite economy, as this is key to channeling more saving channeled through the formal financial system and improving tax compliance. *Watal Committee has recently estimated that cash accounts for about 78 percent of all consumer payments.

*Impediments/Roadblocks in the move to digitization:*

They require special equipment, cellphones for customers and Point-Of-Sale (POS) machines for merchants, which will only work if there is Internet connectivity.

They are also costly to users, since e-payment firms need to recoup their costs by imposing charges on customers, merchants, or both.

*Advantages of digitization:*

Digital transactions help bring people into the modern "wired" era. They bring people into the formal economy, thereby increasing financial saving, reducing tax evasion, and leveling the playing field between tax-compliant and tax-evading firms (and individuals).

*Some quick trivia from the Economic Survey 2016-17: There are approximately 350 million people without cellphones (the digitally excluded); 350 million with regular “feature” phones, and 250 million with smartphones.

Steps to facilitate digital transactions:

- Launch of the BHIM (Bharat Interface For Money) app for smartphones. This is based on the new Uni ed Payments Interface (UPI) 
- Launch of BHIM USSD 2.0 
- Launch of Aadhaar Merchant Pay 
- Reductions in fees (Merchant Discount Rate) paid on digital transactions and transactions that use the UPI.
- Encouraging the adoption of POS devices beyond the current 1.5 million, through tariff reductions.

b) Real Estate:

In the past, much of the black money accumulated was ultimately used to evade taxes on property sales. To the extent that black money is reduced and financial transactions increasingly take place through electronic means, this type of tax evasion will also diminish.

Also, this measure can lead to reduced real estate rates. Reduction in real estate prices is desirable as it will lead to affordable housing for the middle class, and facilitate labour mobility across India currently impeded by high and unaffordable rents.

**COSTS OF DEMONETIZATION:**

The Economic Survey 2016-17 does not get into the details of the costs associated with demonetization exercise citing lack of relevant data and if certain impact can be measured in the correct sense.

It does mention that aggregate sowing of the two major rabi crops—wheat and pulses (gram)-- exceeded last year’s planting by 7 percent and 15 percent, respectively.

The Economic Survey suggests that it would be reasonable to conclude that real GDP and economic activity has been affected adversely, but temporarily, by demonetization.

The question is: how much? The short answer is between 1⁄4 and 1⁄2 percentage points relative to the baseline of about 7 percent.

Projected Growth:

The Economic Survey 2016-17 states that the adverse impact of demonetisation on GDP growth will be transitional. Once the cash supply is replenished, which should largely be achieved by end-March 2017, the economy should revert to normal.

Therefore real GDP growth in 2017- 18 is projected to be in the 63⁄4-71⁄2 percent range.

**How Demonetization affects the Government?**

Positively,

a) Demonetization will redistribute resources - from the private sector to the government.

b) Wealth gain: The RBI/government may receive some gains from the unreturned cash.

c) Income taxes could go up as black money was deposited in bank accounts.

Negatively,

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. 

Moving forward, economic Survey points that the emphasis must be on maximizing demonetization's benefits while minimizing its costs.

**STRATEGY TO COMPLEMENT DEMONETIZATION:**

1. A GST with broad coverage to include activities that are sources of black money creation—land and other immovable property—should be implemented; 
2. Individual income tax rates and real estate stamp duties could be reduced; 
3. 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 any sectoral distinctions); 
4. The timetable for reducing the corporate tax rate could be accelerated; and 
5. Tax administration could be improved to reduce discretion and improve accountability. 

(You can refer to Appendix 1 if you need examples of Demonetization exercise in other parts of the world.)

# Chapter 04 - The Festering Twin Balance Sheet Problem - Highlights of Economic Survey 2016-17

**The Festering Twin Balance Sheet Problem**

Union finance minister Arun Jaitley tabled the Economic Survey 2016-17 in Parliament during the first day of the budget session. Here are the major highlights from the **Chapter 4** of Economic Survey 2016-17.

Chapter 4 of the Economic survey 2016-17 deals with the banking system, its vulnerabilities, ability to adapt to shocks, structural changes and problems associated with the twin balance sheet syndrome.

**What is the Twin Balance Sheet (TBS) problem?**

The balance sheets of both **public sector banks (PSBs) and some corporate houses** are in terrible shape and it has been seen as a major obstacle to investment and reviving growth.

**What are Non-Performing Assets?**

The NPAs are assets that stop generating income for a bank. Bank's assets mostly comprise of loans and when these loans are on the verge of default (that is, about to go bad), they are classified as NPA.

In India, a loan is classified as NPA, if the interest or any installment remains unpaid for a period of more than 90 days.

**What are stressed assets?**

Stressed assets are NPAs plus restructured assets. Restructured loans are loans that have been converted to equity under the corporate debt-restructuring scheme.

**Origin of Non Performing Asset (NPA) or the TBS problem:**

In mid 2000s (Yes, the Economic Survey does pin point it to the UPA regime), everything was going right: corporate profitability was amongst the highest in the world, encouraging firms to hire labour aggressively, which in turn sent wages soaring.

Within the span of four short years, the investment-GDP ratio has soared by 11 percentage points, reaching over 38 percent by 2007-08.

An astonishing credit boom, also the largest in the nation's history, financed this investment. In the span of just three years, running from 2004-05 to 2008-09, the amount of non-food bank credit doubled.

There were also large in flows of funding from overseas, with capital in flows in 2007-08 reaching 9 percent of GDP. All of this added up to an extraordinary increase in the debt of non- financial corporations.

*But just as companies were taking on more risk, things started to go wrong.*

- **Costs soared** far above budgeted levels, as **securing land and environmental clearances proved much more difficult** and time consuming than expected.
- At the same time, **forecast revenues collapsed after the Global Financial Crisis**; projects that had been built around the assumption that growth would continue at double-digit levels were suddenly confronted with growth rates half that level.
- **Financing costs also increased sharply**. Firms that borrowed domestically suffered when the RBI increased interest rates to quell double- digit inflation. And firms that had borrowed abroad when the rupee was trading around Rs 40/dollar were hit hard when the rupee depreciated, forcing them to repay their debts at exchange rates closer to Rs 60-70/ dollar.

**What is 'Balance Sheet Syndrome with Indian Characteristics'?**

TBS did not lead to economic stagnation, as occurred in the U.S. and Europe after the Global Financial Crisis. It co-existed with strong levels of aggregate domestic demand, as reflected in high levels of growth despite very weak exports and moderate, at times high, levels of inflation.

**Why this characteristic?**

1. The unusual structure of our banking system.
2. The lack of infrastructure has hindered expansion of manufacturing and even some service activities, such as trade and transport. These constraints were loosened considerably during the boom, as new power plants were installed, and new roads, airports, and ports built. As a result, there was ample room for the economy to grow after the GFC.
3. Indian strategy of "*give time to time*" - companies sought financial accommodation from their creditors, asking for principal payments to be postponed, on the grounds that if the projects were given sufficient time they would eventually prove viable.

Banks decided to give stressed enterprises more time by postponing loan repayments, restructuring by 2014-15 no less than 6.4 percent of their loans outstanding. They also extended fresh funding to the stressed firms to tide them over until demand recovered.

The Economic Survey notes that the Indian banking strategy was similar to that of China. Both countries provided generous amounts of bank financing to allow highly levered corporations to survive. And in both countries this strategy has proved successful so far in allowing rapid growth to continue. But there remains a question of whether the model is truly sustainable.

**Table 1. Estimated Non-Performing Loans**

| | India | China | India | China |
|---|---|---|---|---|
| | **1998-99** | **2002** | **2016@** | **2015** |
| **Total ($ billion)** | 14.0 | 209.1 | 191.1 | 1300 |
| **Percent of total loans** | 14.7 | 23.4 | 16.6^ | 15.5 |
| **Percent of GDP** | 3.0 | 14.4 | 8.4 | 12.0 |
| Memo Item | | | | |
| **Bank Credit to GDP (%)** | 20.5 | 108# | 53.4* | 137.5** |

***Source:*** **IMF, RBI, Credit Suisse estimates.**

**Effects of Twin Balance Sheet:**

- Countries with TBS problems tend to have low investment, as stressed companies reduce their new investments to conserve cash flow, while stressed banks are unable to assume new lending risks
- TBS is taking a heavy toll on the health of the public sector banks. At least 13 of these banks accounting for approximately 40 per cent of total loans are severely stressed, with over 20 per cent of their outstanding loans classified as restructured or NPAs.

**Indian Public sector banks have a negative Return on Assets (ROA) for the past 2 years.*

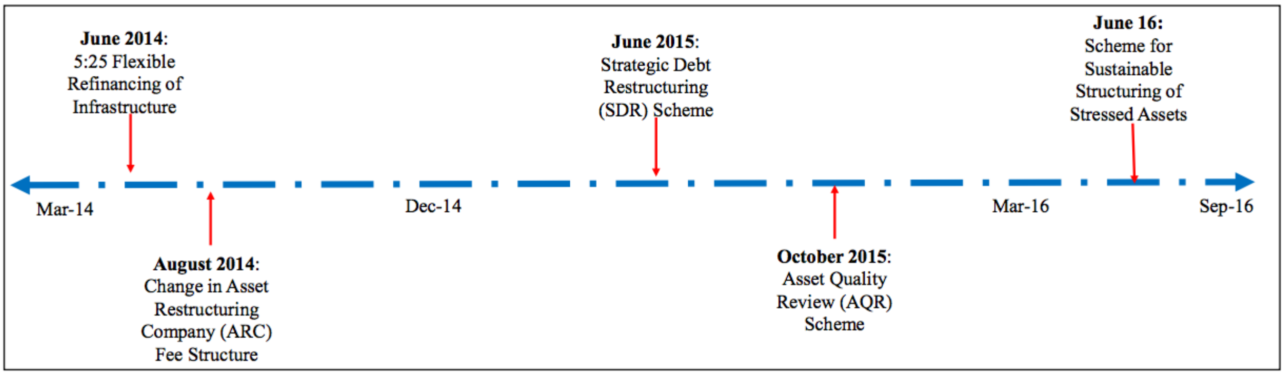
- Total credit to the corporate sector has been decelerating steadily. In real terms, such credit growth is now negative, the lowest it has been in 23 years. But at the same time, household credit and agricultural loans have increased.

**STEPS TAKEN TO SOLVE THE PROBLEM:**

- The RBI has been encouraging the establishment of private **Asset Reconstruction Companies (ARCs)**, in the hope that they would buy up the bad loans of the commercial banks. (But ARCs have been limited in success, buying only 5 percent of NPAs)



**Figure. Chronology of RBI policy actions**



- In June 2015, the **Strategic Debt Restructuring (SDR) scheme** was introduced, under which creditors could take over firms that were unable to pay and sell them to new owners.
- The **Sustainable Structuring of Stressed Assets (S4A)** was announced, under which creditors could provide firms with debt reductions up to 50 percent in order to restore their financial viability.

(Their success, however, has been limited; while two dozen firms have entered into negotiations under SDR, only two cases have actually been concluded as of end-December 2016. And only one small case has been resolved so far under S4A.)

*The Economic Survey 2016-17 goes onto talk about the reasons as to why the progress has been limited and slow, but from UPSC Civil Services point of view, one need not dwell into the details of the same.*

**STRATEGY FOR FUTURE:**

Creation of '**Public Sector Asset Rehabilitation Agency**' (PARA)

The *Economic Survey* 2015-16 had on similar line emphasized that addressing the stressed assets problem would require 4 R's: *Reform, Recognition, Recapitalization,* and *Resolution.*

# Chapter-05 - Fiscal Framework: The World is Changing, Should India Change Too? – Highlights



Fiscal Framework: The World is Changing, Should India Change Too?

The Economic Survey 2016-17 is tabled in the parliament to mark the beginning of budget session. Here are the major highlights from the Chapter 5 of Economic Survey 2016-17.

Economic survey analyses the Fiscal Responsibility & Budgetary Management Act (FRBMA) in the light of increasing fiscal activism in advanced economies. Through the chapter in the Economic Survey 2016-17, one gets an outline of the 13 years since the Act came into existence and India's fiscal position.

**Why is there a need for active fiscal policy?**

1. Prevalence of weak economic activity (twin balance sheet problem, which is holding back investment and credit growth and hence overall economic activity).
2. Inability to address this problem through monetary policy.

