Economic Development

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Inclusive Growth

<u>PPP - Issues & Recommendations</u>

1. Centre - State coordination
    1. The Centre and the State have different levels of jurisdiction in different things needed for the success of PPP projects. Land acquisition, power, water supply is the responsibility of the State Government without which no project can function. Similarly the ability of the State Government to develop a port can be substantially jeopardized by ineffective decision making regarding security or custom arrangements at the Central level.
    2. Obtaining of clearances related to defence, airspace and environment.
2. Enhancing viability of the projects
    1. VGF from government.
    2. Structuring them to make them bankable.
    3. Deepening of the debt market and facilitating long term debt.
3. Selection of land, acquisition thereof and resettlement and rehabilitation of displaced persons
    1. Creation of land pools/land banks. The States should identify the lands available for infrastructure development. All such identified land could be pooled together and offered to prospective project developers. The creation of such land pools would significantly reduce the cost of acquisition and also lead to faster implementation of the projects.
    2. Displaced people must get a meaningful share of the rise in land prices due to development.
4. Capacity building at various levels
    1. Proper structuring of PPPs contracts and documentation is essential.
    2. Establishment of SPV for project execution.

<u>Inclusive Growth</u>

Need

1. Sustainable growth requires high human capital. It needs skilled, educated, healthy workers.
2. Politically and socially non inclusive growth is not sustainable. LWE, terrorism, communalism, caste wars can be the issues. So inclusive growth flows directly from the Preamble, DPSP.
3. Moral considerations.
4. Human rights considerations.

Challenges

1. Political commitment is lacking.
2. Laws and policies need to be aligned.
3. Governance challenges.
4. Crony capitalism.
5. Physical and social infrastructure needs to be built up.
6. Inequality.

Amritsar-Delhi-Kolkata Industrial Corridor (ADKIC) Project

1. Set on of DMIC, the ADKIC will boost industrial development along the Eastern Dedicated Freight Corridor (DFC) that connects Ludhiana in Punjab with Dankuni near Kolkata.
2. The ADKIC not only has a wider spread but also touches the more densely populated and less developed States like UP, Uttarakhand, Bihar and Jharkhand.
3. The region accounts for about 40 per cent of the country's population and has been crying for development.
4. The eastern industrial corridor will also enhance the importance of the inland waterway system by navigating the Ganga.

Q. Manishankar Aiyyar Report on PRIs

1. Direct transfers to PRIs.
2. Untied grants.
3. Grants to go into capacity building of PRIs.

Q. BRGF

Q. Higher Education Cooperation Initiative Between India and US

Q. Good economics, bad politics etc. explore all combinations.

Investment Models for Funding Infrastructure in 12th Plan

FIPB vs CCEA vs CCI

1. If project worth is < Rs. 1200 crore, FIPB approval is sufficient. If project is worth more, then after FIPB approval, CCEA approval is also needed. CCI is a high level coordinating body.

SEZ

1. This year in the Public Trade Policy, the minimum land requirement for multi product SEZs has been reduced to 500 ha (from 1000 ha), single product SEZ to 50 ha and no minimum limit for IT based SEZs.
2. MAT and dividend distribution tax will be levied back on SEZ.

NIMZ vs SEZ

1. Minimum size is 5000 ha.
2. No tax benefits in NIMZ except SMEs.
3. Focus is manufacturing in NIMZ, focus is exports in SEZ.
4. NIMZ has a separate municipal setup of its own.
5. NIMZ is executive decision, SEZ has statutory backing.

Q Since 1991 what is the relevance of land reforms / New dimensions of land reforms?

1. Focus of 12th FYP is on tenancy reforms and group farming.
2. Pool land and then lease it out to small and marginal farmer, women.
3. Kerela model: make SHGs of poor farmers and then lease.

