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ASIAN DEVELOPMENT BANK

STS:IND 96002

COUNTRY OPERATIONAL STRATEGY STUDY

INDIA

July 1996

CONTENTS

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EXECUTIVE SUMMARY

India is in a critical phase of economic transition. The Government has launched a decisive break from the traditional closed and regulated policy regime. Progressive improvements have been made to economic and regulatory frameworks. Almost all key economic areas have been opened up to foreign and domestic private investors to enhance competition and efficiency. A beginning has been made to selectively corporatize strategic public sector undertakings and sell minority stakes. During the past four years, the reforms have increased the role of market forces in the economy and unleashed the energies of the private sector to play a more extensive role in the productive sectors of the economy as well as the infrastructure sectors. With economic liberalization gaining momentum, India has attracted significant flows of foreign capital and technology, and its economy has become more integrated with the global economy.

The first phase of economic reforms, which led to significant deregulation across the board, has been well managed and has supported the revival of economic growth. However, there is need to carry these reforms forward to address the next, but more complex, phase of structural reforms to stimulate higher sustainable economic growth. The major elements of the unfinished economic reform agenda include the need to:

(i) carry the fiscal consolidation program forward, as present levels of Central Government and state government deficits are unsustainable and are crowding out private investment;

(ii) augment trade and financial sector reforms;

(iii) resolve outstanding infrastructure policy, regulatory, and institutional gaps;

(iv) corporatize and divest public sector undertakings to alleviate the strain on the economy and the budget; and

(v) remove regulatory and legislative barriers to ease industrial restructuring that is critical to gear public and private firms to growing competition in the more liberal policy environment.

As most of these areas (excluding trade and finance) are the concurrent responsibility of the Central Government and state governments in India, an effective and coordinated effort to reform the two tiers of government is important. In general, progress in areas under the Central Government has been significant, while the states have lagged behind in fiscal adjustment and structural reforms. So, to meaningfully address the next phase of economic and infrastructure reforms in India, the Bank will need to extend its support, currently largely confined to national programs, to states in order to support the broadening and deepening of the macroeconomic and structural reform process in the country.

A. The Bank's Proposed Strategic Framework

The Bank's operational strategy in India is being reoriented to better respond to the emerging requirements, the Government's development strategy, and the Bank's Medium-Term Strategic Framework, 1995-1998. The proposed strategy attempts to incorporate the lessons drawn from the Bank's sector portfolio review, which underscores the need for greater emphasis on supporting policy reforms and rationalization and prioritization of Bank operations in India. This operational strategy is being developed on the basis of India's current non-accessibility to the Asian Development Fund (ADF).[1] The strategy would need to be reviewed in line with the economic developments in the country and the evolving situation within the Bank.

The strategy proposes that the Bank promote efficiency and higher sustainable economic growth in India to improve employment opportunities and incomes, while reducing poverty (see Figure 1). To realize the overall strategic objective, it is critical to alleviate the severe and growing infrastructure bottleneck facing the country. However, effective and speedy development of infrastructure can only be realized if the Government succeeds in establishing a conducive and transparent policy, regulatory, and institutional environment that is sensitive to the legitimate concerns of all stakeholders and to the risks that investors and consumers face. This underscores the need for the Central Government and the states to coordinate their efforts to resolve gaps in the policy and regulatory frameworks of the infrastructure and to encourage a stronger interface and partnership between the public and private sectors. This is critical to achieve the desired level of economic growth. Thus, the proposed strategy recommends that the overall and sector strategic focus be reoriented to help:

(i) Improve macroeconomic stability and reduce sector inefficiencies to implement and sustain structural reforms effectively,

(ii) promote competition and private sector participation by supporting establishment of the policy, regulatory and institutional frameworks at the state level,

(ii) encourage corporatization, restructuring and commercialization of the public sector, and

(iii) enhance resource mobilization through further reforms of financial and capital markets.

B. The Main Features of Sector Strategies

To attain higher sustainable levels of economic growth, the main emphasis of the strategy will be to alleviate key infrastructure constraints by supporting development of effective policy, regulatory, and institutional environment that encourages an expansion in public and private investment — both of which are critical to meet the sizable requirements of the country. At the sectoral level, the Bank's core emphasis will be to stimulate more expeditious and efficient development of energy,