**How Indian situation differs from other advanced economies?**

- Indian growth rates are substantially higher, while inflation rates are also substantially greater. As a result, monetary policy is nowhere close to the zero lower bound, reducing the need for fiscal activism.
- Because inflation is already relatively high, counter-cyclical policy has to be much more sensitive to triggering higher inflation.

**** A 'countercyclical' fiscal policy refers to the opposite approach: reducing spending and raising taxes during a boom period, and increasing spending/cutting taxes during a recession.***

- India's own recent experience - two episodes of Indian macro- vulnerability in the last 35 years—1991 and 2013—were associated with, even preceded by, large increases in fiscal deficits. The inability to rein in these deficits played a key role in undermining India's external situation, which led to the balance of payments crisis of 1991.
- India's debt-to-GDP ratio is higher than many other emerging markets.

****Debt-to-GDP ratio is the ratio between a country's government debt (a cumulative amount) and its gross domestic product (GDP) (measured in years). A low debt-to-GDP ratio indicates an economy that produces and sells goods and services sufficient to pay back debts without incurring further debt.***

The Economic Survey 2016-17 goes on in great length to discuss the deficits and Indian fragilities. The important observation in the survey is that,

India's ***primary deficit, which is the shortfall between its receipts and its non-interest expenditures, is highly vulnerable***. Put simply, India's government (Centre and states combined) is not collecting enough revenue to cover its running costs, let alone the interest on its debt obligations.

**Consequence of having a Primary deficit** - The government is dependent on growth and favourable interest rates to contain the debt ratio.

The Economic Survey goes onto to mention the path for the future fiscal framework. India has become a middle-income country during the course of the 13 years since FRBM was enacted.

* ***Middle-income countries (MICs) are nations with a per-capita gross national income in 2012 between $1,036 and $12,615. Middle-income countries (MICs) are one of the income categories that the World Bank uses to classify economies for operational and analytical purposes.***

**Concluding remarks:**

Advanced countries have moved away from prudent fiscal rules and principles toward greater fiscal activism, giving counter-cyclical policies much more of a role and giving correspondingly less weight toward curbing the debt stock.

But India's experience has taught the opposite lessons. It has reaffirmed the need for rules to contain fiscal deficits, because of the proclivity to spend during booms and undertake stimulus during downturns. It has also highlighted the danger of relying on rapid growth rather than steady and gradual fiscal and primary balance adjustment. In short, it has underscored the fundamental validity of the fiscal policy principles set out in the FRBM.

The Economic Survey ends the chapter suggesting the need to modify the operational framework of FRBMA designed in 2003 to meet existing macro economic reality.

***N.K. Singh heads the FRBM Review Committee.**

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Fiscal Rules: Lessons from the States

The Economic Survey 2016-17 is tabled in the parliament to mark the beginning of budget session. Here are the major highlights from the Chapter 6 of Economic Survey 2016-17.

*The Economic Survey 2016-17 talks about fiscal lessons from the states. Fiscal challenges are mounting because of the Pay Commission recommendations, slowing growth, and rising payments from the UDAY bonds. Moreover, macro-economic conditions will not be as favorable to states as they were in the mid-2000s. All these mandate the need for prudent fiscal management.*

**Fiscal Responsibility Legislation (FRL)** adopted by the states mirrored the FRBM Act.

**Highlights of the FRL:**

- Fiscal targets were established, which were the same for all states. 
- The 12th Finance Commission allowed states to borrow directly from the market. 
- Finally, broad public discipline was enhanced by introducing new reporting requirements. States were required to publish annual Medium-Term Fiscal Policy reports, which would project deficits over the next three to four years. 

**How FRL has fared?**

The financial position of the states improved considerably after 2005, based on any measure.

- The average revenue deficit was entirely eliminated.
- The average fiscal deficit was curbed to less than 3 percent of GSDP, just as the FRL had mandated.
- The average debt to GSDP ratio accordingly fell by 10 percentage points to a mere 22 percent of GSDP in 2013.

There are other exogenous factors also responsible for states being able to achieve the above-mentioned figures. These include

1. An acceleration of nominal GDP growth (of 6 percentage points on average) helped boost states' revenues by about 1 percent of GSDP; 
2. Increased transfers from the Centre of about 1 percent of GSDP both because of the 13th Finance Commission recommendations and the surge in central government revenues; 
3. Reduced interest payments of about 0.9 percent of GSDP on account of the debt restructuring package offered by  the Centre; and

4. Reduced need for spending by the states—estimated at about 1.2 percent of GDP—as the Centre took on a number of major social sector expenditures under the Centrally Sponsored Schemes

**Impact of FRL:**

FRLs clearly made an important difference, both in terms of outcomes and behaviour.

That said, much of the improvement in financial positions was possible because of exogenous factors, most notably assistance from the Centre in the form of increased revenue transfers, the assumption of state debt, and the introduction of centrally sponsored schemes. As a result, the contribution of the FRL may really have been much more subtle than the headline deficit numbers suggests.

***Constitutional provision related to borrowing - Article 293 (3) of the Constitution. Under this clause, States must take consent of the Centre for additional borrowing.***

**The road ahead:**

The Fourteenth Finance Commission (FFC) attempted to shift toward incentives by relaxing some of the FRL limits for better-performing states.

# Chapter 07 - Clothes and Shoes: Can India Reclaim Low Skill Manufacturing? - Highlights



Clothes and Shoes: Can India Reclaim Low Skill Manufacturing?

Union finance minister Arun Jaitley tabled the Economic Survey 2016-17 in Parliament during the first day of the budget session. Here are the major highlights from the **Chapter 7** of Economic Survey 2016-17.

The Economic Survey 2016-17 notes that creating jobs is India's central challenge. India needs to generate jobs that are formal and productive, provide bang-for-buck in terms of jobs created relative to investment, have the potential for broader social transformation, and can generate exports and growth. The apparel and leather and footwear sectors meet many or all of these criteria and hence are eminently suitable candidates for targeting.

**What is the need to expand the apparel and leather sector?**

- Apparels and Leather sectors offer **tremendous opportunities for creation of jobs, especially for women.**
- **The apparel sector is the most labor-intensive, followed by footwear.** Apparels are 80-fold more labor-intensive than autos and 240-fold more jobs than steel.

*In Bangladesh, female education, total fertility rates, and women's labour force participation moved positively due to the expansion of the apparel sector.*

- India has an opportunity to promote apparel, leather and footwear sectors because of **rising wage levels in China** that has resulted in China stabilizing or losing market share in these products.
- **Wage costs in most Indian states are significantly lower than in China.** But, India needs to act fast as countries like Bangladesh and Vietnam are taking up space in the apparel and leather industry.

**Challenges to the sector:**

- **Logistics:**

The costs and time involved in getting goods from factory to destination are greater than those for other countries. Further, few very large capacity containers (VLCC) come to Indian ports to take cargo so that exports have to be trans- shipped through Colombo which adds to travel costs and hence reduces the flexibility for manufacturers.

- **Labor regulations:**

Regulations on minimum overtime pay, onerous mandatory contributions, lack of flexibility in part-time work and high minimum wages in some cases. There are strict regulations for overtime wage payment as the Minimum Wages Act 1948 mandates payment of overtime wages at twice the rate of ordinary rates of wages of the worker.

- **Tax and Tariff Policies**

1. High tariffs on yarn and fiber increase the cost of producing clothing. India imposes a 10 percent tariff on man-made fibers vis a vis 6 percent on cotton fibers. (World demand is shifting strongly towards man- made fibers and against cotton-based exports)
2. Domestic taxes also favor cotton-based production rather than production based on man-made fibers with 7.5 per cent tax on the former and 8.4 per cent on the latter. A similar problem also afflicts footwear production with taxes of 20.5 per cent on leather and 27 per cent on non-leather footwear. (The global demand for footwear is shifting away from leather footwear and towards non-leather footwear).
3. Indian leather exports also face high tariffs in partner country markets in exports of leather goods and non-leather footwear.

**Sector specific challenges include,**

**Comparative advantage in cattle**

The leather and footwear industry uses raw hides and skins of a number of animals like cattle, buffalo, goat, sheep and other smaller animals as its chief raw material. Amongst these, 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. This trend can be attributed to **the limited availability of cattle for slaughter in India**, thereby leading to loss of a potential comparative advantage due to underutilization of the abundantly available natural resource.

**Policy response for Apparel & Leather industry:**

1. Apparel exporters will be provided relief to offset the impact of state taxes embedded in exports, which could be as high as about 5 per cent of exports.
2. Textile and apparel firms will be provided a subsidy for increasing employment. This will take the form of government contributing the employers' 12 per cent contribution to the Employee Provident Fund (EPF)
3. India will still need to carefully weigh the benefits and costs of negotiating new Free Trade Agreements, such as, with the European Union (EU) and the United Kingdom (UK).
4. The introduction of the Goods and Service Tax (GST) offers an excellent opportunity to rationalize domestic indirect taxes
5. Labor law reforms such as,

- Low Wage Employees (people with less than Rs 20,000 salary per month) only receive 55 percent of their salary because 45 per cent goes to statutory deductions like Employee Provident Fund Organisation (EPFO), Employee Pension Scheme (EPS), Labour Welfare Fund (LWF), Employees' Deposit Linked Insurance Scheme (EDLI), and Employee State Insurance (ESI) etc. 

- Low wage employees do not have a 45 per cent savings rate and therefore they may prefer to receive these contributions today than benefit from them tomorrow. 
- The two largest deductions of Provident Fund and ESI may not result in the best value for money for employees.

Thus, the Economic Survey 2016-17 suggests that more FTAs, GST-induced tax rationalization, and labour law reforms would add considerably to the job creation potential of the clothing and footwear sectors.

# Chapter 08 - Review of Economic Developments-Highlights of Economic Survey 2016-17



Chapter 8 of the Economic Survey 2016-17 deals with a comprehensive review of the Indian economy. This chapter provides huge data related to various macro-economic variables. It also gives an insight into government's commitment in various sectors such as education, health, climate change, social development and so on. Thus, some areas of this chapter from the Economic Survey is of utmost importance to an aspirant from both UPSC Prelims and Mains examination.

The Indian economy is estimated to register a GDP growth rate of 7.1 per cent in 2016-17. (Though the Economic Survey 2016-17 states that there might be downward revision owing to the Demonetization exercise in November, after which there was a slowdown).

**SECTORAL GROWTH ACCORDING TO ECONOMIC SURVEY 2016-17**

**Improved performance of Primary sector:**

Growth of agriculture & allied sectors improved significantly in 2016-17.

**Moderation in the Secondary sector growth:**

The growth in industrial sector, comprising mining & quarrying, manufacturing, electricity, gas & water supply, and construction sectors moderated in 2016-17.

This is in tandem with the moderation in manufacturing, mostly on account of a steep contraction in capital goods, and consumer non-durable segments of 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.***

The contraction in mining and quarrying largely reflects slowdown in the production of crude oil and natural gas.

**Continued dominance of Tertiary sector:**

According to Economic Survey 2016-17 ,the service sector continued to be the dominant contributor to the overall growth of the economy, led by a significant pick-up in public administration, defence & other services, that were boosted by the payouts of the Seventh Pay Commission.

**OTHER MACRO ECONOMIC VARIABLES:**

**Fixed investment rate** has been declining since 2011-12. Government, in co- ordination with the Reserve Bank of India and other stakeholders, has taken a number of steps to improve the ease of doing business and to improve the balance sheet positions of banks and firms.