Issues Arising

Special Category States

Criteria for Special Category Status

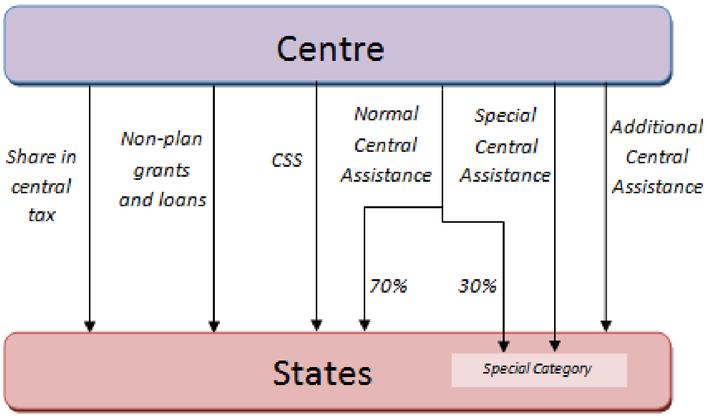
1. The rationale for special status is that certain states, because of inherent features, have a low resource base and cannot mobilize resources for development.
2. Some of the features required for special status are:
    1. Hilly and difficult terrain.
    2. Low population density or sizeable share of tribal population.
    3. Strategic location along borders.
    4. Economic and infrastructural backwardness.
    5. Non-viable nature of state finances.

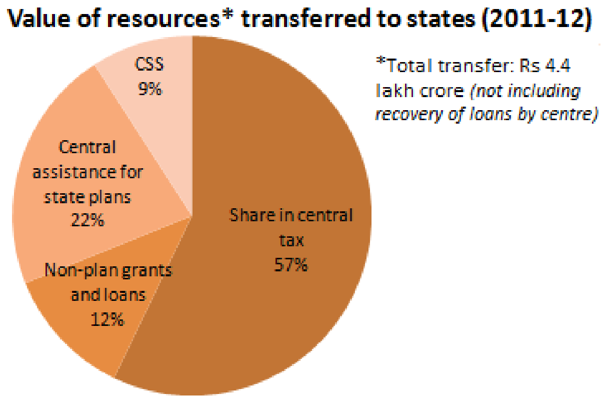
Benefits of Special Category Status

1. PC allocates funds to states through central assistance for state plans. Central assistance can be broadly split into three components:
    1. Normal Central Assistance (NCA) ~ 20% of total central plan assistance to states i.e. 5-6% of the total transfers.
    2. Additional Central Assistance (ACA).
    3. Special Central Assistance.
2. NCA, the main assistance for state plans, is split to favor special category states: the 11 states get 30% of the total

assistance while the other states share the remaining 70%. It is split into 90% grants and 10% loans for special category states, while the ratio between grants and loans is 30:70 for other states.

3. For allocation among special category states, there are no explicit criteria for distribution and funds are allocated on the basis of the state's plan size and previous plan expenditures. Allocation between non special category states is determined by the Gadgil-Mukherjee formula which gives weight to population (60%), per capita income (25%), fiscal performance (7.5%) and special problems (7.5%).





1. But what benefits would Bihar actually get if it is made into a special category state? During the Eleventh Plan, under the Gadgil-Mukherjee formula, the Bihar's share in total NPA was 11%, 2nd highest among all non-special category states.
2. Besides the higher assistance to special category states, tax breaks for excise duty as well as income tax exemptions are also available for setting up of industries within their territories.
3. Even though the number of special category states has increased from only three to 11 between 1969 and now, the kitty of 30% of the central Plan funds has remained unchanged. As a result, the share of individual states within the category had declined.
4. As per the 2013-14 budget, the total central assistance to states is Rs 1.3 lakh crore, of which the NPA is only Rs 27,636 crore, and about a third of this money would only go to the special category states.

Raghuram Rajan Committee to Determine Backwardness.Criteria

1. Chidambaram argued for inclusion of HDI indicators in determining whether a state is backward or not.
2. Backward states will also benefit from BRGF.

Employment
Planning
Growth and Development
Effect of Liberalization
Industrial Policy
Investment Models
Mobilization of Resources

FDI Restrictiveness Index (FRI)

1. Despite successive moves to liberalize the FDI regime, India is ranked fourth on FRI compiled by OECD.
2. FRI gauges the restrictiveness of a country's FDI rules by looking at the four main types of restrictions:
    1. Foreign equity limitations.
    2. Screening or approval mechanism.
    3. Restrictions on the employment of foreigners as key personnel.
    4. Operational restrictions.
3. A score of 1 indicates a closed economy and 0 indicates openness. FRI for India in 2012 was 0.273 (it was 0.450 in

2006 and 0.297 in 2010) as against OECD average of 0.081.
4. China is the most restrictive country as it is ranked number one with the score of 0.407 in 2012 indicating that it has more restriction than India.