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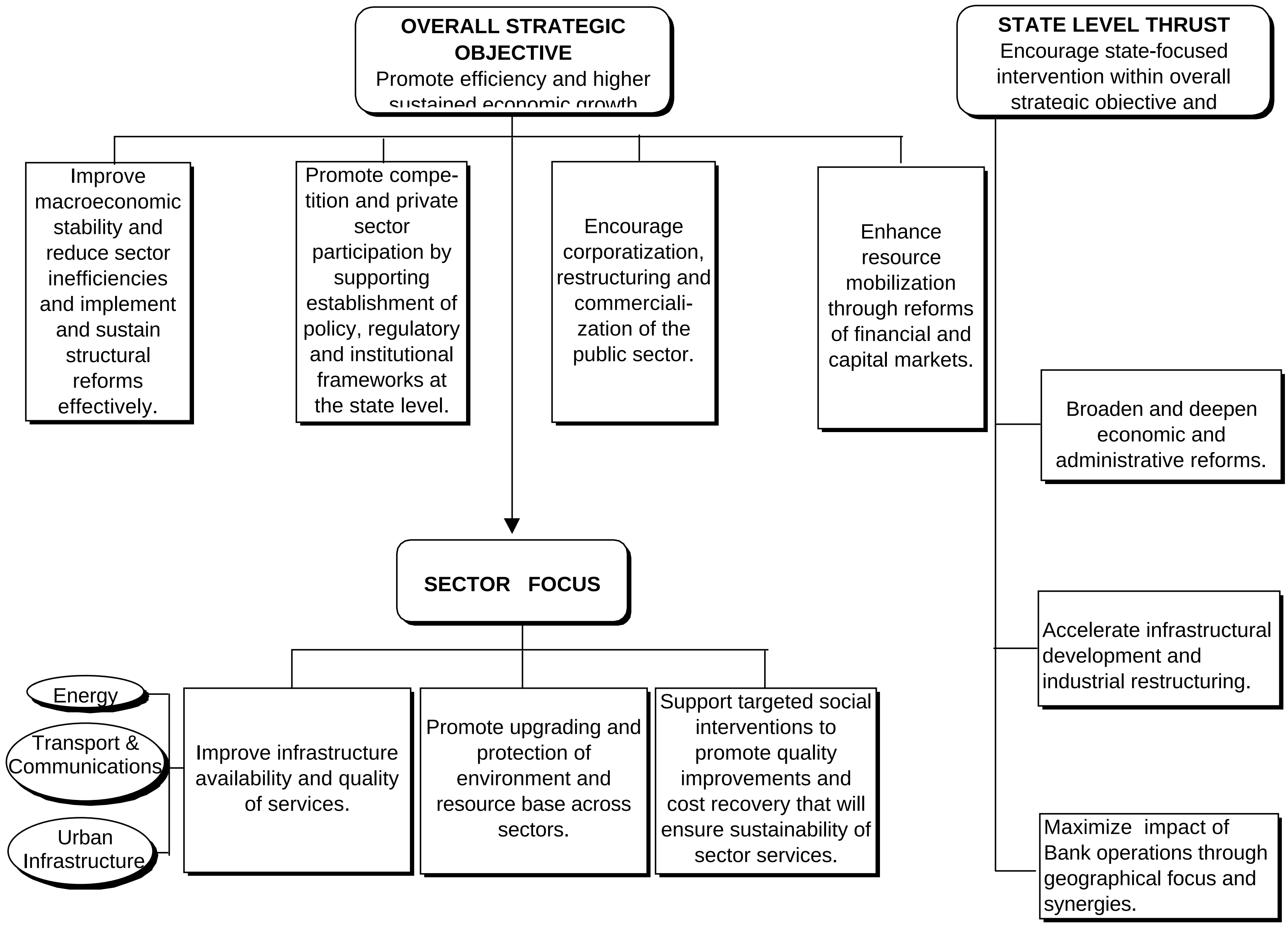
[1] This simply reflects the current situation without prejudicing India's eligibility to ADF resources.

Figure 1: India -- Operational Strategy at a Glance



I. DEVELOPMENT ISSUES, CHALLENGES, AND OUTLOOK

A. The Government's Development Strategy and Macroeconomic Setting

1. The Government's development strategy, as set out in the Eighth Five Year Plan (EFYP) covering 1992 to 1997, is to achieve macroeconomic stability and rapid sustainable economic growth over the long term. This is to be attained by a steady decline in fiscal deficits and a sustainable balance of payments (BOP), while maintaining price stability. To support economic growth, the EFYP accords priority to:

(i) encouraging high levels of capacity utilization to raise productivity and cost efficiency,

(ii) attracting private initiative by reducing the Government's regulatory controls,

(iii) reforming the public enterprise sector,

(iv) enhancing competition by allowing the inflow of foreign capital and technology to allow for greater integration of the economy with the world, and

(v) reorienting public expenditures for human resource and infrastructure development.

2. The EFYP, launched in the wake of an economic crisis in June 1991,[1] necessitated a fundamental and radical shift in economic policies in order to restore macroeconomic stability and break away from centrally planned and inward looking policies that, among other things, encouraged high capital intensity and excessive dependence on the public sector. Embarking on a macroeconomic adjustment program[2] in 1991/92, India introduced broad and sweeping structural reforms across the industry, finance, and trade sectors to facilitate the country's transition to a more open and dynamic economy.

3. After a low growth period marked by deflationary demand management policies introduced in 1991/92, India recorded a significant economic recovery. The real Gross Domestic Product (GDP) grew by 6.3 percent in 1994/95 in response to good agriculture performance and a rebound of industrial growth as manufacturing activity gained momentum following industrial and trade deregulation. Improvements in the BOP have exceeded expectations. However, the fiscal adjustment program has been slower-than-expectation. The consolidated Central and State Governments and state deficits

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[1] This crisis was precipitated by the sharp rise in the public sector fiscal deficit to over 12 percent of Gross Domestic Product (GDP) and external current account deficit to $10 billion (or 3 percent of GDP). The widening of macroeconomic imbalance was accompanied by a significant acceleration in the inflation rate to 17 percent. These developments created uncertainty and prompted a sharp drop in the foreign exchange reserves level to below $1 billion, bringing the country on the verge of default on external debt.

[2] This was supported by an 18-month International Monetary Fund standby arrangement.

declined to about 7.2 percent of GDP in 1992/93 but remained around 8.1 percent of GDP during 1994/95. The developments in the fiscal sector, along with the buildup of foreign exchange reserves, induced monetary expansion beyond expectations in 1994/95. Despite these pressures, the authorities have managed to contain the inflation rate. This has been facilitated by favorable foodcrops, easing of supply constraints, and liberalization of imports.

4. The recent gains are, however, no cause for complacency due to following factors:

(i) the overall economic growth in India while reaching 6.3 and 6.2 percent in 1994/95 and 1995/96 is still below expectations and a major challenge facing policymakers is to raise the living standards of the country's vast number of poor;

(ii) there is a need to raise the gross domestic saving and investment rates to sustain desired economic growth;[1]

(iii) the sustainability of the reform program is clouded by the (a) slow improvement in fiscal deficits the financing of which is crowding out private investment and affecting financial sector reforms, and (b) vulnerability of BOP in view of the surge in imports and slow down in the foreign inflows in 1995/96 though foreign direct investments did gain momentum;

(iv) monetary and exchange rate management has been more difficult in the wake of fiscal and external pressures;

(v) the continued rigidities in factor markets have delayed industrial restructuring, and held captive abundant investible resources; and

(vi) the public enterprise reforms have been delayed.