*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.*

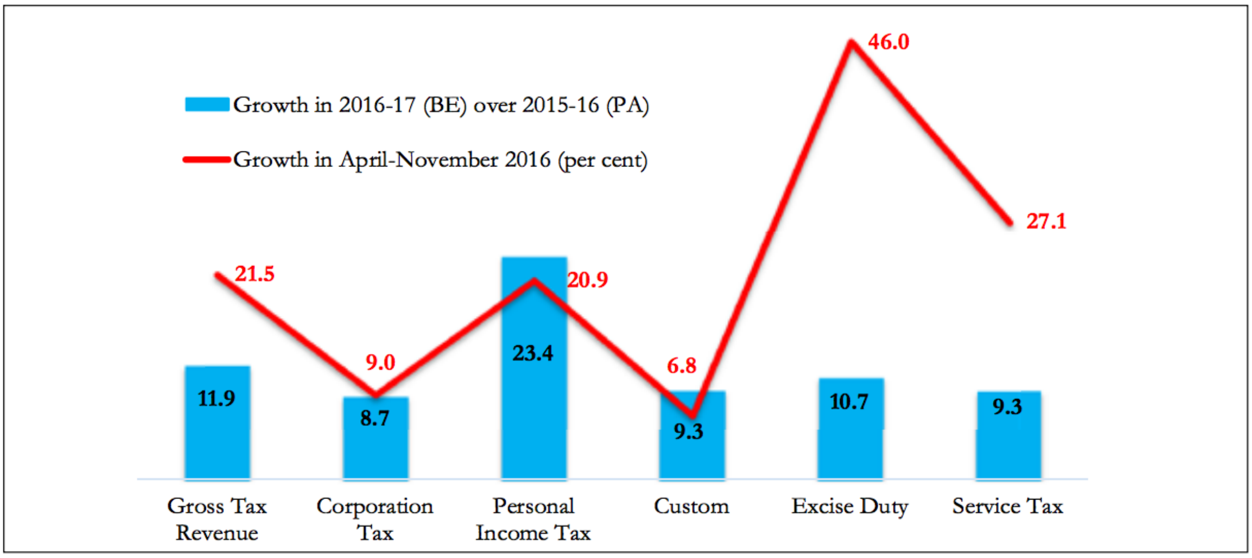
**How did the trade deficit decline?**

1. Steeper contraction in imports, compared to exports
2. The decline in merchandise trade deficit helped improve the position of net exports of goods and non-factor services in the national accounts.

**FISCAL DEVELOPMENTS:**

The buoyancy of non-debt receipts of the Union Government, consisting of net tax revenue, non-tax revenue and non-debt capital receipts during April-November 2016 supported fiscal rectitude.

**Figure 3. Growth in Central taxes (per cent)**




***Source:*** **CGA**
***Note:*** **PA: Provisional Actuals**

**Why was there a growth in Revenue expenditure?**

1. The salary component of the revenue expenditure increased by 23.2 per cent owing to the commitments under the Seventh Pay Commission.
2. Increase in subsidies, especially a 21.6 per cent surge in food subsidy.
3. increase of 39.5 per cent in the grants for creation of capital assets (GCCA) .

**Outstanding liabilities:**

The growth in the total outstanding liabilities of the Union Government remained closely similar during 2014-15 and 2015-16.

***The total outstanding liabilities of the Central Government are composed of internal debt, other internal liabilities like provident funds, small savings, etc. and external debt.***

**INFLATION:**

Headline inflation as measured by the Consumer Price Index (CPI) remained under control.

The average CPI inflation declined to 4.9 per cent in 2015-16 from 5.9 per cent in 2014-15. It was 4.8 per cent during April- December 2016.

The average inflation based on the wholesale price index (WPI) declined to (-) 2.5 per cent in 2015-16 from 2.0 per cent in 2014- 15. **The downward trend, however reversed** during the current financial year partly due to

1. Impact of rise in global commodity prices and
2. Partly owing to adverse base effect.

**Food Inflation:**

The inflation in India is repeatedly being driven by narrow group of food items. Pulses (mainly tur and urad) continued to be the major contributor of food inflation.

- *On account of the volatility of prices of pulses, a Committee on 'Incentivising Pulses Production Through Minimum Support Price (MSP) and Related Policies' was set up under the Chairmanship of Dr. Arvind Subramanian, Chief Economic Adviser, which submitted its report on 16th September 2016.*

- 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.

Sugar prices also firmed up on account of lower production and hardening of price in the international market.

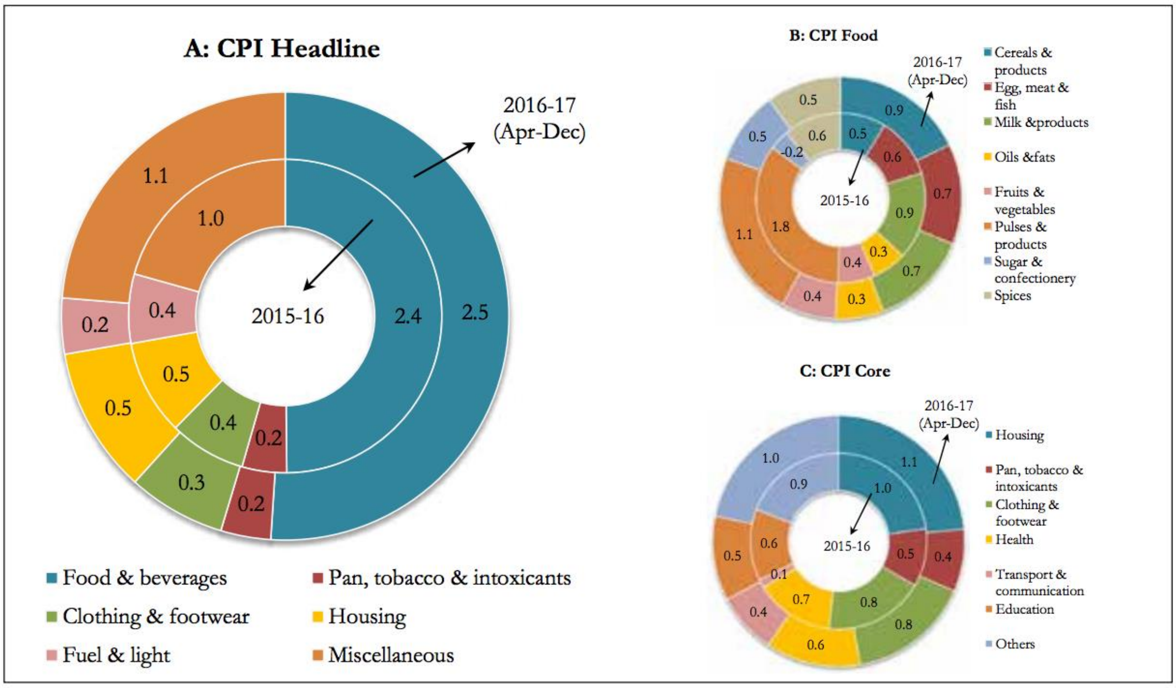
**Core Inflation:**

CPI based refined core inflation (exclusive of food & fuel group, petrol & diesel) has been averaging around 5 per cent in the current fiscal year.

**Major contributors of the core inflation:**

- Inflation for Pan, tobacco & intoxicants,
- Clothing & footwear,
- Housing and Education groups
- Transport & communication
- Higher gold price in the international market

**Figure 8. Drivers of CPI-Headline, Food and Core inflation (Contribution in percentage points)**




***Source:*** **Calculated using CPI data, CSO**

## MONETARY MANAGEMENT & FISCAL INTERMEDIATION:

### Amendment of RBI Act 1934:

The amended Act provides for inflation target to be set by the Government, in consultation with the Reserve Bank, once in every five years and further provides for a statutory basis for the constitution of an empowered Monetary Policy Committee (MPC).

** 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*

** The Government has also notified the constitution of the MPC on 29th September 2016.*

The Economic Survey 2016-17 mentions that the banking performance has been rather subdued with deteriorating asset quality. At the same time, Non-food credit grew by 10 percent and lending to industrial sector remained low at 1 percent.

**Measures to strengthen Corporate Bond market: (One need not go into the details here, just remember Khan committee and masala bonds for UPSC Prelims)**

***Khan committee*** recommendations, implemented by RBI

(a) Commercial banks are permitted to issue rupee-denominated bonds overseas (**masala bonds**) for their capital requirements and for financing infrastructure and affordable housing;

(b) Brokers registered with the Securities and Exchange Board of India (SEBI) and authorized as market makers in corporate bond market permitted to undertake repo / reverse repo contracts in corporate debt securities.

(c) Banks allowed to increase the partial credit enhancement they provide for corporate bonds to 50 per cent from 20 per cent. This move will help lower-rated corporates to access the bond market;

(d) Permitting primary dealers to act as market makers for government bonds

(e) To ease access to the foreign exchange market for hedging in over the counter (OTC) and exchange-traded currency derivatives, the RBI has allowed entities exposed to exchange rate risk to undertake hedge transactions with simplified procedures, up to a limit of US$30 million at any given time.

**Foreign Portfolio investments:**

**Negative,** (outflow from India) for the first time, since the Global Financial Crisis of 2008.

**Why?**

FPIs pulled out of most Emerging Market Economies (EMEs) in a big way due to higher returns in advanced economies.

**Balance of Payments:**

India's **current account deficit continued to decline**.

**Why?**

1. The downward spiral in international crude oil prices resulted in a decline in oil import bill by around 18 per cent.
2. Sharp decline in gold imports led to a reduction in India's overall imports

**External debt:**

World Bank's annual publication titled 'International Debt Statistics 2017', which contains the external debt data for the year 2015, indicates that India continues to be among the less vulnerable countries.

**INITIATIVES TO FACILITATE INVESTMENT & EASE OF DOING BUSINESS:**

1. Initiatives such as Make-in-India, Invest India, Start Up India and e-biz Mission Mode Project under the National e-Governance Plan.
2. Measures to facilitate ease of doing business include online application for Industrial License and Industrial Entrepreneur Memorandum through the eBiz website 24x7 for entrepreneurs;
3. Simplification of application forms for Industrial Licence and Industrial Entrepreneur Memorandum;
4. Limiting documents required for export and import to three by Directorate General of Foreign Trade; and
5. Setting up of Investor Facilitation Cell under Invest India to guide, assist and handhold investors during the entire life-cycle of the business.

**SOCIAL SECTOR EXPENDITURE:** (You can quote the figure for essay or GS Mains)

**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 |
| *of which:* | | | | | |
| 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.**

**EMPLOYMENT SCENARIO:**

- Overall employment increased by 135 thousand.

**Major contributors include:**

IT/BPOs sector, textiles including apparels and metals.

**Employment, however, declined in** gems & jewellery sector, handloom/powerloom sector, leather, automobiles sectors and transport sector

*There is a clear shift in employment to secondary and tertiary sectors from the primary sector.*

Labour sector is plagued by multiplicity of laws - 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.

**EDUCATION SECTOR:**

Issues include low learning outcomes, which has been caused by teacher absenteeism and the shortage of professionally qualified teachers.

** An option to address teacher absenteeism that can be explored is biometric attendance of all teachers in primary schools for each scheduled class/lecture/session/ distinct from the present system, where it is morning and evening to ostensibly record arrival and departures*

*Apart from the biometric attendance being regularly monitored by local communities and parents, it should also be put in public domain.*

*This should be backed by adequate teaching aids, recorded lectures, etc. to fill in for absentee teachers.*

**HEALTH:**

The aim of good health and well being for all as envisaged in the **Sustainable Development Goal (SDG) 3**, *"Ensure healthy lives and promote well being for all at all ages"*

- Life expectancy has doubled and infant mortality and crude death rates have reduced sharply.
- India's total fertility rate (TFR) has been steadily declining.
- Infant Mortality Rate (IMR) has declined to 37 per 1000 live births in 2015 from 44 in 2011. (Though gap exists between rural and urban IMR).
- 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. (Region or state wise disparities are present).

* The high levels of anaemia prevalent among women in the age group 15-49 have a direct correlation with high levels of MMR - Under the National Health Mission, Government of India has programmes to address the issue of anaemia through health and nutrition education to promote dietary diversi cation, inclusion of iron foliate rich food as well as food items that promote iron absorption.