Government Budgeting

Budgeting Techniques

The Line Item Budget

1. Here individual items are grouped by cost centers or departments.
2. It also shows the comparison between the data for the past budgeting periods and estimated figures for the current period.
3. These line items include detailed ceilings on the amount a unit would spend on salaries, traveling allowances, office expenses, etc. The focus is on ensuring that the agencies or units do not exceed the ceilings prescribed.
4. A central authority or the Ministry of Finance keeps a watch on the spending of various units to ensure that the ceilings are not violated.

Performance Budgeting

1. Concept
    1. A Performance Budget gives an indication of how the funds spent are expected to give outputs and ultimately the outcomes.
    2. A performance budget reflects the goals of the organization and spells out performance targets.
    3. These targets are sought to be achieved through a strategy(s).
    4. Unit costs are associated with the strategy and allocations are accordingly made.
2. Issues in implementation
    1. It is difficult to arrive at the unit costs while relating them to the objective in social programmes.
    2. Its scope is limited to plan programmes and hence utility severely curtailed.
    3. Performance budgets were presented on a supplementary basis. The departments continued the practice of preparing performance budgets annually in addition to their regular budget. The preparation of performance budget has become a routine affair without any discernible influence on expenditure management.
    4. It is not sufficient to have the performance budget document as a supplementary one, as in that case it will not have any impact whatsoever on the existing system. For one, the performance budget is being evolved to overcome the deficiencies in the existing budgetary process. The idea of a supplementary document would inevitably mean the continuation of the existing process.

Zero-based Budgeting (ZBB)

1. Concept
    1. Unlike the earlier systems where only incremental changes were made in the allocation, under zero-based budgeting every activity is evaluated each time a budget is made and only if it is established that the activity is necessary, are funds allocated to it.
    2. The basic purpose of ZBB is phasing out of programmes/ activities which do not have relevance anymore.
2. Issues in implementation
    1. Because of the efforts involved in preparing a zero-based budget and institutional resistance related to personnel issues, no government ever implemented a full zero-based budget.
    2. Ideally, prioritisation should be done among all items of expenditure whether on-going or new, Non-Plan or Plan. But the system in which Plan and Non-Plan expenditure are treated differently and assigned varying priorities, ZBB would have to be applied separately to Plan and Non-Plan expenditures and hence efficacy limited.

Outcome Budget

1. Performance budgets lack of clear estimation of unit costs and inadequate target-setting. Hence there was a need for tracking ‘outcomes’ and not the ‘outputs’.
2. However, the outcome budget experience shows that in many cases the measurement of outputs and outcomes seems to have been mixed up. Measuring outcomes is difficult given the fact that they could be influenced by many other extraneous factors.
3. It is also seen that in some cases Departments have merely reproduced the outputs targets as outcomes and, in many other places, general intents of the programmes are described as outcomes.
4. Outcome Budget cannot be prepared for all Ministries/Departments simply by way of declaration.

Programme Budgeting and Result Oriented Budgets

1. The basic building block of the system was classification of expenditure into programmes. Programmes with common objectives are considered together.
2. The question is how well have the reforms worked in introducing result-orientation into the budgeting process? Not well for the following three reasons:

1. Firstly, even though performance targets are being developed, they are actually kept separate from the budget.
2. When they are included in the budget, often outputs are confused with inputs and outcomes remain unconsidered. Targets / objectives are not identified effectively.
3. Thirdly, and the most important point is that even when effective targets are provided, the budgets fail to specify who should be accountable for the results.

3. So programme budgeting by itself may not bring the outcome orientation. Unless there are institutional reforms, like bringing in the 'agency' concept, where the heads of the agencies are made accountable for delivery of services in an efficient and effective manner, the reform in budgeting process would be difficult to implement.