A more concerted attack on these fronts is possible only if the states support the Central Government in carrying forward the economic reforms to address structural rigidities. India is gearing itself to address these issues. Meanwhile the corporate sector is well-positioned to sustain growth recovery and is restructuring to invest in new capacity to compete effectively in a more competitive environment.

5. Provided political stability persists, medium-term prospects for the economy are favorable. A more broad-based and sustainable growth of 7 percent could be achieved over the next few years with the inflation rate at 5 percent provided fiscal consolidation and structural reforms gain momentum. Industrial diversification and a competitive exchange rate policy is likely to encourage a real export growth of 8 percent, which is anticipated to offset the growth in imports. Consequently, the external current account deficit will be held well within manageable limits. To maintain macroeconomic stability, the public sector deficit must be brought down to 4-5 percent of GDP over the

[1] Investment and saving rates have recovered in 1994/95 after registering a fall during 1991/92 to 1993/94 period.

medium term. This calls for a sizeable reduction of the Central Government's fiscal deficit which stood at about 6 percent of GDP in 1995/96. A reduction in state fiscal deficit is also important to bring down the public sector deficit as well as to avoid any spillover of its negative impact on the Central budget. The development program will need to be further reoriented to support antipoverty and employment promotion programs to improve incomes and the living standard of population.

B. Economic and Infrastructure Policy Framework

1. Economic Policy Framework

6. To implement its development objectives and strategy, the Government has launched wide ranging reforms in the 1990s to liberalize the economic policy framework (see Box 1).

7. The recent policies have restored investor's confidence and improved the image of the economy, as evident from large foreign capital inflows in the country during 1994/95. The structural reforms have enhanced:

(i) domestic competition by abolishing all restrictive industrial and trade licenses,

(ii) external competition by liberalizing trade and payment systems and deregulating foreign investment,

(iii) allocative efficiency of loanable funds and introduced competition and prudential norms in the banking system, and

(iv) efficiency and equity of the taxation structure.

2. Infrastructure Policy and Regulatory Framework

8. Adequate infrastructure is critical to stimulate economic growth and improve the competitiveness and internationalization of the economy. However, growing public resource and infrastructure constraints in India underscore the need to attract private sector participation in infrastructure development. Traditionally, since most infrastructure sectors were under public sector monopoly in India, breaking controls and evolving legal and regulatory frameworks to involve the private sector have required more lead time than originally envisaged. Although significant progress has been made in developing the policy framework, there is still need to develop (i) a well-designed and competitive incentive framework for investors, and (ii) effective interface as well as partnership between the public and private sectors to develop and regulate sectors properly. Also, the Government has yet to develop the long-term debt market to meet the financing requirements for long-gestation infrastructure projects.

Box 1. Major Economic Policy Initiatives in 1990s

FINANCIAL SECTOR REFORMS

Progress in financial liberalization has been substantial because of:

(i) the reduction in the statutory liquidity reserve ratios from over 37.8 percent in 1990/91 to 29 percent and the approval by the Government Securities to auction the incremental holdings yield market determined rates;

(ii) relaxation of credit controls, reduction of the interest rate subsidy of priority sector programs, and rationalization of export credit schemes;

(iii) deregulation of interest rates, except for a ceiling on deposit rates;

(iv) development of the Government securities market and its secondary trading;

(v) adoption of international accounting and prudential norms; and finally

(vi) enhanced competition with the entry of new private banks and permission to divest up to 49 percent of Government equity in public sector banks.

In addition, the restructuring of public sector banks is proceeding well and the Government has provided budgetary support of about Rs100 billion over the last two years for the recapitalization of banks. Stronger banks have approached the capital market for their capital adequacy requirements. Among other things, this has broadened the ownership base of public sector banks and has paved the way for their restructuring.

CAPITAL MARKET REFORMS

The functioning of capital markets has improved as a result of:

(i) the strengthening of the mechanisms for market regulation and supervision with the setting up of an independent body, Securities and Exchange Board of India in 1992, which oversees the operations of merchant banks, mutual funds, and the securities market, and regulates corporate acquisitions and takeovers, guards against insider trading, and protects investors from illegal practices;

(ii) access by Indian corporate borrowers to international markets and by foreign institutional investors to the local stock market;

(iii) the development of a national integrated market system to provide timely information and access by investors at the best available prices;

(iv) the promulgation of the depository legislation and the development of a clearing and settlement system;

(v) the elimination of bottlenecks to ensure market growth by improving market practices such as streamlining the “carry forward system”;

(vi) tax incentives such as exemption of mutual funds from income tax, wealth tax on holdings of shares and debentures etc.; and

(vii) modernization and automation of the stock exchanges, as demonstrated by the National Stock Exchange, which was established in 1993.

INDUSTRIAL POLICY

The new Industrial Policy in 1991 resulted in a more liberalized investment climate. These include:

(i) the relaxation of entry restrictions in all sectors except insurance and railways, excluding containerization and maintenance, which has been opened to private sector;

(ii) the automatic approval of foreign investment, up to 51percent of equity and technology agreements;

(iii) the amendment of the antitrust legislation to control activities of large firms, and the Monopolies and Restrictive Trade Practices Act, which allows firms to expand, diversify, merge, and/or acquire without prior government approval; and

REFORMS OF PUBLIC SECTOR UNDERTAKINGS (PSUs)

The PSUs have been exposed to competition as the private sector may participate in all businesses. To introduce greater accountability, all central public sector undertakings (PSUs) are now subject to memorandums of understandings with indicative performance targeting. Moreover, budgetary support for unprofitable PSUs has been phased out. Unprofitable PSUs have been referred to the Board for Industrial and Financial Reconstruction. Legislative framework under which the Board has been set up is being amended to expedite and streamline the process of corporate restructuring. A National Renewal Fund was set up in 1992 to provide budgetary support for labor retrenchment and employment generation and training. Partial divestiture of PSUs has been allowed and the

(iv) the deregulation of the steel and coal industries in 1992.