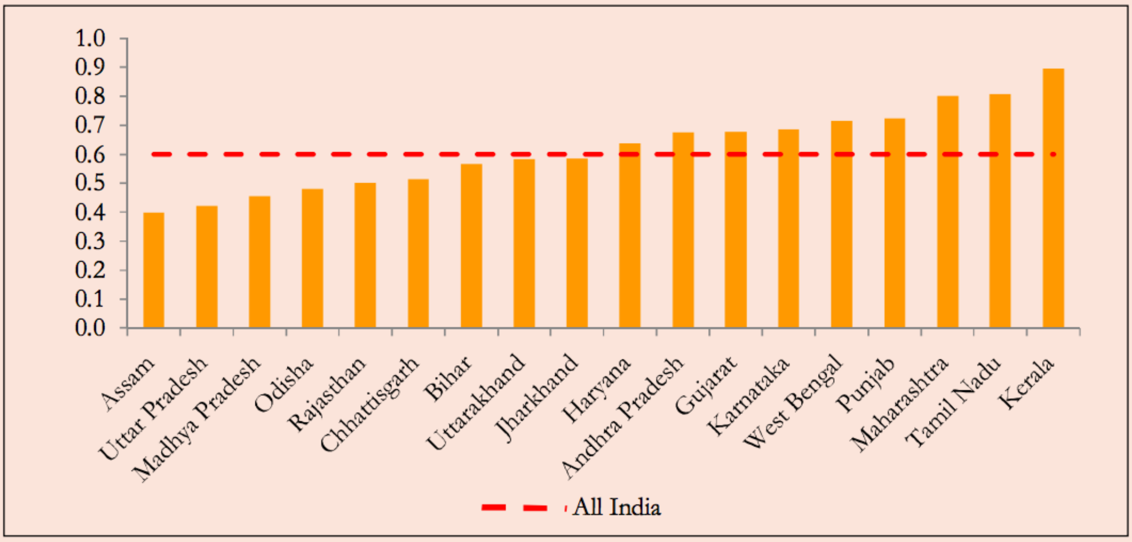
The Economic Survey 2016-17 also comes out with a Health outcome Index.

Email: selflearn.co@gmail.com


**Box 1. Experimental Health Outcome Index**

An experimental Health Outcome Index (HOI) has been computed using Life Expectancy at age 1 year (LE1), IMR and MMR as indicators. LE1 figures are from the period 2010-14. IMR and MMR figures for majority of the States are for 2011-13. The Health Outcome Indices computed by standardising the above indicators for the 18 States are plotted below.

**Figure B1. Health Outcome Index**




***Source:* Calculated by using Sample Registration System data, O/o RGI & Census of India.**

*Note:* Standardised LE1 = (Actual value-Minimum value)/ (Maximum value-Minimum value). Standardised IMR= (Maximum value-Actual value)/ (Maximum value-Minimum value). Standardised MMR= (Maximum value-Actual value)/ (Maximum value-Minimum value). Here Andhra Pradesh includes Telangana.

As per the data, Assam has the lowest health outcome index whereas Kerala has the highest. Out of the eighteen States, nine States have recorded a health outcome index higher than the All India index (0.6). Assam which has the lowest health outcome index has reported the highest MMR as can be seen in Figure 24.

**INCLUSIVE POLICIES OF GOVERNMENT:**

Economic Survey 2016-17 points out the following policies as inclusive policies :

1. Accessible India Campaign (Sugamya Bharat Abhiyaan)

** The Department of Empowerment of Persons with Disabilities (DEPwD) launched 'Accessible India Campaign (Sugamya Bharat Abhiyan)'*

*Objective: Nation-wide Campaign for achieving universal accessibility for Persons with Disabilities (PwDs).*

*Focus on three verticals:*

- *Built Environment,*
- Public Transportation and Information &

- Communication Technologies.

*'Inclusiveness and Accessibility Index' 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.*

***"Rights of Persons with Disabilities Bill – 2016"*** *passed by the Parliament aims at securing and enhancing the rights and entitlements of PwDs. The bill has proposed to increase the reservation in vacancies in government establishments from 3 per cent to 4 per cent for those with benchmark disability and high support needs.*

2. For social empowerment, the 'Nai roshni' scheme for leadership development of minority women,
3. 'Padho Pardesh', a scheme of interest subsidy on educational loans for overseas studies for the students belonging to the minority communities,
4. For skill development and economic empowerment of minorities, schemes like 'Seekho Aur Kamao' (Learn & Earn),
5. Upgrading Skill and Training in Traditional Arts/Crafts for Development (USTTAD) and
6. 'Nai Manzil'- a scheme to provide education and skill training to the youth from minority communities are in operation.

**INDIA ON CLIMATE CHANGE:**

**India ratified the Paris Agreement** on 2nd October 2016. India's comprehensive NDC target is

- To 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, and
- To create an additional (cumulative) carbon sink of 2.5–3 $GtCO_2e$ through additional forest and tree cover by 2030.

**India's renewable energy sector is undergoing transformation with a target of 175 GW of renewable energy capacity to be reached by 2022**. In order to achieve the target, the major programmes/ schemes on implementation of 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. have been launched.

Government has **amended the National Tariff Policy for electricity** (Jan 2016). The Tariff Policy amendment has a focus on the environmental aspect.

With India's initiative, **International Solar Alliance (ISA) was launched**, which is envisaged as a coalition of solar resource-rich countries to address their special energy needs and will provide a platform to collaborate on addressing the identified gaps through a common, agreed approach. 24 countries have signed the Framework Agreement of ISA.

Government of India has established the **National Adaptation Fund for Climate Change** to assist States and Union Territories to undertake projects and actions for adaptation to climate change.

India is also one of the few countries in the world to **impose a tax on coal**. This coal cess, which has been renamed as "**Clean Environment Cess**" in the Union Budget 2016-17 funds 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.

# Chapter 09: Universal Basic Income - Highlights of Economic Survey 2016-17

Union finance minister Arun Jaitley tabled the Economic Survey 2016-17 in Parliament during the first day of the budget session. Here are the major highlights from Chapter 9 of Economic Survey 2016-17.

**What is universal basic income?**

- Universal Basic Income is a form of social security paid to individuals, not households, and it is paid to everyone. That's how it becomes universal.
- It can be paid in kind (such as food or services) or in vouchers or can be a direct transfer into bank accounts to help reduce leakage.
- The government will offer about $15 a month (1,000 rupees), and only to families below the poverty line (BPL).
- It is paid at regular intervals, say monthly, not as a one-off grant.
- It is unconditional and paid without a requirement to work or to demonstrate willingness-to-work.
- Finland and Scotland are planning pilot runs. Switzerland rejected the plan.
- The virtue of this arrangement, it is claimed, is that it would eliminate poverty and yet leave some over to actually raise public investment.
- UBI is not framed as a transfer payment from the rich to the poor. Its basis is rather different. UBI gives concrete expression to the idea that we have a right to a minimum income, merely by virtue of being citizens.

**Components of UBI**

UBI has three components:

1. universality
2. unconditionality
3. agency (by providing support in the form of cash transfers to respect, not dictate, recipients' choices).

**Why should we think about UBI?**

**Social Justice:** UBI is, first and foremost, a test of a just and non-exploitative society.

**Poverty Reduction:** Conditional on the presence of a well-functioning financial system, a Universal Basic Income may simply be the fastest way of reducing poverty.

**Agency:** The poor is offered choices to determine what he / she should consume as cash transfers are made.

**Employment:** They allow for more non-exploitative bargaining since individuals will no longer be forced to accept any working conditions, just so that they can subsist

**Administrative Efficiency:** In India in particular, the weakness of existing welfare schemes enhances the case for UBI.

**State capacity:** UBI is not a substitute for state capacity: it is a way of ensuring that state welfare transfers are more efficient so that the state can concentrate on other public goods

When the trinity of Jan-Dhan, Aadhaar and Mobile (popularly referred to as JAM) is fully adopted the time would be ripe for a mode of delivery that is administratively more efficient.

**Insurance Against Risk And Psychological Benefits**

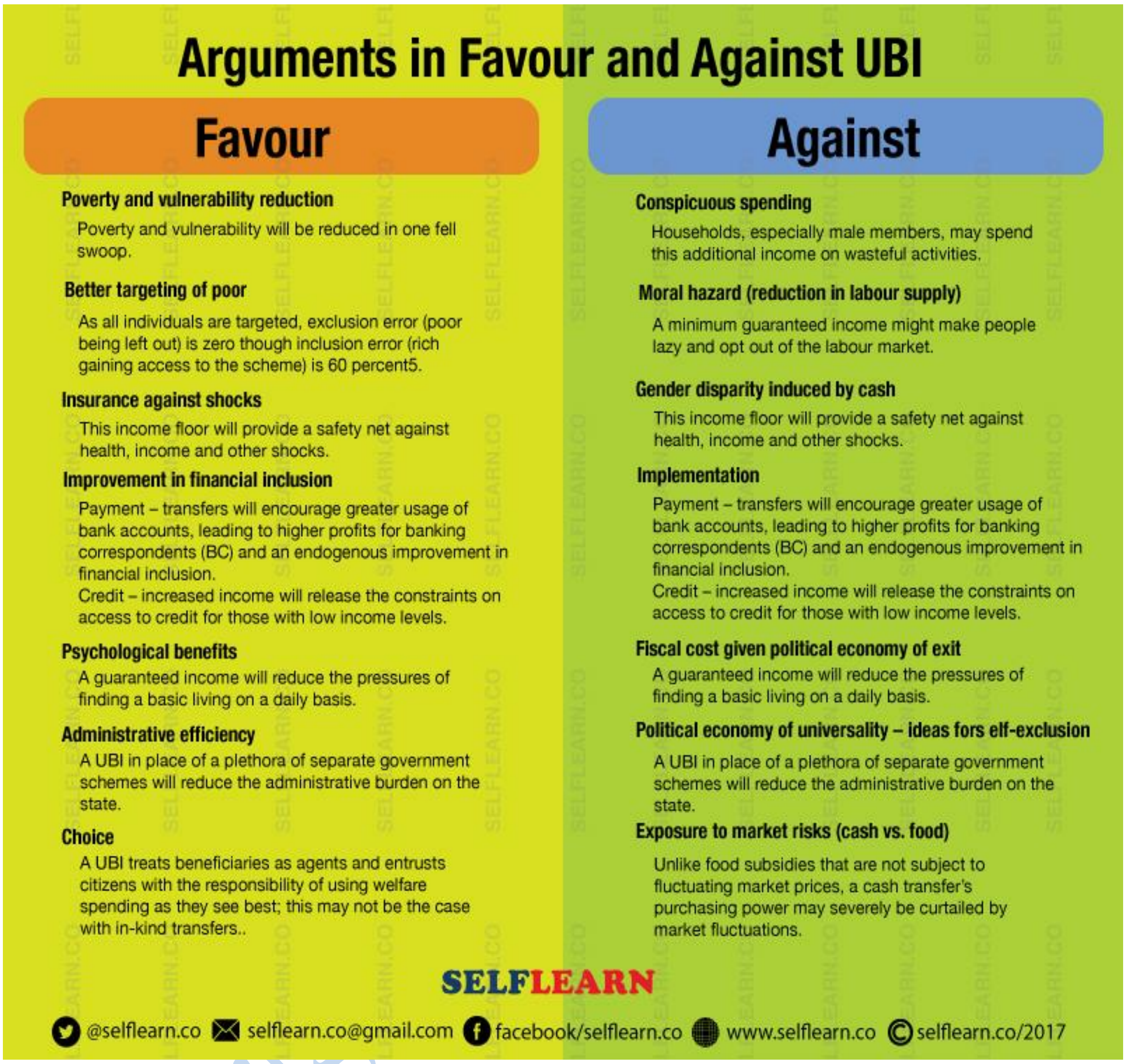
Poor households (in fact even many of those above poverty) are often faced with shocks such as bad health job loss etc. A study shows that slightly more than 50 percent of rural households across India face one or more forms of shock, with the most prominent such as crop loss, water borne diseases, loss of property, cyclones, drought, etc.

**The Conceptual Case Against UBI**

From an economic point of view there are three principal and related objections to a universal basic income.