Top-down budgeting techniques

1. Bottom up budgeting
    1. Budgeting has traditionally operated on a bottom-up principle. This means that all agencies and all ministries send requests for funding to the finance ministry.
    2. These requests greatly exceed what they realistically believe they will get.
    3. Budgeting then consists of the Finance Ministry negotiating with these ministries and agencies until some common point is found.
2. Disadvantages of bottom up budgeting
    1. It is very time consuming and it is essentially a game; all participants know that the initial requests are not realistic.
    2. This process has an inherent bias for increasing expenditures; all new programmes or expansions are financed by new requests; there is no system for reallocation within spending ministries.
    3. Difficult to reflect political priorities in this system as the budget "emerges" from the bottom at the end of this process.
3. Top down budgeting
    1. This has been of great assistance in achieving fiscal consolidation.
    2. The starting point is the government making a binding political decision as to the total level of expenditure and then dividing them among individual spending ministries.
    3. This decision is made possible by the medium-term expenditure frameworks which contain baseline expenditure information, i.e. what the budget would look like if no new policy decisions were made.
    4. The political decision is whether to increase expenditures for a high-priority area, for example education, and to reduce expenditures, for example defence programs.
    5. Once this decision is taken, the Finance Ministry largely withdraws from the details of budgetary allocations for each ministry. The Finance Ministry concerns itself only with the level of aggregate expenditure for each ministry; not the internal allocations.
    6. Each minister becomes his own Finance Minister. Each ministry has a total amount and it can freely reallocate that money among its various programmes.
    7. Advantages
        1. It serves to hamper creeping increases in expenditures as new policies are funded by reallocations within the ministry.
        2. It creates ownership in the respective ministries.
        3. Decisions are also better informed as spending ministries are in the best position to judge the relative merits of their programmes.

Budgeting Reforms

Medium-Term Framework Statements

1. They clearly state the government's medium term fiscal objectives in terms of high-level targets such as the level of aggregate revenue, expenditure, deficit/surplus, and debt.
2. They then operationalize these high-level targets by establishing hard budget constraints for individual ministries and programmes over a number of years.
3. They contain baseline expenditure information, i.e. what the budget would look like if no new policy decisions were made.
4. Utility / need: Budgets are however enacted for a time period of one year, and are notorious for their short-term focus. This short-term time horizon is often criticised for ineffective expenditure management; decisions on resource allocation are said to be made on an ad hoc basis. Medium-term budget frameworks bridge this gap.
5. They generally mirror the format of the budget. These are rolling frameworks that are presented with the budget each year-3 is added.
6. These frameworks are not, however, enacted into legislation; they are planning documents that reflect the political commitment to fiscal discipline.

Prudent Economic Assumptions

1. Deviations from the forecast of the key economic assumptions are a key fiscal risk.
2. Sensitivity analysis should be made.

3. A comparison should be made between the economic assumptions used in the budget and what private sector forecasters are applying for the same time period where practicable.
4. The establishment of an independent body to recommend the economic assumptions to be used in the budget may be considered as well.

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Relaxing Central Input Controls

1. This is based on the premise that the heads of individual agencies are in the best position to choose the most efficient mix of inputs to carry out the agency's activities.
2. The end-result is that an agency can produce the same services at less cost, or more services at the same cost. This greatly facilitates fiscal consolidation.
3. It operates at 3 levels:
    1. First, the consolidation of various budget lines into a single appropriation for all operating costs (salaries, travel, supplies, etc.).
    2. Second, the decentralisation of the personnel management function. The above may not enough to generate managerial flexibility as various central management rules inhibit this flexibility. It is in the area of human resource management where most of the central management rules exist.
    3. Third, the decentralisation of other common service provisions, notably accommodations (buildings).