Rangrajan Committee for Disinvestment of Shares in PSUs has recommended that the Government sell at least 74 percent of its stock in PSUs in sectors opened up for private sector participation.

REFORM OF TAXATION STRUCTURE

Personal income tax rates were reduced from 50 percent to 40 percent and incentives were rationalized. These include:

(i) rationalization of the saving deductions;

(ii) introduction of a presumptive tax (lump sum) for small traders, and

(iii) streamlining of transport operators and income attribution (clubbing) rules.

The corporate profits tax (subject to 45 percent rate for widely held companies and 50 percent for others) rates were unified and lowered to 40 percent. Moreover, the tax rate on capital gains for portfolio investments by foreign institutional investors was lowered. Other key measures include:

(i) a uniform depreciation allowance at 25 percent declining balance rate for plant and machinery;

(ii) five-year tax holiday for investments in infrastructure sectors and industries in backward states and electronic hardware and software parks; and

(iii) tax deduction at source for fees on professionals, technical services and contracts, and interest income.

Reforms of indirect taxes have included:

(i) restructuring of excises by replacing specific duties with ad valorem rates;

(ii) merger of basic duty with special surcharge;

(iii) reduction in rates for machinery, inputs, and consumption goods;

(iv) extension in the coverage of MODVAT (a modified Value Added Tax) to include manufacturers and selected services; and

(v) simplification of reporting for assessment purposes by relying on invoices for value determination.

The states are taking steps to harmonize their sales tax. The possibility of introducing the VAT is likewise being explored.

TRADE AND EXCHANGE RATE LIBERALIZATION

Trade liberalization has resulted in:

(i) dismantling of import licensing for all imports and consolidation of the remaining 26 restrictive items into a negative list;

(ii) reduction of the "canalized lists" items (goods that can only be imported by state trading agencies including fertilizers, petroleum products) from 53 to 8;

(iii) reduction in export controls from 439 to 215 items; and

(iv) importation of selected consumer goods under open general license, with exporters allowed to import specified consumer goods within limits under special licensing arrangements.

In addition, maximum tariff rates have been lowered from 400 percent in 1990/91 to 50 percent by 1995/96. Tariffs on general machinery, machine tools, instruments, and projects are unified at 25 percent eliminating the multiplicity of rates in these categories and reducing anomalies on input tariffs. Tariff rationalization has brought down effective rates (import-weighted) from 87 to 27 percent over the 1990/91 to 1995/96 period. Substantial steps have been taken to streamline export incentive framework.

The liberalization of the foreign exchange markets, which was conducted in three phases, has resulted in, among other things,

(i) convertibility of the rupee on current account transactions;

(ii) lifting of most restrictions on exporters and domestic companies by the 1973 Foreign Exchange Regulation Act, including the previously required Reserve Bank of India clearance prior to the appointment of technicians and managers and the use of trademarks;

(iii) reunification of the exchange rate and removal of requirements to surrender foreign exchange paved the way for a floating exchange rate system allowing the rupee/dollar exchange rate to reflect the market rate;and

(iv) India's acceptance of the obligations of Article VIII of the Fund's Articles of Agreement.

9. In recent years, India has made some headway in exploiting private capital to expand infrastructure capacity, while promoting efficiency and productivity through more rational use and maintenance of existing assets. In order of the state of preparedness, however, the policy and regulatory environment for private sector participation is fairly developed for the energy sector, followed by telecommunications, ports, and roads.

10. The private sector has been allowed to invest in ***power*** generation, with up to 100 percent foreign equity, and can distribute power. Investors are allowed guaranteed post-tax return on equity of 16 percent (at a plant load factor of 68.5 percent) based on a cost plus two-part tariff formula that covers both fixed and variable costs. Furthermore, investors can fully repatriate profits and dividends and are allowed a five-year income tax holiday for new generation and distribution companies, and tariffs were lowered to 20 percent on imports of equipment. To support the implementation of this policy, the Private Investment Cell has been created in the Ministry of Power, and a high powered board has been established to monitor the statutory clearances and to resolve issues. While the Central Government has taken these initiatives, the states have yet to reform their power sector, which has been affected by the operational and financial weaknesses of the state electricity boards (SEBs),[1] subsidized agriculture tariffs, and development of more transparent and competitive bidding procedures for sponsors selection.

11. The private sector has also been allowed to participate in the exploration of ***oil and gas***. Competitive terms and conditions have been set for the production sharing contracts of oil and gas, and the maximum exploration period being awarded is seven years. The private sector is allowed to participate in the development of discovered medium- and small-sized fields; refining, upstream and downstream industries; and associated infrastructure including pipelines, terminals, and tankers. A negotiating committee has been empowered to approve and award contracts, and the Directorate General of Hydrocarbons, set up in 1993, serves as a regulatory body to coordinate and develop sector policies and to offer technical advice on exploration and exploitation of hydrocarbon reserves. To streamline incentives, importation of petroleum products (except crude oil, motor spirit, and diesel oil) has been liberalized and gas prices are to be market-determined.

12. The private sector can now invest in all modes of ***transport***: air, roads, shipping, ports, and intercity and certain urban bus operations. The National Highways Act, 1956 was amended in June 1995 to allow the private sector to develop and maintain ***roads***, collect and retain fees, regulate and control traffic flows, and to allow punishment of encroachment on national highways/expressway. Fiscal concessions are to be provided to sponsors including five year tax holiday, reduction of import duty for specified equipment, deduction of up to 40 percent of taxable income derived from road-related long term finance instruments. While policy guidelines have yet to be firmed up, the toll charges could be determined by the Government keeping in view capital and operation and maintenance costs, interest during construction, volume of traffic, and concessions to build-operate-transfer (BOT) operators. To keep toll charges low, the Government could share the cost of land acquisition with BOT operators and lease them land free of all encumbrances, and/or provide BOT operators access to the adjoining land for

[1] Further discussion on the SEBs' performance and reforms is provided in paragraphs 71 to 80.

commercial purposes. The National Highway Authority of India is in the process of resolving these issues to finalize the policy and regulatory framework to develop national highways in high density corridor on a BOT basis.