1. **UBI reduces the incentive to work** – The levels at which universal basic income are likely to be pegged are going to be minimal guarantees at best; they are unlikely to crowd incentives to work.
2. **Should income be detached from employment?** Any society where any form of inheritance or accepting nonwork related income is allowed, already detaches income from employment. So, receiving a small unearned income as it were, from the state should be economically and morally less problematic than the panoply of "unearned" income our societies allow.
3. **Concern out of reciprocity :** If society is indeed a "scheme of social cooperation", should income be unconditional, with no regard to people's contribution to society? The short answer is that individuals as a matter of fact will in most cases contribute to society. In fact, UBI can also be a way of acknowledging non-wage work related contributions to society, for example, homemaking contributions of women are largely unacknowledged economically, this can be acknowledged through UBI.
4. **Promote conspicuous spending :** Detractors of UBI argue that, as a cash transfer programme, this policy will promote conspicuous spending or spending on social evils such as alcohol, tobacco etc. There is a general perception that cash transfers get spent on these 'temptation goods'. This is indeed a crucial point especially if UBI is expected to replace other in-kind programs such as PDS. The NSS 2011-12 data points out that these goods form a smaller share of overall budget/consumption as overall consumption increases This provides an indication that an increase in income from UBI alone will not necessarily lead to an increase in temptation goods consumption

**Why Should we go for UBI? What are the problems with the existing programmes of poverty reduction?**




The Budget for 2016-17 indicates that there are about 950 central sector and centrally sponsored sub-schemes in India accounting for about 5 percent of the GDP by budget allocation. The problems with the existing programmes are

**Misallocation**

- The poorest areas of the country often obtain a lower share of government resources when compared to their richer counterparts.
- Several districts which accounts for larger share of poor receives lesser amount. On the other hand some other districts comprising of large share of the poor receive more than-proportional share of the spending.

**Why misallocation occurs? :** One major explanation for misallocation is state capacity – resources allocated to districts are often a function of the district's ability to spend them; richer districts have better administrative capacities to effectively implement schemes.

**Consequence :** A natural consequence of misallocation is that genuine poor will be unable to access benefits of poverty eradication programmes. For instance, consider the states of Bihar, Madhya Pradesh, Rajasthan, Orissa and Uttar Pradesh: despite accounting for over half the poor in the country, these states access only a third of the resources spent on the MGNREGS in 2015-16. This almost certainly implies that some deserving individuals are left out. An estimate of the exclusion error from 2011-12 suggests that 40 percent of the bottom 40 percent of the population are excluded from the PDS.

**How can a UBI overcome the issues faced by present welfare schemes?**

**Misallocation to districts with less poor**

- The UBI, by design, should effectively tackle issues related to misallocation. Beneficiaries are simply required to withdraw money from their accounts as and when they please, without having to jump through bureaucratic hoops.
- The simplicity of the process also implies that the success of a UBI hinges much less on local bureaucratic ability than do other schemes.
- By focusing on universality, UBI reduces the burden on the administration further by doing away with the tedious task of separating the poor from the non-poor.

**Out of system leakage**

- Conceptually, a UBI reduces out of system leakage because transfers are directed straight to the beneficiaries' bank accounts.The scope for diversion is reduced considerably, since discretionary powers of authorities are eliminated almost wholly.
- UBI's expanded coverage will likely impact out of system leakage since the state is answerable to a larger section of its citizens.
- Given the fewer avenues for leakages, monitoring a UBI would be easier than many other schemes.

**Exclusion error:** By virtue of being universal, exclusion errors (error occurring when genuine poor doesn't benefit from scheme implemented for them) under the UBI should be lower than existing targeted schemes

**Better Targeting**

- An immediate and intuitively appealing solution to the fiscal costs of UBI is to make it a targeted basic income scheme, attempting to guarantee a basic income to only the poor and the deserving.
- However, India's record of targeting welfare programmes to the poor has been suspect. Recognizing this, the government of the day attempted to measure poverty using an easily identifiable list of criteria and a simple scoring methodology through the Socio-Economic Caste Census (2011).

- Simultaneously, acknowledging the inherent problems with targeting, individual states- like Tamil Nadu and Chhattisgarh - universalized access to the PDS and a few other government schemes.
- The National Food Security Act (2013), in a clear break away from targeting to a minority of the population, mandated access to the PDS to nearly 70 percent of all households, choosing to exclude only the identifiably well-off.
- This gradual move will lead to higher coverage and lower leakages.
- Technology can be the game changer in better targeting.

**Financial inclusion and UBI**

According to Financial Inclusion Insights (FII – 2015),while ownership of bank accounts has increased to about 2/3rd of all adults in India, active use has increased to about 40 percent.

Geographically, most of the country has over 50 percent of adults owning banking accounts.

**How to improve financial inclusion?**

Improving financial inclusion is both a demand and supply side challenge.

**Demand side :** On the demand side, there is a need for behavioral change on the part of account holders so that they use their accounts more often,

**Supply Side :** On the supply side, banks need to find it profitable to provide access to banking services. Increasingly, banks have been making use of BCs to provide last mile access to banking. The profitability is highly dependent on the volume of transactions per BC, and one can model scenarios where a UBI can lead to increased financial inclusion through an increased number of transactions.

**Access to Formal Credit :** A UBI can potentially also unlock credit constraints in the form of a higher income. As one moves along the consumption spectrum, the proportion of farmers taking informal loans falls and formal loans take over.

**How will we determine UBI amount?**

- The process of determining a UBI amount is not a one-time exercise: as the UBI is a cash transfer, its 'real' value tends to be determined by inflation in the economy.
- It is, therefore, important to index it to prices such that the amount gets revised periodically.
- Politics can play a huge role in determining the exact amount each time it is up for revision and so it is important to set up a sufficiently politically neutral mechanism to do so. Setting UBI as a constant share of the GDP overcomes this complication.

**Guiding Principles for Setting up a UBI**

**Universality in principle, quasi universality in practice**

If universality has powerful appeal, it will also elicit powerful resistance. In that light and keeping in mind fiscal costs, the notion of transferring even some money to the well-off may be difficult.

How to exclude well off from UBI?

Below, is a list of four by which we can exclude the rich from UBI

1. Define the non-deserving based on ownership of key assets such as automobiles or air-conditioners or bank balances.
2. Adopt a 'give it up' scheme wherein those who are non-deserving chose to opt out of the programme
3. Introduce a system where the list of UBI beneficiaries is publicly displayed
4. Self-targeting: Develop a system where beneficiaries regularly verify themselves in order to avail themselves of their UBI – the assumption here is that the rich, whose opportunity cost of time is higher, would not find it worth their while to go through this process and the poor would self-target into the scheme.

**Gradualism**

A key advantage of phasing would be that it allows reform to occur incrementally – weighing the costs and benefits at every step.

There can be different approaches of gradually adopting a UBI. The eventual goal of each approach, however, is to inform the path towards a de facto UBI.

Rather than providing a UBI in addition to current schemes, it may be useful to start off by offering UBI as a choice to beneficiaries in place of existing programs.

- It gives people agency, not only in that they have greater choice, but importantly because they have greater power in negotiating with the administrators who are currently supposed to be giving them benefits. For example, the dealer knows that if he diverts the rice for his own purposes, he faces the threat of exit – beneficiaries will switch to a UBI. Designed in this way, UBI could consequently not only improve living standards; it could also improve administration (and cut the leakage costs) of existing programs.
- However, there are at least two concerns with the process listed above: one, by allowing the UBI as a choice over current entitlements, it reinforces all the current problems with targeting. This also ensures continuity of the misallocation problem. Another problem is that this would be administratively cumbersome.

**UBI for women**

- A UBI for women can, not only reduce the fiscal cost of providing a UBI (in the form of higher social benefits) but have large multiplier effects on the household. Giving money to women also improves the bargaining power of women within households and reduces concerns of money being splurged on conspicuous goods.

- The UBI could also factor in children in a household to provide a higher amount to women.
- This addition, though, has three potential problems – one, it may not be easy to identify the number of children in a household; two, it may encourage households to have a greater number of children; and three, phasing out boys from beneficiary list once they reach a certain age (say 18 years) may not be easy to monitor and undertake.

**UBI for certain vulnerable groups**

- Another approach is to phase in a UBI for certain vulnerable groups – widows, pregnant mothers, the old and the infirm – first.
- This would serve as a means to support the most vulnerable and these are easily identifiable groups of individuals.
- Previous studies show that leakages in pensions are already low and while the maternity benefits pilots suffer from implementation problems, there is some evidence to show that they have helped smooth over medical costs for the poor. However, as things stand today, there exist exclusion errors in both these schemes. These groups of persons are less likely to have access to bank accounts and are further away from the JAM frontier.

**Prerequisites for UBI**

**JAM**

- Crucial to the success of the UBI is effective financial inclusion. Nearly a third of adults in India still do not have a bank account and are likely to be left behind.
- These are also likely to belong to the poorest social groups – women, SCs, STs, the ageing and the infirm – who benefit most from state-funded subsidies.
- In terms of JAM preparedness, considerable ground has been covered rapidly, but there is quite some way to go.
- While Aadhaar coverage speed has been exemplary, with over a billion Aadhaar cards being distributed, some states report authentication failures. Failure to identify genuine beneficiaries results in exclusion errors. It is not clear if a universal cash transfer will necessarily result in lower leakages.
- The success of the UBI hinges on the success of JAM.

**Centre-State Negotiations :**

- The UBI amount will be a crucial factor in ensuring the success of such a programme.
- A key federal question will be the centre-state share in funding of the UBI.
- This would, like the GST, involve complex negotiations between federal stakeholders. Initially, a minimum UBI can be funded wholly by the centre.
- The centre can then adopt a matching grant system wherein for every rupee spent in providing a UBI by the state, the centre matches it.

**Conclusion**

If, as appears to be the case, that thinkers on both the extreme left and right have all become its votaries, then UBI is a powerful idea whose time even if not ripe for implementation is ripe for serious discussion.

**Reference :** Economic times

# Chapter 10 - Income, Health, and Fertility: Convergence Puzzles – Highlights



Union finance minister Arun Jaitley tabled the Economic Survey 2016-17 in Parliament during the first day of the budget session. Here are the major highlights from Chapter 10 of Economic Survey 2016-17.

Despite rapid overall growth, there is striking evidence of divergence, or widening gaps in income and consumption across the Indian states, in sharp contrast to patterns within China and across the world. Compared to international standards and accounting for levels of income, India does well on life expectancy, not-so-well on infant mortality rate, and strikingly well on fertility rate.

This Chapter of the Economic Survey 2016-17 focuses on the income, health and fertility indicators and relates it to the concept of convergence, thus making a strong case for measuring performance on national and international scale.

**The indicators used in this chapter of Economic Survey 2016-17 are broadly divided into two:**

1. Income and Consumption;
2. Health and Demographic indicators

- Life Expectancy,
- Infant Mortality rate
- Total Fertility Rate

First part of this write up focuses upon the Income/ Consumption factors, second upon Life Expectancy and Infant Mortality Rate, and lastly would deal with Total Fertility Rate.

## Income and Consumption Divergences

**What is 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.

*To learn: What is Income Convergence?*

**How study on Income Convergence helps us?**

Convergence based study show that while the poorer countries are catching up with richer countries (convergence), in India, the less developed states are not catching up; instead they are, on average, falling behind the richer states. (divergence).

While 90s saw weak divergence and weak convergence for China and India, post 2000s saw convergence in China, but not in India. This is despite the indicators showing improved performance in relatively less developed states such as Bihar, Madhya Pradesh and Chattisgarh. This leads to the conclusion that the data were not strong enough to show a change in the divergence.

**How does Convergence happen?**

**Convergence happens essentially through:**

1. Trade and
2. Mobility of factors of production.

**TRADE:**

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 states/countries.

**MOBILITY:**

Trade, is really a surrogate for the mobility of factors of production.

In the context of India, we will see in Chapter 11 that India has porous borders between the States and that the trade within Indian states is quite high. Also mobility of people has surged almost by double. Yet convergence is not seen in India. This makes India stand out as an exception.

**WHY IS THIS THE CASE?**

Some derivable conclusions in such cases could be due to:

**Governance or institutional traps.**

- When we have governance traps, capital will not flow to regions of high productivity because this high productivity may be more notional than real.
- Poor governance could make 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.**

- Reliance on growth of skill-intensive sectors rather than low-skill ones
- (This is reflected not just in the dominance of services over manufacturing but also in the patterns of specialization within manufacturing).
- If the binding constraint on growth is the availability of skills, there is no reason why labor productivity would necessarily be high in capital scarce states.

- However these are not conclusive as to why convergence is not witnessed in the income and consumption side and therefore the Survey has left this as an open question.

## Health Convergence in India

This forms the second part of this Chapter.

Two key indicators of Health and demographic outcomes help us in analysing the trend in India :

1. Life Expectancy (LE) at birth; and
2. Infant Mortality Rate (IMR).

**What is Life Expectancy**?

Life expectancy at birth (LE) indicates the number of years a newborn would live if prevailing patterns of mortality at the time of its birth were to stay the same throughout its life.

