"Future-Proofing India's Economy: Reforms in MSMEs and Digital Infrastructure"

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Economics Expert Shares Strategies to Shield India’s Vulnerable Assets Amid Global Economic Shifts

Intro: This week on **Socio-economic Voices,** we have **Dr Manoranjan Sharma, Chief Economist, Infomerics Ratings** helping us catch the pulse of the Indian economy amid the geo-political turmoil. From how to overcome the challenges faced by MSMEs to the revolutionary impact of digital payments in rural areas, Dr. Sharma offers a compelling analysis of India's growth story from both sides of the coin. Speaking to senior journalist **Mahima Sharma**, he shares insights spanning economic reforms, financial inclusion, and the future of India's youth amid the call for better and more employment. This conversation at **Indiastat** is a must-read for anyone interested in understanding the nation's evolving economic landscape and how you can benefit better from the opportunities that arise.

MS: India's MSME conundrum: Can the sector rise through its present challenges? If not, what should be the reform ahead and how must the Govt ensure that these are implemented in a stipulated span of required time?

Dr Sharma: Well, the MSMEs contribute 30% of India's GDP, 40% of India's exports, and as of August 2023, employed 12.40 crore people in India. The Government of India has an ambitious plan of adding another 5-crore people in MSMEs by 2025 by cheaper loan, easy establishments, subsidies, marketing of their products etc.

In India, over 99% of MSMEs are micro and small enterprises, of which 51% are in rural areas and 49% are in urban areas. So, irrespective of the criteria or benchmarks adopted, MSMEs form an important driver of the Indian economy and there is **humongous potential for innovation, growth, and modernisation.** In the post economic reforms period, the growth of MSMEs, in terms of all parameters like income, output, and employment has largely outperformed large industries.

The unfortunate and disconcerting aspect of the MSME growth saga in India is that over the years they continue to face persisting problems of marketing, credit, technology and infrastructure. **Some of the basic issues of credit faced by MSMEs include cost of credit, adequacy of credit, issues of collaterals, etc.** These issues continue to make things difficult. Despite all the development in the banking and financial sector in India over the last few decades, **about 80% of financing needs of MSMEs are still met by friends and relatives.**

Going forward, we must move from collateral-based lending to a cash-flow based lending process. Further, innovative financing, greater use of the CGTMSE Scheme, significantly enhancing the proportion of digitally mature

MSMEs from the present level of 12 % in India and meeting the credit demand of USD 200 billion across e-commerce, food, travel, ed-tech, etc. in these 88 % MSMEs in a much greater measure is manifestly needed.

An emphasis on the factor productivities of MSMEs, online financing of invoices, technology adoption and adaptation and use of Udyam portal for formalisation and various credit schemes is essential.

The pathway to the future of better MSMEs requires a renewed thrust on:

- Simplified regulatory procedures with streamlined licenses, permits, and compliance processes.
- Timely and enhanced access to finance by innovative financing strategies
- Reduced interest rates as well as promotion of financial literacy
- Streamlined infrastructure, vis., power, water, transportation, and digital connectivity.

There are also issues of greater marketing support, e.g., training, market research, and access to e-commerce platforms; technology enablement, e.g., incentives, training, and digital literacy programs; skill development initiatives and environmental and social support in this "new normal" of intensified competition and increased business complexities

MS: As you stated, the MSMEs contribute to about 30% of India's GDP and employ over 110 million people. In the next decade, what more needs to be done, considering India will soon have the world's largest number of youths looking for jobs?

Dr Sharma: The Union Budget FY25 attempts to provide employment opportunities for nearly 4.1 crore youth over the next five years. The allocation of ₹1.48 lakh crore for employment and education to skill 20 lakh youth during this period is contextually significant.

The government's initiatives to enhance skills and boost women's workforce participation by skilling loan scheme, facilitating loans up to ₹7.5 lakh, and upgrading 1,000 Industrial Training Institutes (ITIs), higher education loans, working women hostels, and women-focused skilling programs, are welcome.

The introduction of direct benefit transfers of one-time wage for first- time employees under the new Prime Minister's Package is an admirable step. The Prime Minister's package (3 schemes, A, B and C) with a central outlay of ₹ 2 lakh crore and a provision of ₹ 1.48 lakh crore for education, employment, and skilling are important. There has to be a paradigm shift from outlay to outcome.

MS: Food inflation hits 9.4%; retail price rise rebounds to 5.1%. How should India be managing inflationary pressures without stifling economic growth and affecting the middle and lower classes?

Dr Sharma: Inflation is largely under control, with core inflation way below 4 % and has stayed at 3.2% for two consecutive months–is expected to average (around 3.5-3.7% in H1 FY25, and 4.5% in H2) and with retail inflation at 5.4 % in FY24, the lowest level since the pandemic. But elevated sticky food inflation, which hits hard the vulnerable sections of the society-what Mahatma Gandhi called the "teeming millions" of India-causes concern and consternation. **Open market operations (OMOs), retailing in specified outlets, timely imports, reducing the prices of Liquified Petroleum Gas (LPG) cylinders and cutting petrol and diesel prices, have attempted to check the inflationary spiral.**

The RBI has kept the benchmark repo rate unchanged at 6.50%. The Monetary Policy Committee remains focused on withdrawing accommodation and bringing inflation to the target (4%, +/-2%).