An Increased Focus on Results

1. An increased focus on results is a direct quid pro quo for relaxing input controls as described above. Accountability in the public sector has traditionally been based on compliance with rules and procedures. A new results-based system is needed to hold managers accountable.
2. This is a fundamental change: holding managers accountable for what they do, not how they do it.
3. <u>Difficulties in implementation</u>
    1. Results measurement may be much more difficult in some activities than in others. Various social services are the outstanding example.
    2. From an accountability point of view, the question arises whether you hold managers responsible for outputs or outcomes. An example highlights this.
        - A government may wish to reduce the number of fatalities on highways caused by drunk drivers. This would be the outcome. In order to achieve this, it may launch a series of advertisements which is the output.
        - Let's, however, assume that at the same time the number of fatalities went up, not down. The link between the advertisements and this outcome is very unclear, since many other factors than the advertisements would impact on the outcome.
        - Alternatively, do we want an accountability regime based on outputs even though the outputs may not be contributing to the desired outcome?
        - Finding the right balance between the outputs and outcomes is a difficult choice to implement.

Budget Transparency & Citizen Participation

1. When the governments need to institute large fiscal consolidation programmes, it is often painful and getting the public's understanding of the problems is necessary. The most effective manner for achieving that was simply to throw open the books and say to the public: "Look, things are really as bad as we told you, we're not hiding anything."
2. This is also in consonance with the principles of good governance.
3. The steps involve:
    1. The first is the release of budget data - systematic and timely release of all relevant fiscal information.
    2. The second element is an effective role for the legislature. It must scrutinize the budget reports and independently review them. It must debate and influence policy and effectively hold the government to account.
    3. The third element is an effective role for civil society, through the media and NGOs. Citizens must be in a position to influence

budget policy and must be in a position to hold the government to account.

Modern Financial Management Practices

1. Accrual based budgeting
    1. Drawbacks of Cash Accounting
        1. Cash accounting does not provide a full picture of the government's financial position at any given point and the changes that take place over time as a result of government policy.
        2. It fails to reflect accrued liabilities.
        3. It is unable to track current assets as well as capital assets. It does not provide information on the assets held by the government at all.
        4. It provides room for fiscal opportunism, as tax revenues can be collected in excess during a period followed by high incidence of refunds, payments can easily be deferred. It takes no note of state guarantees.
    2. Issues in Implementation of Accrual Accounting
        1. There is a high cost of transition from cash to accrual accounting as it requires higher training, identification and evaluation of assets and setting up the technological infrastructure.
        2. The transition period takes a fairly long time to settle, sometimes even more than a decade.
        3. A number of activities associated with the accrual-based accounting system involve high level of subjectivity for example valuations and risk assessment.
        4. Many countries have attempted to move towards accrual accounting but success has not been widespread.
        5. Even in countries where it has been implemented, it is not being used in decision making.
        6. A gradual approach is thus recommended. Focus could be first on implementing methods to better recognize financial liabilities and assets and their capital costs.

1. Capital charges
    1. Capital has tended to be viewed as a free good in the public sector. This involves putting a cost on the balance sheet.
    2. The government decides to levy a charge on the cost of capital tied up in all assets in an agency. For example, if an agency has $10 million in assets, the government will levy a charge (often equivalent to the long-term government bond rate), of 10%. This means that the agency will have to pay the finance ministry 1 million dollars annually.
    3. When the system is first introduced, the appropriations to all agencies will be increased by the amount of their capital charge, so there's no net impact on agencies. However, agencies will in future be allowed to dispose of the assets and thus relieving themselves of the capital charge.
    4. This saves a lot of government balance sheet.
2. Carry-overs
    1. Currently all appropriations lapse at the end of the fiscal year. This creates a great and irrational rush to spend moneys before the end of the fiscal year.
    2. Not only because they would otherwise lose the money this year, but also because future years appropriations would take account of this underspending as well.
    3. Hence the need of carryovers. Only in cases where an agency continuously, year after year, builds up carry-overs does the Ministry of Finance intervene.
3. Interest-bearing accounts
    1. This means that the appropriation of an agency is divided into twelfths (representing each month) and deposited into an agency's account. If an agency spends at less than this rate, they will receive interest on the difference. If they spend at a faster rate, they will pay interest on the difference.
    2. This makes them much more aware of cash management practices.