13. In the shipping and ***port*** subsectors, the Merchant Shipping Act has been amended to open private capital markets to Indian vessel owners and operators.[1] Foreign interests can now set up companies that own and operate ships under the Indian flag and can acquire up to 51 percent of existing Indian carriers. The policy and regulatory framework is being evolved to privatize or lease selected port operations.[2] The Government has already: (i) leased two berths at Haldia port to the private sector; (ii) leased waterfront for private ship repair facilities at Calcutta, Madras, and Mormuga; (iii) privatized container terminal and chemical terminal in Jawaharlal Nehru Port; and (iv) offered dedicated berths for private shipping lines in several ports, including Bombay and Madras. While laying off 9,000 employees, the major Port Trusts have recently signed a memorandum of understanding with All India Labor Federation that binds labor to agreed productivity increases and links wage settlement to such productivity increases and a freeze on refilling vacant positions. To facilitate private sector involvement further the major Port Trusts need to develop the land-use and waterfront plan of ports. The lease period for facilities being offered to the private sector could be 30 years, and operators will have to agree on minimum performance standards, terms and conditions of rentals, and use of the existing port labor. Furthermore, there is need to increase autonomy of the major Port Trusts to promote and establish companies or joint ventures; and grant them greater administrative and financial autonomy for management of their operations with the objective of eventually corporatizing them.[3]

14. In ***railways***, built-own-lease and transfer schemes have been introduced to allow private consortiums to build facilities (including electrified lines) in exchange for annual lease payments. Ownership of these facilities will be transferred to Indian Railways after 20 years. Privatized container operations have been allowed to and from major ports. In view of Indian Railways' resource constraint, the Ministry of Railways and the state government concerned have evolved a mechanism to share, on a 50/50 ratio, the investment costs and net revenues for developing the Bombay suburban rail system.

15. In ***telecommunications***, private investment with up to 49 percent foreign equity is now allowed for manufacture of telecommunication equipment, value added,[4] and basic services. In the National Telecom Policy, announced in May 1994, the Government committed to provide telephone service on demand to all villages and a public call office in urban areas for every 500 persons by 1997, and value-added services within 1996. The National Telecom Policy further encourages pilot projects to use new technology, and to develop a funding mechanism to upgrade indigenous research and development to international standards. Licenses for telecom services are

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1 Also, restrictions have been withdrawn on ship acquisitions and registration, mortgage processing, retention of foreign exchange earnings, and tapping of eurocurrency markets.

2 These include container terminals; warehousing and storage facilities; operation and maintenance of various cargo handling terminals; provision of pilotage and cranage services; dredging; and lease of berths, equipment, and other facilities.

3 See TA No. 1771-IND: Policy Reforms in the Ports and Shipping Sector, for $970,000 approved on July 1994.

4 Refers to electronic mail, voice mail, data services, audio and video text services, radio paging, and cellular mobile phones.

granted through a competitive bidding process. Under the criteria, companies bidding for basic services are required to maintain a prescribed urban-rural coverage and meet agreed tariffs and revenue sharing arrangement. As part of the sector reforms, the Government plans to restructure the Department of Telecommunications by assigning it the principal responsibility to develop, operate and maintain state-owned telecommunication services and by separating from it (i) policy function(s) that are to be assigned to a telecommunication commission; and (ii) regulatory functions. The Government has set up an independent Telecom Regulatory Authority of India in January 1996 that will regulate the telecommunication services to ensure that the state-run and private networks compete on an equitable basis. The Authority has been entrusted with setting of standards, tariff regulation, ensuring technical capability and intermediation of networks, revenue sharing, consumer protection, etc.

C. Unfinished Economic Policy Agenda

16. Although the Government has made substantial progress in liberalizing and rationalizing the macroeconomic and infrastructure policy frameworks, a lot remains to be done to pave the way for sustained higher growth with adequate macroeconomic stability. Of foremost urgency is the need for the states to extend the macroeconomic and sector reforms[1] launched by the Center. On the macroeconomic side, the overall fiscal deficit must be reduced further to scale down the Government's reliance on high cost borrowings, release resources for the private sector, and protect core infrastructure and social sector programs. Reduction in the fiscal deficit calls for carrying forward the tax reforms to raise the revenue/GDP ratio by at least 2 percentage points of GDP over the medium term and to institute more stringent controls on unproductive expenditures.

17. Equally critical is the need to launch more aggressively the public enterprise reforms. So far, 35 public sector undertakings (PSUs) have been partially divested (by a maximum of 49 percent) involving equity of Rs102 billion ($3.6 billion). However, the PSUs do not have the desired autonomy and are being squeezed in the present environment as their budgetary support has been curtailed, while their prospect for accessing capital markets is currently weak. Most PSUs hold on to prime land and redundant facilities, which could be turned into viable commercial and industrial ventures through restructuring supported by partial divestiture and revenues from land sales. However, factor market rigidities have prevented restructuring of PSUs. Meanwhile growing competition from private sector participation in their sectors have compounded the financial difficulties of PSUs. Easing legislative and regulatory constraints that have inhibited labor and capital mobility will facilitate industrial and corporate restructuring and place increased emphasis on adopting more conducive labor practices to protect workers, both within PSUs and in private firms.

18. To sustain growth in the industrial sector, the Central Government will need to remove remaining barriers to entry (including small-scale industry) and to augment the trade liberalization program by lifting restrictions on consumer goods and agriculture commodities. On the other hand, maintenance of a competitive exchange rate is crucial to ensure sound growth in exports.

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[1] See paragraphs 50-58.