As compared to its peers, India tends to deviate less from its targets and has one of the lowest average deviations since 2021. Central banks in developed countries that have successfully implemented inflation targeting tend to "maintain regular channels of communication with the public, may it be lower or middle class". India was the only country amongst others with a high-growth and low-inflation path in the period FY22 – FY24. Hence this moderation seems to be working.

MS: Considering India's burgeoning population and the fact that only 51.25% of youth are employable, what practical and implementable reforms are needed to improve employability and prevent youth from resorting to wrong means to earn?

Dr Sharma: Creation of productive employment is the key here. This occurs mainly in the private sector. In terms of financial performance, the corporate sector has never had it so good. Job creation helps absorb the growing workforce and also drives higher productivity, increases disposable income, and enhances the purchasing power capacity of individuals, thereby powering overall economic prosperity.

There has to be a sharper focus on sectors, regions and schemes with higher employment intensity, financial literacy, skilling, and employability. **Towards this end, a triad of the government, the private sector and academia is needed to reboot the mission to skill** and equip Indians to catch up with and move ahead of the curve. It is a social responsibility of the corporate sector to hire the section with the right passion and skill-set and prudent risk takers.

On the employment front, according to the annual PLFS, the all-India annual unemployment rate (persons aged 15 years and above, as per usual status) has been declining since the pandemic. This has been accompanied by a rise in the labour force participation rate and worker-to-population ratio. The government has made job creation the central focus in the Union Budget FY25. These initiatives aim to enhance enrollment with the Employee Provident Fund Organisation (EPFO) and emphasise support for first-time employees, as well as offer assistance to both employers and employees.

MS: India dominates with 46% of global digital payments and 80% of domestic transactions via UPI. In FY24, digital payments grew at a 51% CAGR, with UPI comprising 80% of the volume. How is this shift influencing the banking sector and financial inclusion in rural areas? And what more needs to be done for the rural sectors?

Dr Sharma: Since the launch of the UPI app in 2016, the volume of transactions has increased multi-fold. The UPI has been a game-changer in rural and semi-urban areas, where access to the banks has historically been limited because of structural and deeply entrenched factors and digitisation has created a silent revolution in the countryside.

The JAM trinity with its "productivity-induced gains" (IMF) brings ease of access, affordable and convenient banking services, access to credit, DBT, market expansion, DBT, Insurance and subsidies, Bill payments and recharges, etc. to the backward areas. With just a smartphone and internet connection, remote villagers can perform financial transactions.

Digital literacy and consistent internet access still cause some problems. But hopefully the introduction of the UPI Lite feature will make payments more convenient.

Now coming to your question about what more needs to be done for digitization in the rural sectors? Well, given the lack of infrastructure and awareness, there continues to be a striking digital divide between urban and rural India. The latest TRAI report placed internet penetration in rural India at only about 33% vis-a-vis 99% in urban India. The time is now apposite to drive digitization in rural areas in India.

This requires investment in necessary infrastructure, cheaper mobile phones capable of use in the local language, uninterrupted electricity, cheaper internet connectivity, availability of a complete suite of online banking products in rural areas, and common service centers ('brick and click' centers) run at village level to provide both government and business services to rural people.

There are also aspects, such as greater access to institutional credit by an elaborate network of banking and financial institutions and digitized mode of transaction (e.g., Kisan Suvidha' app with about 100 million registered users, start-ups like Jai Kisan and FIA technology, offline solutions), renewed thrust on cyber security, an accent on Prime Minister Digital Literacy Abhiyan (PMGDISHA), and deployment of new digital technologies like big data analytics, machine learning, blockchain, cloud computing and artificial intelligence (AI).

NASSCOM, SWAYAM (an Indian government portal), "Enhancement in Learning with Improvement In Skills (ELIS)", iGOT, and ICT are some of several initiatives of considerable contemporary significance in promoting digital literacy.

MS: India Drops In 'Ease Of Doing Business' Ranking. India has been placed at 142 among 189 countries in the latest World Bank's "Ease of Doing Business" report, a drop by two places. What's your take on the same and an apolitical view for the future?

Dr Sharma: This minor fall must be placed in a proper historical and comparative perspective of India's ranking of 63 in the World Bank's Doing Business Report (DBR), 2020 before its discontinuation by the World Bank. India's rank in the DBR improved from 142nd in 2014 to 63rd in 2019, zooming 79 ranks in a span of merely five years.