*Learn FOR PRELIMS & MAINS: What is the LE in India - in 1950 and 2011?*

**What is Infant Mortality Rate?**

Infant mortality rate (IMR) is defined as the number of infants dying before reaching one year of age, per 1,000 live births in a given year.

*Learn for PRELIMS & MAINS: What is IMR/ Neo Natal Mortality rate?*

**Why Convergence is expected from Health Indicators, unlike the Income indicators?**

1. *Common availability* of many medical "technologies" such as antibiotics and other medical practices across the world and India.

- *Clear indicators on health that would "naturally lead to convergence".*

For example, once a country has reduced its infant mortality to near zero, it is fundamentally impossible for it to experience a drastic reduction while countries with high mortality rates have much more room for improvement.

**Comparison of the level of LE and IMR against a country's level of per capita GDP.**

**In LE,** the Indian states are doing about the same or better on average than their international counterparts;

**In IMR**, most states look worse in this international comparison.

*Last year's Economic Survey had Chapter on Women and Child, which specifically pointed out this anomaly. It found that children and women perhaps bear the burden of deficient systems of health delivery.*

**In short, India is doing reasonably well on life expectancy on an international scale, but on IMR has scope for improvement**

**Fertility Indicator**

**What is Total Fertility Rate?**

Total fertility rate (TFR) is defined as the number of children that would be born to a woman if she were to live to the end of her childbearing years and bear children in accordance with age-specific fertility rates in a given year.

*Learn: What is the current TFR? Which State shows the highest and lowest TFR in India?*

This area has shown one of the most striking developments over the past decade.

**In what ways?**

- Firstly, 12 Indian states out of the reporting 23 states have reached levels of fertility that are below the replacement rate (2.1).

*Know: What is replacement level?*

- Secondly, there is evidence of strong convergence across the states.

**Some important stats on TFR**

- All the Indian states (with the exception of Kerala which has attained levels of Replacement level), are performing much "better" (in the sense of more rapid fertility declines) than countries on average.
- The extent to which they are doing better is striking especially for the high TFR states such as Bihar, UP, MP and Rajasthan.
- High TFR states are in fact posting much stronger fertility declines than is true of the average country.

## Concluding remarks

- Despite growing rapidly on average, there is sign of growing regional inequality among the Indian states.
- On health and demography, there is strong evidence of convergence amongst the states in the 2000s.
- With regards to life expectancy, the Indian states are close to where they should be given their level of income.
- This is, however, not true of IMR, suggesting that the "mother and child" (Please go through Economic Survey 2015-16 Chapter Mother and Child) bear the brunt of weaker delivery of health services.
- With regard to fertility, India has a strikingly remarkable progress. in comparison to our international counterpart. These unusually large declines in fertility have strong—and positive—implications for India's demographic dividend going forward.

# Chapter 11 - One Economic India - Highlights of Economic Survey 2016-17

This chapter of the Economic Survey 2016-17 is an attempt to assess the extent to which India can bring the idea of "**ONE ECONOMIC INDIA**", similar in tune to the affirmed political "idea of India,". The assessment is based primarily on data based and juridical analysis of Indian economy and laws and thus, definitely makes an interesting and equally important study for civil services aspirants. An understanding of this chapter will help the aspirant in understanding the relation between interstate trade dynamics, effect of tax system and also legal position in relation to interstate trade and commerce. The idea here is to make out a strong case for an internally integrated one economic India, about which the CEA seems optimistic.

**This chapter of the Economic Survey 2016-17 is broadly divided into two sets** :

Section One: - **One India: Internal Trade in Goods**

Section Two: - **One India: Before the Law**

So, let's begin with the factual analysis of internal trade in goods by understanding the significance of the idea of One Economic India as described in the Economic Survey 2016-17

**Why One Economic India?**

India is highly integrated internally, with considerable flows of both people and goods and statistics and data further strengthen this.

1. Cross-border (between the States) exchanges between and within firms amount to **at least 54 per cent of GDP**, implying that interstate trade is **1.7 times larger than international trade.**
2. A non conclusive evidence also points out that **language barriers does not seem to be a demonstrable barrier** to the flow of goods.
3. The current system of **indirect taxes perversely favours interstate trade** over intra-state trade, especially in the cases of final consumption items, exempted goods, or goods that are input tax credit ineligible. However, the GST by ironing out these oddities may normalise interstate trade.
4. Intra firm trade across states is surprisingly large than Arms-length interstate trade (that is trade between firms), despite being affected by trade costs to a greater extent than interfirm trade.
5. The **Constitution favours preserving state sovereignty** over one market.

**Does India Trade Internally More Than Other Countries?**

To understand this, lets compare our inter state trade, international trade and its ratio with other countries. Please look at the table below.

| Nations | Aggregate Interstate trade |
| --- | --- |

| | |
|---|---|
| India | 54 % of the GDP |
| USA | 78% of GDP |
| China | 74% of GDP |
| EU | 20% of GDP |
| Canada | 20% of GDP |

**The data according Economic Survey 2016-17 shows that India's aggregate inter State trade is not as high as** that of the United States, but "*greater than provincial trade within Canada and greater than trade between Europe Union (EU) countries*". Further, EU countries are governed by the "*four freedoms*": allowing unfettered movement of goods, services, capital, and people.

***Lets look at another table, this one in reference to measuring the magnitude of trade by comparing countries' internal trade with their international trade.***

| NATIONS | AGGREGATE INTERNATIONAL TRADE |
|---|---|
| India | 32 % of GDP |
| USA | 31 % of GDP |
| China | 45 % of GDP |
| EU | 84 % of GDP |
| Canada | 62 % of GDP |



**This table brings out country specific understanding of its inter state trade vis-a-vis International trade.**

| NATIONS | Ratio of Inter State to International Trade |
|---|---|
| India | 1.0 |
| USA | 2.5 |
| China | 1.6 |
| EU | 0.2 |
| Canada | 0.3 |

Source: Economic Survey: 2016-17

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**Table 1. Comparisons of International and Interstate Trade Flows**

| Country | Year | Interstate/GDP | International/GDP | Ratio of Interstate to International |
|---|---|---|---|---|
| Brazil[e] | 1999 | 76% | 14% | 5.4 |
| USA[a] | 2015 | 78% | 31% | 2.5 |
| India (C+F form) | 2015 | 54% | 32% | 1.7 |
| India (C Form) | 2015 | 32% | 32% | 1 |
| China[d] | 2009 | 74% | 45% | 1.6 |
| Canada[b] | 2012 | 20% | 62% | 0.3 |
| European Union[c] | 2015 | 20% | 84% | 0.2 |
| Indonesia[f] | 2005 | 12% | 63% | 0.2 |

**a: Freight Analysis Framework Data Tabulation Tool, b: Statistics Canada, c: Eurostat, d: Xing, Whalley and Li(2015), e: Vasconcelos (2001), f: Firdaus and Widiyasanti (2010)**

Analysing these data, one finds that India's trade profile is more similar to that of China, whose internal trade is 1.6 times its international trade but less than the United States whose internal trade is 2.5 times its international. The conclusion derivable is that the **large countries trade more within their own borders than beyond them** because of the **size of their domestic markets**.

**How does interstate trade take place?**

Inter State trades take place in two ways:

1. Intra firm and

2. Arms Length Trade

**What is Arms Length Trade?**

The concept of an arms length transaction allows the market to ensure that both parties in the deal are acting in their own self-interest and are not subject to any pressure or duress from the other party.

*Source: investopedia*

However, it must be understood that comparing intrafirm and armslength trade for analysis of state pairs indicates that there is **no discernible correlation between the two types of trades** – a state open to arms length trade may not be equally amenable to intrafirm trade. Madhya Pradesh stands out as having much higher intrafirm trade than interfirm trade, possibly owing to its central location in the country, making it ideally suited to logistics supply chains.

*(P.S.: How are the estimates for interstate trade values and trade balances calculated?)*

The Government has used the TINXSYS dataset, administered and hosted by the Goods and Services Tax Network (GSTN).)

**What is TINXSYS?**

~ Tax Information Exchange System

**What explains India's Pro - Internal Trade Bias!**

Analysis from Economic Survey reflect upon a pro internal trade bias in India. The reason for this is relatable to :

1. **Area-based tax exemptions.**
2. **The current structure of domestic taxes**

**Area-based exemptions**

Eg: The Central Excise Act **exempts manufacturing in certain states from excise duty**, including all the North-eastern states, Sikkim, Jammu and Kashmir, Uttarakhand, Himachal Pradesh and Kutch in Gujarat.

This exemption **creates a strong incentive to shift real or reported production to these areas.**

Such exemptions out weigh other factor such as trade costs and other traditional determinants of trade and firm location.

**Current structure of domestic taxes- CST/VAT**

Under the current system, states levy a value-added tax on most goods sold within the state, the centre levies a near VATable excise tax at the production stage. Sales of goods across states fall outside the VAT system and are subjected to an origin-based non-VATable tax (the Central Sales Tax, CST). It turns out that the CST – far from acting as a tariff on interstate trade – **may actually provide an arbitrage opportunity away from a higher VAT rate on intra-state sales in some cases. This represents a case for tax distortion.** It is not possible to measure to what extent interstate trade in these goods is suppressed by the tax distortion.

The relatively low elasticity of trade in India with respect to distance and the comparability of India's trade to international norms seems to suggest that the pro-trade bias wins over the disincentives to trade.

**What can GST do here?**

GST when implemented would effectively eliminate such tax distortions and it "will actually lead to a normalisation in internal trade".

**Concluding remarks**

There is enormous variation across states in their internal trade patterns. Smaller states tend to trade more, while the manufacturing states of Tamil Nadu, Maharashtra and Gujarat tend to have trade surpluses (exporting more than importing). Belying their status as agricultural and/or less developed, Haryana and Uttar Pradesh appear to be manufacturing powerhouses because of their proximity to NCR.

The analysis does leave open the possibility that some proportion of India's internal trade could be a consequence of current tax distortions, which are likely to be normalised under the GST. One market and greater tax policy integration but less actual trade is an intriguing future prospect.

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*Coming to the second portion of the Chapter based solely on assessment of legal position, the constitutional position and comparative legal position, it helps derive some interesting analysis directing in favour of One Economic India.*

**Section 2: One India : Before the Law**

**India's Constitutional Provisions and Jurisprudence**

**What are the constitutional provisions that relate to trade and commerce in India?**

Part XIII of the Constitution covers Articles 301-304 which provide a layered set of rights and obligations in reference to Trade and Commerce. While Article 301, sets the principle, 302-304 elaborate upon it. A brief note on these Articles is mentioned below.

| | |
|---|---|
| Article 301 | establishes the fundamental principle that India must be a common market. |

| | |
|---|---|
| | It essentially holds that trade, commerce and intercourse throughout the territory of India shall be free. |
| Article 302 | It gives Parliament the power to restrict free trade between and within states on grounds of public interest |
| Article 303 | It imposes a most-favored nation type obligation on both Parliament and state legislatures; that is no law or regulation by either can favor one state over another |
| Article 304 | It imposes a national treatment-type obligation on state legislatures (apparently not on Parliament); that is, no taxes can be applied to the goods originating in another state that are also not applied on goods produced within a state.<br><br>But then Article 304 (b) allows state legislatures to restrict trade and commerce on grounds of public interest. |

**The gist of these provisions is that both the Centre and the States have considerable freedom to restrict trade and commerce that hinder the creation of one India.**

*(One can expect question for Prelims 2017 based on these Articles of the Constitution of India.)*

**The Evolving Jurisprudence:**

Over and above the constitutional provisions which strengthen the idea of Freedom of Trade and Commerce within India, the jurisprudence has **unsurprisingly come down** in favor of even more permissiveness.

While the purpose of Part XIII was to ensure free trade in the entire territory of India, this is far from how its practical operation has panned out.

**What has led to the difference in the Constitutional ideology and practise?**

**Financial levies** as well as **non-financial barriers** imposed by the **States** have become a major impediment to a common market.

**Financial levies in the nature of** :

- motor vehicles taxes,
- taxes at the point of entry of goods into specified local areas,
- sales tax on manufacturers of goods from outside a particular State,

have always existed between States.