19. To improve resource mobilization and its allocative efficiency, further development of financial and capital markets is essential. However, the future sequencing and pacing of financial sector reforms depends on (i) the degree of success achieved in reducing fiscal deficits and the directed credit programs, and (ii) the trends in foreign exchange reserve build-up that may compel the Reserve Bank of India to pursue a more conservative monetary policy. To restore the health of public sector banks, the Government would have to further liberalize monetary policy, address issues of agriculture and housing finances, and expose banks to enhanced competition through faster divestiture and changes in management and technology. To meet the infrastructure financing needs, the capital market has to be developed further by strengthening of regulatory systems, constraints to development of debt market and promoting custodian and depository infrastructure to facilitate secondary trading of securities.

20. Finally, beside more transparent and competitive bidding procedure for sponsor selection, the private sector needs a more assured and conducive framework to take risky long-term stakes in India's infrastructure development. A number of outstanding issues remain to be resolved in infrastructure subsectors (see paras. 8 to 15) and further development and effective implementation of the policy and regulatory environment these areas would give major impetus to private sector involvement.

D. The Government's Social and Antipoverty Initiatives

21. India has made steady progress in improving its social indicators. For instance, from 1960 to 1991 life expectancy at birth rose from 41 to 61 years, the infant mortality rate declined from 146 to 74, and the total fertility rate decreased from 6.0 to 3.6. Concurrently, the education indicators have been rising as illiteracy declined and school enrollment ratios rose. The overwhelming size and growth of the population, however, has made it difficult to have more visible improvements. India currently has 904 million people of which about 30 percent (or 271 million) are below the poverty line and 48 percent are illiterate (over 434 million) with 70 percent of the population receiving no formal schooling. Gender disparities are fairly pronounced across sectors.[1]

22. The steady improvements in social and poverty indicators in India in the past few decades have resulted from a combination of several key policies. First, the Government has promoted economic growth (which rose by an average of 5.7 percent over the 1980s compared to 2.6 percent in the 1970s) with the objective that the gains reach the poor. The poor have benefited as the economic growth was accompanied by (i) improvements in food availability because of growing self-sufficiency in foodgrain production, and (ii) growing activity in secondary and tertiary sectors enabled a rise in employment at a time when the labor absorption of agriculture and industrial sector was weak. Furthermore, while employment in the organized and private sector has been constrained by rigidities in the labor market, the growth of the informal sector has managed to absorb the growing work force.

[1] See Appendix 2(D).

23. Second, continued efforts have been undertaken to gradually reorient public expenditures for social and human resource development. Of the EFYP outlays, about 18 percent[1] (or 8.4 percent of GDP) have been devoted to the social sectors. As a result, the share of education in development outlays has risen from 2.7 percent during the Sixth Plan period to about 5 percent over the EFYP period, and of water supply and sanitation from 3.2 to 3.8 percent. However, health and family welfare expenditures remained around 3.2 percent and those for the Minimum Needs Program declined from 42 to 38 percent of total development outlays.

Table 1: Key Socioeconomic Indicators

	1951	1961	1971	1981	Latest	Developing Countries
Demographic						
Population (million)	361	444	560	701	904[a]	--
Average Growth Rate (%)	1.3	1.9	2.2	2.3	1.8[a]	1.9
Life Expectancy at Birth (yrs)	32	41	46	50	61	63
Birth Rate (per 000)	40	42	41	37	29	30
Death Rate	27	23	19	15	9	9
Infant Mortality Rate	146	146	129	110	73	69
Total Fertility Rate[b] (births per woman)	n.a.	6.0	n.a.	4.5	3.6	3.8
Health						
Population (000) per Doctor	6	5	4	3	2	7
Population (000) per Bed	3	2	2	1	1	3
Government Health Expenditures (% GDP)	n.a.	n.a.	n.a.	n.a.	1.3	2.2
Education						
Literacy Rate	18	28	34	44	52	69
Male	28	40	46	56	64	79
Female	9	15	22	30	39	58
Primary Enrollment Ratio	22	42	70	94	103	99
Government Education Expenditures (% GNP)	1.2	2.5	3.1	3.1	3.9	3.9

n.a. = not available.
[a] Latest official projections based on 1991 census.
[b] 1961 figure refers to average for 1951-1961 and latest is for 1992.
Sources: Ministry of Finance: *Economic Survey. 1994-95;* Ministry of Human Resource Development: *Education For All - The Indian Scene;* October 1993; Ministry of Planning and Programme Implementation: *National Accounts Statistics;* UNDP: *Human Development Report. 1994;* UNFPA: *The State of World Population. 1993*; World Bank: *India's Family Welfare Program: Toward A Reproductive and Child Health Approach 1995.*

24. Third, the Government has augmented resources for the relatively poor and backward states by giving special weights to less developed states under the Central Government tax transfers.

[1] The comparable ratio for Indonesia is 29.8 percent; for the People's Republic of China, 39.8 percent; and for Malaysia, 25.4 percent.

25. Fourth, aside from encouraging small-scale industry (through various tax and credit incentives) to promote employment, the Government has managed a number of employment generation and poverty alleviation programs (see Box 2). These programs have been financed by the Central Government and the states. While issues of efficiency and targeting prevail, these special programs have contributed significantly to improving the welfare of the poor. The impact of such programs could be enhanced through better targeting and greater decentralization at the local level.

26. With continued improvements in the standard of living and rising economic activity, the progress in poverty reduction attained in the 1980s is likely to have persisted. Exception to this was the modest rise in poverty incidence after 1991/92 because of the temporary decline in real wages and inflationary pressures accompanied by rise in food prices[1] (both procurement and issue prices) that constitute a large component of the consumption expenditure of the poor. An analysis of the provisional sample of the National Sample Survey (NSS), however, suggests that subsequently poverty incidence fell to about 19 percent in 1993/94 and the average real wages rose by 5.1 percent during 1992/93 to 1994/95. India has undoubtedly witnessed a swift economic recovery and steered its stabilization program and structural reforms well to minimize the adverse social consequences, however, the recent analysis of poverty incidence based on partial data of NSS, may overstate the case. There is, however, no doubt that in the last few years the Government has assigned greater priority to enhancing development of social sectors, population and family welfare programs, rural, and employment programs. The increase in central plan outlays over 1992/93 to 1995/96 period for education is 92 percent (with over 120 percent rise in elementary education), for health 62 percent, rural development 148 percent, and rural water supply and sanitation 144 percent.