With an FDI equity flow of over US$ 11.5 billion in Q 3 of FY 24 alone, **India has emerged as one of the preferred choices for business globally** in its pursuit of becoming an industrial hub and a factory for the world. Future efforts should focus on simplifying regulatory processes, further enhancing the infrastructure, and streamlining business procedures to further propel the good environment for global enterprises and sustained economic growth.

MS: Amid the geopolitical shifts, looming war threats from China and climate battering India, what kind of financial sector reforms are required on an immediate basis?

Dr Sharma: Erratic weather patterns during the year and an uneven spatial distribution of the monsoon in 2023 impacted overall output, which has led to marginal decline in total foodgrain output for FY24 of 0.3 % as per the third advance estimate of foodgrain production released by the Ministry of Agriculture and Farmers' Welfare (MoAFW).

Even in the year 2024, food prices are the most vulnerable to the weather pattern such as heat waves, spatially asymmetric monsoon distribution, unseasonal rainfall, hailstorms, torrential rainfall and historic dry conditions. **Food inflation based on the Consumer Food Price Index (CFPI) rose from 3.8 % in FY22 to 6.6 % in FY23 and further to 7.5 % in FY24.**

This is a difficult disruptive time- a time, when all elements are critically in churn. Going forward, progressively rising disinvestment in a gradual and calibrated manner, **infrastructure upscaling, lowering of the tax rates, FDI, exports, investment and incremental and structural reforms** to increase both the size of the national cake and more even distribution of its slices are needed.

MS: How do India's trade policies and regulatory frameworks compare to global standards? Which specific reforms are needed to make India a more attractive and competitive player in global supply chains?

Dr Sharma: India has so far signed 13 regional/free trade agreements (FTAs), all differing in their nature and scope depending on the strength of the regions, the relative merits and distinctive peculiarities of India's relationship with different blocks. The partners include Japan, South Korea and Sri Lanka, along with the Association of Southeast Asian Nations (ASEAN) and, more recently, Australia, the European Free Trade Association (EFTA), Mauritius and the UAE.

India has also signed preferential trade agreements (PTAs) with regions such as Mercosur (Argentina, Bolivia, Brazil, Paraguay and Uruguay).

India was found to have very high export volumes in the top 10 imports coming into Bangladesh already, thus showing existing high market penetration. India does have some import challenges (such as in textiles) with regard to Bangladesh which need attention though.

Despite some improvement, India's port infrastructure lags behind global standards necessary for handling ultra-large vessels. **Delayed clearances, inadequate handling facilities at ports and slower turnaround time (TAT) constrain development and need to be effectively addressed with a sense of urgency.** The National Logistics Policy (NLP), which was launched by the government in 2022, will help in further reducing the logistics costs and provide a level playing field to the industry.

Also, the unified payment interface (UPI) service was launched in France. This not only enhances India's influence, but also opens new trade avenues through technology exports. The RBI has been collaborating bilaterally with various countries to link India's Fast Payments System (FPS), i.e., UPI, with their respective FPSs for cross-border Person to Person (P2P) and Person to Merchant (P2M) payments. The RBI joined Project Nexus, a multilateral international initiative to enable instant cross-border retail payments by interlinking domestic FPSs. The Nexus aims to connect the FPSs of four ASEAN countries (Malaysia, Philippines, Singapore, and Thailand) and India, who would be the founding members and first mover countries of this platform.

The key steps needed for India's global growth are:

- the ease of doing business, efficiency and productivity
- greater collaboration and cooperation with both bilateral and multilateral partners
- trade diversification in terms of products and countries to reduce the inherent element of skew
- value addition and moving up the exports value-added chain.

These efforts should not be seen as a one-off measure but as an integral part of an ongoing process to discernibly alter the ground-realities in crafting the India of tomorrow, an India, which has moved from "swaraj" (i.e. self-rule) to "su-raj" (i.e. good rule) in the Gandhian lexicon. The trial of adversity was that of our forefathers during the struggle for independence, the trial of prosperity is ours today. And succeed we will!

Key References

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About Dr Manoranjan Sharma

Currently the Chief Economist at Infomerics Ratings, Dr Sharma was earlier Chief Economist, General Manager, and Chief Learning Officer at Canara Bank. Recognised as one of 30 global experts by UN Virtual University, he is an expert in Indian economy, banking, MSMEs, rural credit, financial inclusion, etc. With multiple globally accepted papers, he is a member of over 12 Advisory Councils across States, vis., Member, Governor's Advisory Council, Rajasthan; Chancellor's Senate Nominee, SNDT University, Mumbai; Chancellor's Senate Nominee, Rajasthan University, Jaipur; Expert Member, BIRD, Lucknow; etc. He is associated with banks, IITs, IIMs, Universities, Terrapinn Pte Ltd. (Singapore); Marcus Evans (Malaysia); Naseba (Paris/Dubai); Government of India and State Governments. He has published 6 books and 300 papers in India and abroad. His views have been cited in The Associated Press (New York), Dow Jones (New York), International Herald-Tribune (New York), Wall Street Journal (New York).