The existences of these levies have been **constitutionally held valid** and have been upheld, in principle, by the Supreme Court.

In several cases where entry taxes have been challenged, the Supreme Court has upheld their validity on the ground that **these taxes are 'compensatory' in nature, which means that the proceeds from the taxes are used for facilitating trade in the charging State.**

*Why such a trend developed?*

*In looking to achieve free trade, while protecting the sovereignty of states to raise revenue, would always have led to trade-offs. The experience of past 70 years of Indian trade, thus, effectively cripples the idea of a common market.*

This view of the Court is entirely consonant with the constitutional scheme of Part XIII, which when read as a whole, seeks economic integration while ensuring considerable leeway for states to differentiate their own products from those from other states.

**LEGAL POSITION IN USA**

1. In countries like USA, the states are constitutionally barred from regulating interstate trade and commerce as it was felt that such power would **fundamentally hamper free trade and movement**.
2. A liberal interpretation is accorded in foreign jurisdictions as regards the Art. 300's counterpart.
3. The approach has been to **liberally view** the Commerce Clauses and make efforts to maintain one common US market, with restrictions applied as a matter of exceptions.

**LEGAL POSITION IN EUROPE**

In the Europe, Maastricht Treaty that created the common market, it is now accepted that countries within the EU must not, except under narrow circumstances, restrict the four freedoms of movement: of goods, services, capital, and people.

**For Prelims:**

What is Maastricht Treaty related to:

It created a common market in Europe!

*Should we follow US and EU model?*

*This is not necessarily important for the UPSC Mains exam. However, to make your thought process go a little deeper few arguments can definitely be laid here.*

There are arguments in favour and against.

It could be argued that both the US and EU are very different from India

1. long and particular histories of nationhood
2. Indian states are more diverse than states within the US and hence require greater freedom of tax and regulatory maneuver.

The counter-argument would be that

1. The American states were always fiercely jealous of their sovereignty and that the Constitution embodies that.
2. The strong interstate commerce clause exists despite strong states.
3. The states within India should have more regulatory freedom than sovereign countries within Europe.

**Indian position with the developments in WTO Law**

The WTO imposes a most favoured-nation and national treatment requirement just as the Constitution does.

But the key difference with the Constitution is the freedom provided to depart from these anti-protectionism requirements. The contrast is really between Articles 302 and 304 (b) of the Constitution and Article XX of the General Agreement On Tariff and Trade (GATT) WTO. It can be understood from the following:

a. **Idea of "public interest" in Constitution**

The reasons for invoking departures from free trade/ common market principles are more clearly and narrowly specified in the WTO than in the Constitution which instead refers to an open-ended "public interest."

b. **Criteria for departure from norms**

In the WTO, the measure must not constitute arbitrary discrimination; must not be a form of disguised protectionism; and above all must be "necessary."

**The key point is that in the WTO the departures from a common market across widely varying countries is quite heavily circumscribed whereas similar departures between states within India is easily condoned by the Constitution and consequent constitutional jurisprudence.**

***For Prelims:***

*Know about:*

*~ WTO*

*~ GATT*

*Quotes useful for Mains - on WTO (GS2/GS3)*

*The WTO has a membership of 164 countries with widely varying income levels and political systems.*

*The ratio of per capita GDP of the richest countries is more than 60 times that of the poorest, while the corresponding ratio within India is less than 5.*

*The WTO has democracies like the US and Europe and non-democracies like China whereas all Indian states are democratic. So, it cannot possibly be argued that the Indian states should have greater freedom than countries in the WTO on the issue of creating a common market*

**One thing becomes simple from the above analysis.**

1. **India cannot embrace the strong standards** of a common market prevalent in the US and EU, due to practical complexities.
2. It would be in the **nation's interest** to "*at least aspire to the weak standards of a common international market embraced by countries around the world*".

**Concluding remarks**

The context has changed today. At the time of the drafting of the Constitution, and given the considerable anxieties of holding together a large and disparate nation, the demands for respecting states' sovereignty were understandably strong. Nearly 70 years on, the sense of nationhood and unity is strong, and anxieties about territorial integrity have faded. **Cooperative federalism is becoming an increasingly important governance dynamic**. Reflecting this, the country has unanimously passed **a landmark Constitutional amendment to implement the GST** which should result in a common market.

**Can we go ahead with this idea of One Economic India?**

The evidence of this chapter and a review of Indian history suggests that on the question of creating one economic India, technology, economics, and politics have been surging ahead. Perhaps, it is time for the Constitution to catch up to further facilitate this surging internal integration.

# Chapter 12 - India on the Move and Churning - Highlights of Economic Survey 2016-17



Chapter 12 of the Economic Survey 2016-17 talks about labour migration and the prevailing economic conditions in the country. The Economic Survey conducts an extensive study to arrive upon various conclusions. This chapter is not that important for UPSC Prelims, but topics such as migration, urbanization, female labour force etc can be a part of your Mains examination.

The traditional view, based on a straightforward reading of the 2001 Census, is that the stock of migrants in India is low (around 33 million), and not increasing very rapidly.

**Existing environment related to migration:**

1. There exist discouraging incentives such as domicile provisions for working in different states,
2. Lack of portability of benefits, legal and other entitlements upon relocation.

**Three findings related to Indian migration and movement of people:**

- India is increasingly on the move – and so are Indians. Annually inter-state labour mobility averaged 5-6 million people between 2001 and 2011, yielding an inter-state migrant population of about 60 million and an inter-district migration as high as 80 million.
- Migration is accelerating. In the period 2001-11, according to Census estimates, 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.
- While internal political borders impede the flow of people, language does not seem to be a demonstrable barrier to the flow of people.

The growth rate of migrants rose spectacularly to 4.5 per cent per annum, while the workforce growth rate actually fell. Thus, the migrants' share of the workforce rose substantially. ***A breakdown by gender reveals that the acceleration of migration was particularly pronounced for females.***

The Economic Survey 2016-17 also mentions the term "Circular migration" (It states that labour migration in India tends to be circular in nature in both short and long-term migration streams and is not adequately captured by Census data).

****Circular migration or repeat migration is the temporary and usually repetitive movement of a migrant worker between home and host areas, typically for the purpose of employment.***

**Facts about migration in India:**

1. 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.

2. Out-migration rates increased in Madhya Pradesh, Bihar and Uttar Pradesh and have dipped in Assam.
3. The sum of all the out-of-state net migrants in the 20-29 age cohort for the period 2001-11
4. Until the 2000s, migration was largely a male dominated phenomenon. But in the 2000s there was a marked shift in the distribution for females.

The Economic Survey 2016-17 also uses net annual flows of unreserved passenger travel as a proxy for work-related migrant flow.

1. There is an interesting dynamic between Gujarat and Maharashtra where Surat has started acting as a counter magnet region to Mumbai and attracts migrants from the neighboring districts of Maharashtra. Other counter- magnet region dynamics are observed in Jaipur and Chandigarh (to Delhi).

*The Economic Survey 2016-17 utilizes several gravity models and CMM econometric studies to arrive upon findings regarding Migration. As an UPSC aspirant, you need not worry about these models since it wouldn't be a part of your Civil Services examination.*

1. The patterns of migration – less affluent states and districts evince higher out-migration, and rich metropolises attract large inward flows of labour.

The Economic Survey also predicts an increasing rate of growth of migrants over the years.

**Initiatives to sustain the migration momentum:**

1. Portability of food security benefits, healthcare,
2. A basic social security framework for the migrant is crucial – potentially through an interstate self-registration process.
3. Enhancing financial inclusion for migrant workers and family.

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# Chapter 13 - The 'Other Indias' - Highlights of Economic Survey 2016-17

Chapter 13 of the Economic Survey 2016-17 focuses upon various development models found in India and how far states have progressed since Independence. The survey here notes that the government has been less than efficient in providing redistributive justice and promoting social welfare.

Economic Survey 2016-17 identifies three successful models of development found in Peninsular India:

1. The traditional East Asian mode of escape from development based on manufacturing (Gujarat and Tamil Nadu);
2. The remittance-reliant mode of development exemplified by Kerala;
3. "Precocious India" model based on specializing in skilled services (Karnataka, Andhra Pradesh and Tamil Nadu.

There are two other models visible (less developed states), notably,

1. Those based on "aid" or special status - The "aid" model is most applicable to the erstwhile 'Special Category' states that includes North-eastern states and Jammu and Kashmir;
2. Those based on natural resources - the natural resources model to Jharkhand, Chhattisgarh, Odisha, Gujarat and Rajasthan.

The Economic Survey brings in another reference - "***Dutch disease***", named after the impact that discovery of natural gas in the North Sea had on the domestic economy in the Netherlands.

**This windfall caused the real exchange rate to appreciate as the extra income was spent domestically, pushing up the price of non-tradeables, such as services geared to the local economy. The higher prices for services then eroded profitability in export and import-competing industries, de-industrializing the economy, with the share of manufacturing in the economy falling.*

**How can development be achieved?**

1. Through foreign aid
2. Through government aid in the form of transfers and other funds.
3. Through utilizing its own natural resources.

Indian development model has largely focused on redistribution through extensive transfers to certain poorer states in an attempt to spur their development.

Economic Survey 2016-17 goes onto introduce another concept - ***'Redistributive Resource Transfers' (RRT)*** - *RRT to a state is defined as gross devolution to the state adjusted for the* *respective state's share in aggregate gross domestic product. Thus RRT is not identical to gross devolution.*

The higher the RRT:

- The slower is growth. 
- The smaller is the share of manufacturing in GSDP. 
- The lower is own tax revenues. 

Another concept mentioned in the Economic Survey is ***"Resource curse"*** - economies with abundant natural resources have actually tended to grow less rapidly than resource- scarce economies.

*The above incidence of resource curse is attributed to*

1. Exploitation of natural resources generates rents, which lead to rapacious rent seeking (the voracity effect) and increased corruption.
2. Natural resource ownership exposes countries to commodity price volatility, which can destabilize GDP growth.
3. Natural resource ownership – like foreign aid -- makes countries susceptible to "Dutch Disease"

Analysis in the Economic Survey reveals that mineral rich newly formed Indian states like Jharkhand, Chhattisgarh and Odisha too have fallen to this very trap of "Resource Curse", albeit with some improvement in overall social indicators.

**PATH AHEAD TO REDISTRIBUTIVE JUSTICE & FURTHER DEVELOPMENT AS MENTIONED IN ECONOMIC SURVEY 2016-17**

- **Improving Infrastructure and Connectivity:** Enhancing connectivity - financial and physical - on a war footing (as the government has attempted for financial inclusion with the Pradhan Mantri Jan Dhan Yojana (PMJDY), expediting the optical fibre network, etc.) will have a moderating effect.

1. **Redirecting flows to households:** One possibility would be to redirect a certain portion of RRT and channel the resources directly to households as part of a Universal Basic Income (UBI) scheme.
2. **Conditioning transfers on fiscal performance:** Another possibility would to find ways to offset the fiscal bias uncovered by the above analysis, in which higher resource flow leads states to relax their own tax effort.
3. **Making governance- contingent transfers:** To encourage better governance and sound institutional practices, the fund transfer mechanism could explicitly include a few monitorable institutional indicators as criteria for receiving transfers.

4. **Mines and Minerals (Development and Regulation) Amendment Act**, 2015 included the following in the Act:

- *Establishment of a trust, to be called the District Mineral Foundation (DMF) for districts affected by mining related operations.* 

- The composition and functions of DMF are to be prescribed by the respective State governments. The foundation shall work for the benefit and interest of persons affected by mining related operations. 

1. **Citizen's participation:** One way to increase citizens' participation is via creation of a dedicated Fund to which all mining revenue must accrue. 
2. **An alternative structure** would be to redistribute the gains from resource use directly into the accounts of the concerned citizens as part of a UBI.

# Chapter 14 - From Competitive Federalism to Competitive Sub-Federalism - Highlights of Economic Survey 2016-17

Chapter 14 of the Economic Survey 2016-17 focuses on attempt to make cities entrusted with responsibilities, empowered with resources, and encumbered by accountability so as to make them effective vehicles for competitive federalism and, indeed, to unleash competitive sub federalism.