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[1] For example, since 1991 rice prices (sold through public foodgrain distribution system) rose by 90 percent and wheat by 70 percent .

Box 2: India: Major Employment Generation and Poverty Alleviation Programs

The **Public Foodgrain Distribution System** (PFDS) is designed to reduce disruptions in food supply and interstate differences in food availability, provide subsidized food to the poor, and stabilize prices of essential agricultural commodities. The Central Government-owned Food Corporation of India procures rice, wheat, and sugar and sells them to the states at a subsidized "issue price." They are resold to consumers at the "issue-rate" through 350,000 retail outlets and fair price shops, 80 percent of which are in rural areas. The inadequate coverage of the PFDS network, its accessibility to higher income groups, and high operational costs have affected the efficiency of PFDS to serve the poor. To address these concerns, the Government intends to add 11,000 new fair price shops primarily in drought prone, tribal, and dessert areas. In 1992, the PFDS has been extended to another 1.9 million poor.

The **National Renewal Fund**, established in February 1992, finances voluntary retirement schemes and retraining and redeployment of employees arising as a result of industrial restructuring. The Government has so far used the National Renewal Fund to make voluntary retirement scheme payments to some 80,000 employees of Central Government public sector undertakings and training to 1,500 laid-off workers.

Urban Anti-Poverty Programs provide basic physical and social amenities to urban slums. Among these, the Urban Basic Services Program focuses on women and child survival through immunization; nutrition supplementation; preschool facilities; and provision of water supply, drainage, and low cost sanitation. In addition, an Environmental Improvement Program targets about 9 million slum dwellers at a total cost of Rs2.7 billion.

The **Differential Rate of Interest Scheme** provides concessional credit at 4 percent, without collateral, for specified activities. The credit available to the poor whose income does not exceed Rs7,200 in urban areas and Rs6,400 in rural areas.

Integrated Rural Development Program, assists marginal and small farmers, agricultural labors, and artisans with investments in minor irrigation, livestock purchases, bullock carts, etc. and supports self-employment ventures through grants and loans at subsidized interest rates. The Program is to reach about 30 million low-income households towards the end of the decade.

The **National Rural Employment Programs** employs labor to construct rural roads, school buildings, minor irrigation structure, etc., and has generated 360 million work days annually.

Landless Employment Guarantee and Jawahar Rozgar Yohajana Programs are rural-based programs providing funds to employ landless, women, schedule castes and tribes, etc. for construction of minor public works. These programs have generated over 900 million person-days of work.

Nehru Rozgar Yojana is an urban-based program providing employment to the poor. Under the scheme, infrastructural support is provided to set up microenterprises in urban settlements, and wage labor is generated through municipal construction works and upgrading the housing/shelter of urban settlements.

Maharashtra Employment Guarantee Scheme (MEGS) employs labor to create productive assets such as small-scale irrigation schemes, maintain roads, etc. The MEGS has generated employment of 170 million days annually. The daily wages offered under MEGS are at par with the prevailing agricultural wages.

The **Scheme for Self-employment of Educated Unemployed Youth** was launched in 1983/84 to promote self-employment among educated youth (aged 18-35) whose families' income does not exceed Rs10,000 per annum. The Central Government provides a subsidy of 25 percent for this program, while the rest is covered by banks. From 1983 to 1992, about 1.5 million beneficiaries were sanctioned loans, amounting to Rs30 billion.

II. EXTERNAL ASSISTANCE

A. Overall Trends and Composition of External Assistance

27. During the 1950-1970 period, official development assistance financed over one fourth of the development outlays and imports in India (see Table 2). The flow of external assistance, however, slowed down in the first half of the 1980s. This occurred partly because of India's desire to achieve a higher degree of self-reliance following the rise in domestic savings, and partly because of problems of aid absorptive capacity resulting from lack of timely availability of counterpart funding and slow project implementation. The significance of aid has gradually picked up in India in the late 1980s, reflecting adoption of more expansionary policies, though it never reached the pre-1970s level. While the level of aid inflows has fluctuated, the terms and conditions of external assistance to India have hardened as the grant component in official development assistance fell sharply from 22.5 percent in 1979/80 to 7.5 percent in 1993/94. This is largely because of a significant change in the International Bank for Reconstruction and Development (IBRD)/International Development Association (IDA) blend from 22/78 in 1980/81 to 66/34 in 1993/94, although part of the impact of this is likely to have been offset by the growing funding available on concessional terms from the Overseas Economic Cooperation Fund (OECF).