Budgetary Process

Preparation of the Budget

1. It follows both the top-down and bottom-up approaches. While guidelines and instructions are issued by the Ministry of Finance and Planning Commission, the spending Ministries/Departments make requests for budgetary allocations based on their own estimates.
2. The Ministry of Finance issues a Budget Circular which contains the guidelines and instructions in the month of September.
3. This Circular is issued for the guidance of Ministries/Departments in framing the Revised Estimates for the current year and the Budget Estimates for the ensuing year.
4. The departmental estimates are examined and analyzed by the Financial Adviser and then forwarded to the Budget Division in the Finance Ministry. This is followed by pre-budget meetings with the Secretary (Expenditure).

5. Once this stage is over, the expenditure ceilings are communicated (which include ceilings on both revenue and capital expenditure). The Departments then prepare the Statement of Budget Estimates (Final).

Issues in Budgetary Process and Recommendations

1. Emphasis on expenditure targets, not results
    1. At present, government departments often measure their performance in relation to the expenditure targets laid down in the budget without adequate regard to outputs and even less to outcomes.
2. Unrealistic budget estimates
    1. Weakness in preparing proper estimates leads to frequent revisions and supplementaries.
    2. Despite having such an elaborate and time consuming system of making budgetary estimates, large amounts of unspent money have been surrendered every year. This indicates lack of efficiency in estimation at the departmental level. It shows that proper forecasting methods are not used to estimate expenditure. The concerned Ministries/Departments have not made any serious attempts to apply effective corrective measures as per PAC.
    3. The root cause of the problem lies in the prevalent method of formulation of the annual budget by getting details from different organizations and fitting them into a pre-determined aggregate amount. This method should be given up along with the method of budgeting on the basis of 'analysis of trends'. Top-down budgeting techniques along with a medium-term expenditure framework should be followed.
    4. Budget Estimates and Revised Estimates should be prepared with reference to the measurable commitments made in the Outcome Budget.
    5. Ministries/Departments may review each major scheme at regular intervals and apply the result at the time of budget formulation.
3. Delay in Implementation of Projects
    1. In many cases, such delays are due to token provisions made on account of poorly conceived projects. Not only this, they also tie down resources and hence delay other good projects as well.
    2. Budgetary provisions should be made only when administrative and technical sanctions have been obtained and a detailed feasibility report and cost-benefit analysis have been made.
4. Skewed Expenditure Pattern
    1. The major portion is spent in the last quarter of the financial year, especially in the last month.
    2. A Monthly Expenditure Plan should be worked out for each Demand for Grant. Savings should not be available for automatic carry forward to the next quarter.
5. Inadequate Adherence to the Multi-year Perspective and Missing Line of Sight between Plan and Budget
    1. Ad hoc deviations distort the long-term plan objectives. Major projects and schemes are launched by government which are not provided for in the plan.
    2. Another weakness of the current budget exercise is the absence of a clear link between the plan and the budget. While preparing the budget estimates, the allocations indicated by the Planning Commission get dispersed over various heads and sub-heads of expenditure. Further, while the plans are formulated scheme-wise and sector-wise, the budgets are formulated under different heads and sub-heads. Thus a 'clear line of sight' is not present.
    3. Consequently, even the final accounts reflect the expenditure only under various heads. This makes it difficult to link the expenditure under various heads to the objectives sought to be achieved by the different developmental schemes/projects. Thereby the accounting process loses its potential as a measuring tool for achievement of objectives.
6. No Correlation between Expenditure and Actual Implementation
    1. The expenditure figures do not reflect actual expenditure. At present, the release of funds from any head of account is deemed as an expenditure. In a large number of cases, especially in CSS, such releases cannot be construed as expenditure because funds lie in the pipeline.
    2. The present system of release of funds to project authorities outside the government often leads to parking of funds which is often resorted to in order to prevent lapsing of funds. This leads to idle funds being maintained outside government accounts and thus portrays an incorrect picture of government funds besides causing loss of interest to government.
7. Irrational 'Plan – Non-Plan' Distinction
    1. It has led to ever increasing tendency to start new schemes/projects to the utter neglect of existing ones.
    2. The distinction also often leads to the misperception that non-plan expenditure is inherently wasteful and should be avoided.
    3. The problem is assuming greater significance with higher priority to social sectors where salary constitutes an important element of the programme. The embargo imposed on recruitment for nonplan posts have caused serious problems of service delivery in health and education sectors.