**What's Competitive sub federalism according to economic survey 2016-17?**

The term 'competitive sub - federalism' has been used in close reference to highlighting the importance that urbanisation play in Indian development. Accordingly, the cities that are entrusted with responsibilities, empowered with resources, and encumbered by accountability can become effective vehicles for unleashing dynamism so that to competitive federalism India can add, and rely on, competitive sub-federalism.

**Why study on Urbanisation is important for India?**

Urbanisation will define the trajectory of Indian development.

The exodus of rural Indians into the cities over the coming decades will pose tremendous challenges for government.

The municipalities are primarily responsible for providing the services that the new migrants – and established residents – will need. So a performance analysis of ULBs is imperative for the nation to seize the opportunities that migration to the centres of economic activity can create.

For GS Mains:

Rising Urbanisation trend

| | |
|---|---|
| 1991 | ~ 220 million Indians living in cities |
| 2011 | ~ 380 million |
| Urban Indians | One third of the population - constitutes 3/5th of GDP |

Before we understand the content in the Chapter, we need to be clear with the basics on development of urban areas.

**What are the recent initiatives by the Government on urban rejuvenation?**

Impetus for many recent initiatives basically emanates from the higher grants to ULBs through the Fourteenth Finance Commission (FFC) for 2015-2020. It is estimated to be almost 277 per cent higher than the grant recommended by its 13th FC.

Higher devolution of taxes to the states and grants to the ULBs leads to increase in the overall public funds available for urban rejuvenation. This led the Government to launch several new initiatives to rejuvenate urban areas, as a follow up to JNNURM of 2005.

**Some of the key schemes are -**

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Smart Cities Mission | AMRUT | Swachh Bharat Mission (SBM) | HRIDAY | Digital India | Skill development | Housing for All | Metro transport |

The emphasis is now laid on strong convergence between area based and project-based schemes so as to exploit synergy and optimize benefits while avoiding costs overlap.

**Smart Cities Mission**

**1. What is Smart Cities Mission?**

Smart Cities Mission (SCM) is a holistic city rejuvenation programme for 100 cities in India.

The SCM initially covers five years (2015-16 to 2019-20) and may be continued thereafter based on an evaluation.

**2. What are the core infrastructure elements in a smart city?**

This includes:

1. adequate water supply,
2. assured electricity supply,
3. sanitation, including solid waste management,
4. efficient urban mobility and public transport,
5. affordable housing, especially for the poor,
6. robust IT connectivity and digitalization,
7. good governance, especially e-Governance and citizen participation,
8. sustainable environment,
9. safety and security of citizens, particularly women, children and the elderly, and
10. health and education.

**3. How is area-based development in the SCM made achievable?**

The components to area based development in the SCM include:

- city improvement (retrofitting),
- city renewal (redevelopment) and

- city extension (greenfield development)

It also includes a pan-city initiative in which smart solutions are applied covering larger parts of the city.

**AMRUT**

**1. What is AMRUT?**

Expanded, AMRUT is Atal Mission for Rejuvenation and Urban Transformation (AMRUT).

**2. What does it seek to achieve?**

AMRUT aims to improve basic urban infrastructure in 500 cities/ towns which would be known as Mission cities/ towns.

It aims to cover all cities and towns with a population of over one lakh with notified Municipalities, including Cantonment Boards (civilian areas) and certain other cities like capital towns, some cities on stem of main rivers and tourist and hill destinations.

**Its operational period:** Five years from financial year 2015–16 to 2019–20.

**3. What are the core infrastructure elements in AMRUT?**

The components which are to be covered under the AMRUT are:

- water supply,
- sewerage,
- septage,
- storm water drains,
- urban transport, in particular, with the focus on facilities for non-motorised transport and
- development of green space and parks with special provision for children-friendly components in 500 cities & towns.

**HRIDAY**

**1. What is HRIDAY?**

National Heritage City Development and Augmentation Yojana (HRIDAY) scheme launched in 2015, focuses on holistic development of heritage cities.

**2. What does it seek to achieve?**

The scheme aims to preserve and revitalise soul of the heritage city to reflect the city's unique character by encouraging aesthetically appealing, accessible, informative and secured environment.

**Operational period:**

A duration of 27 months (completing in March 2017) and a total outlay of $ 500 crore, in a mission mode.

**3. What are the places where the HRIDAY project is implemented?**

The scheme is being implemented in 12 identified cities namely, Ajmer, Amaravati, Amritsar, Badami, Dwarka, Gaya, Kanchipuram, Mathura, Puri, Varanasi, Velankanni and Warangal.

Swachh Bharat Mission

**1. What is the Swachh Bharat Mission (SBM)**

Launched on 2nd October, 2014, SBM is a mission with a target to make the country clean by 2nd October, 2019.

All 4041 statutory towns as per census 2011 are covered under SBM.

**2. What are the components of SBM?**

The programme includes

- elimination of open defecation,
- conversion of unsanitary toilets to pour flush toilets,
- eradication of manual scavenging,
- municipal solid waste management and bringing about a behavioural change in people regarding healthy sanitation practices.

Under the solid waste management state/cities are being encouraged to come out with innovative solutions and MoUD supports them technically and financially. Some of the initiatives being taken are waste to energy, composting plants, capping of the dumpsites.

*Coming back to the basics on urban bodies,*

**Who has the primary responsibility for development of urban areas?**

This responsibility lies with the state governments and the municipal corporations, municipalities and nagar panchayats, commonly known as urban local bodies (ULBs).

**What are ULBs?**

The 74th Constitutional Amendment Act of 1992 provides for the ULBs as the third tier of government and 'recommends' that state governments assign them a set of 18 functions under the Twelfth Schedule.

What are the Challenges faced by these levels of government?

1. Poor governance capacities,
2. Large infrastructure deficits and
3. Inadequate finances.

Discussing each of them in brief is essential.

**a. Poor Governance Capacities**

What are the issues faced in governance?

i. Functional overlap

   Cities do not have a single city government or a local self-government. This leads to functional overlap.

ii. Fragmentation of responsibilities and service delivery across a gamut of institutions:

   The municipality, state departments (Police, PWD, Health, Education, Housing), and parastatal agencies or civic agencies reporting directly to the state government.

iii. Transparency Issues/ Accountability Issues

   Lack of most basic information on ULBs finances and poor quality of basic services.

(One cause identified for this has been non uniform implementation of e-governance.)

**b. Large infrastructure deficits**

Productive and healthy urbanisation requires efficient public services delivery.

What are the challenges faced in relation to infrastructure?

- water and power supply,
- waste management,
- public transport,
- education,
- healthcare,
- safety, and
- pollution.

Examples:

- The Millennium Development Goal (MDG) has placed a target of 77 per cent while India has managed to provide access to only 63 per cent of the population by 2015.
- As per the ranking of global cities based on urban infrastructure (State of World Cities 2012/13), New Delhi and Mumbai are placed at 47th and 50th positions, respectively, showing comparatively lower levels of infrastructure in these cities.

**c. Inadequate finances**

Please take a brief look at the following data:

| | |
|---|---|
| $ 39 lakh crore (at 2009-10 prices) - | required for creation of TOTAL urban infrastructure over the next 20 years. |
| 44 per cent of this amount | needed for roads |
| 20 per cent of this amount | for services such as water supply, sewerage, solid waste management and storm water. |
| $20 L Crore | Separately for operation and maintenance (O&M). |

Mobilisation of resources, therefore, is quite essential to resolve the above challenges and bring India into the trajectory of development through the urban regions.

**How can resource be mobilised?**

These resources could come from the Centre and the states.

The Fourteenth Finance Commission (FFC) has recommended a grant of around $ 87,000 crore to the municipalities for the period 2015-20, constituting assistance of around $ 500 per capita per annum on average.

The rest of the required funds would have to come from local resources.

**What are the issues faced in raising sufficient resources from local resources.**

1. The 74th amendment to the Constitution which provides for constitution of ULBs, however, leaves it to the discretion of state legislatures to devolve finances so that ULBs can fulfil these functions.(It is important to know that there are glaring inter stat disparities in terms of functional and financial powers to the ULBs. Some states have not even allowed the municipalities to levy property taxes.)
2. Exercising the powers has proved difficult.
3. Municipal own income comes from taxes; user fees; and domestic borrowing:
4. Non bouyant source of revenue:Problems of low coverage, low rates, low collection efficiency, and lack of indexation of property values
5. Inability to levy adequate user charges to cover even the operation and maintenance costs.
6. Issuing municipal bonds has been challenging owing to the poor state of ULB finances and governance.

**The end result of these problems have been that :**

1. Cities face grave difficulties in securing sufficient revenues.
2. Own revenue as a share of total expenditure is low.

3. Per capita expenditure is too low in most of the ULBs with few exceptions such as Mumbai and Pune.

**Where and how would the ULB mobilise its resources?**

Many factors, together with power to impose taxes, are important for being able to collect greater revenues. This includes:

1. size of the tax base
2. Efficiency in tax collection
3. Level of economic activity in the city area.

Under point (i) immediately above, reference was raised on Property tax!. Amongst all, the greatest immediate scope for revenue comes from the property tax. However, the evidences show that (Bhopal and Ranchi, for example) revenue realisation from property tax has been poor.

The major factors contributing to poor realisation from property tax are:

- the poor assessment rate,
- weak collection efficiency,
- flawed methods for property valuation,
- loss on account of exemptions, and
- poor enforcement.

It is an estimate and expectation in the Survey that cities could increase their resources five to twenty fold if all efforts are directed at realising potential of property taxes.

**CONCLUDING REMARKS**

The challenges that the urbanisation can place upon our municipalities are many. However, this can be over when focus is shifted to certain priority areas:

**1. Empower ULBs financially.**

Why this is important?

The analysis shows that municipalities that have generated more resources have been able to deliver more basic services.

Property tax potential is large and can be tapped to generate additional revenue at city level.

What can be done?

The states should empower cities to levy all feasible taxes.

Municipalities also need to make the most of their existing tax bases.

There is a need to adopt the latest satellite based techniques to map urban properties.

The Government should leverage the Indian Space Research Organization (ISRO)/ National Remote Sensing Agency (NRSA) to assist ULBs in implementing GIS mapping of all properties in the area of a ULB.

**2. ULBs need to be empowered but political economy challenges exist**.

This is essentially in the form of higher level bodies (state governments) needing to cede power and sharing resources. This is particularly daunting.

To address this dilemma, we have two options open:

1. Finance Commissions should take cognizance of this political economy challenge and allocate even more resources to ULBs.
2. Respect the sovereignty of states and hope that they will themselves be forthcoming in decentralizing down – fiscally and governance wise – commensurate with the needs of urbanisation.

**3. Role of Data and Transparency**

MoUD should give greater priority to compile and publish comprehensive data on ULBs and urban sector.

Grants to ULBs should be more tightly linked to comprehensive and updated data disclosure and transparency by ULBs.

NITI Aayog should compile comparative indices of municipalities' performance annually based on the actual accountability and administrative capacity to deliver the core public services.

**Look at the QUESTION FOR GENERAL STUDIES MAINS Paper 3 -2016**

What are 'Smart Cities? Examine their relevance for urban development in India. Will it increase rural-urban differences? Give arguments for Smart Villages' in the light of PURA and RURBAN Mission.

Just to know:

**What is Zipf's Law?**

According to this law, used in economic circles, it claims that the city with the largest population in any country is generally twice as large as the next-biggest; three times the size of the third biggest, and so on. However, India faces a peculiar type of situation which is deviating from this model. We have a situation where the large cities and small cities are unusually small.

**Why are large cities are unusually small?**

Possible explanations:

- Overburdened infrastructure
- Scarcity of land resource

This discouraging migration particularly because distorted land markets render rents unaffordable.

By 2050, its land-to-population ratio will have declined fourfold relative to 1960, and India will be amongst the most land-scarce countries in the world

- Limited mobility due to strong place based preferences embedded in deep social networks in India.

That is, India's urbanisation rate should begin to converge with those in similar emerging markets, rising to 40 per cent by 2030. And much of this urban growth is likely to take place in the bigger cities, possibly bringing the country in line with Zipf 's Law.

## Also Read : Top 10 Key Highlights of Economic Survey 2016-17 for UPSC Aspirants

## Also Read: 8 Facts about Economic Survey

## Also Read: All you want to know about Budget

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