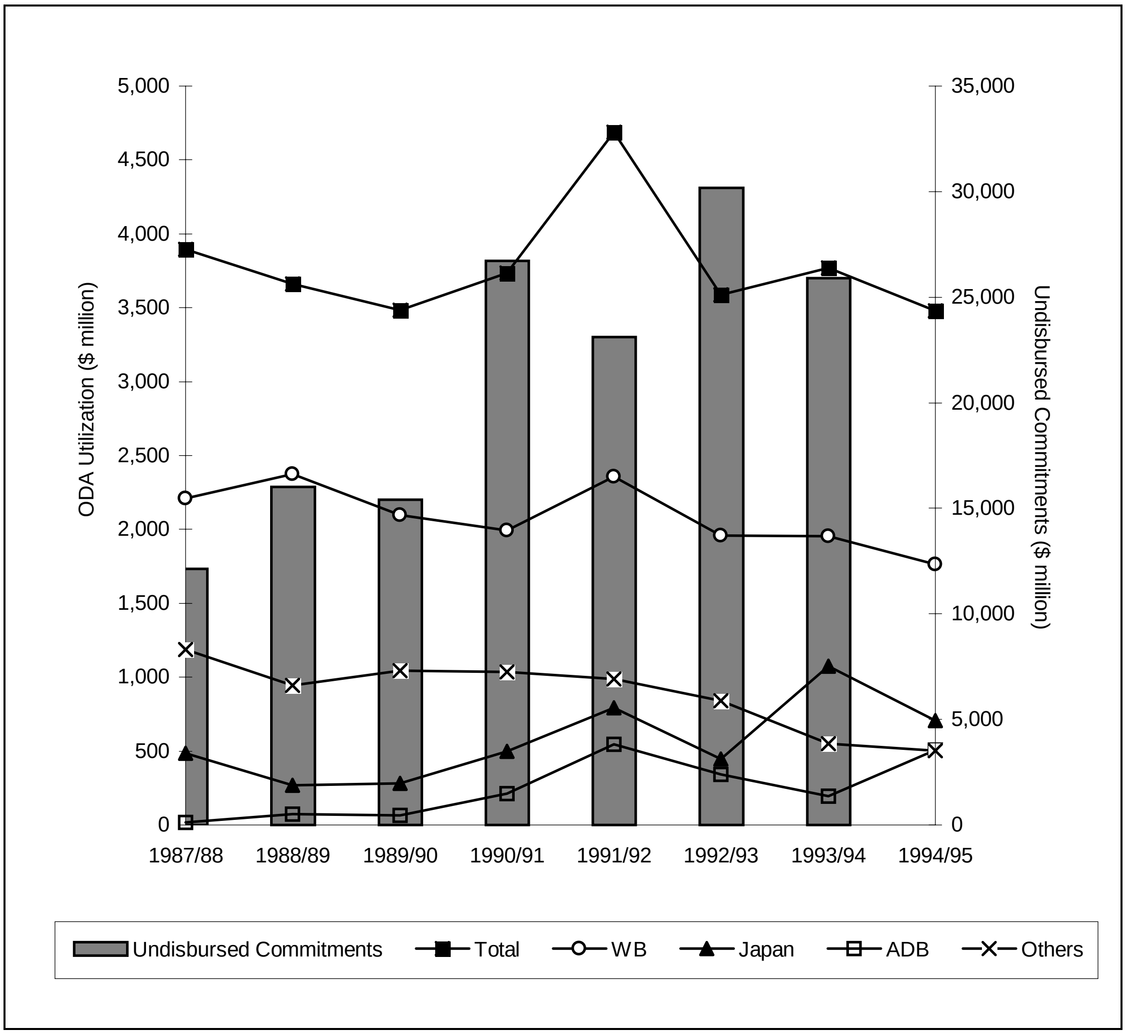
Table 2: Trends and Significance of External Assistance Flow

	External Utilization	**Plan Outlays**	**Imports**	**External Assistance As % of**	
	(billion rupees)			**Plan Outlays**	**Imports**
First to Third Plan (1951 to 1966)	41	152	147	27	28
Fourth to Fifth Plan (1969 to 1979)	86	552	376	16	23
Annual Plan 1979/80	14	122	91	12	15
Sixth Plan 1980 to 1985	109	1105	734	10	15
Seventh Plan 1985 to 1990	227	2214	1256	10	18
1990/91 to 1994/95	520	3903	3421	13	15

Sources: Ministry of Finance: *Economic Survey. 1994-95.*; Planning Commission: *Eighth Five Year Plan. 1992-97;* and Bajaj J.L. *Externally Aided Projects and State Finance.*

28. Cumulative aid authorizations to India amounted to Rs1355 billion as of 1993/94 compared to Rs952 billion utilization. The aid utilization has in general been slower than expected since the late 1980s and could have inhibited the growth of official development assistance, though a small component of it is being gradually replaced by recourse to private credit. Excluding 1991/92 when aid utilization rose to $4.7 billion with support of quick disbursing loans to meet the country's unforeseen external liquidity crisis, India's aid utilization has averaged around $3.4 billion annually during the last decade.

Figure 1: Trends in Utilization of ODA



29. The overall aid disbursement ratios in fact fell from about 30 percent in 1987/88 to 14 percent in 1990/91 and reached its lowest level (10 percent) in 1992/93.[1] The decline in disbursement ratios is attributable to the shortage of counterpart funding in view of the growing fiscal pressures and the inability of PSUs to raise resources

1 See Ministry of Finance: *External Assistance 1993/94—A Performance Review.*

because of tight market conditions; procedural delays in approvals (including for land acquisitions); and weaknesses of executing agencies (EAs) in implementing projects. Exchange rate movements also affected the disbursements as the rupee depreciated significantly in the 1990s over the 1989/90 levels. The slowdown in disbursement and the continued rise in aid commitments (averaging about $22 billion over 1988/89 to 1992/93) led to an increase in undisbursed commitments, from $12 billion in 1987/88 to an average of $26 billion[1] over the 1990s — almost double the 1987/88 level.

30. Trends in aid inflows, however, mask the vital role external assistance has played in some sectors where investment requirements are high. External assistance has contributed over 20 percent of the power investment and 12.5 percent of social sector investments. This is largely because about 40 percent of external assistance in the 1990s has supported the energy sector, most of which was directed for power subsector. Another 17 percent of external assistance supported the social sector.

31. Almost two thirds of the authorized official development assistance supported Central Government programs, with the remaining one fourth devoted to state-specific programs. Almost half of the authorized official development assistance for states had been for five states (Maharashtra, Gujarat, Karnataka, Tamil Nadu and West Bengal, which have 30 percent of India’s population, and have per capita incomes above the all-India average), and another one third to two states (Andhra Pradesh and Uttar Pradesh, which accounts for 24 percent of the population and report per capita incomes below the all-India average). Further details on sector and state distribution of external assistance are shown in Figure 2.

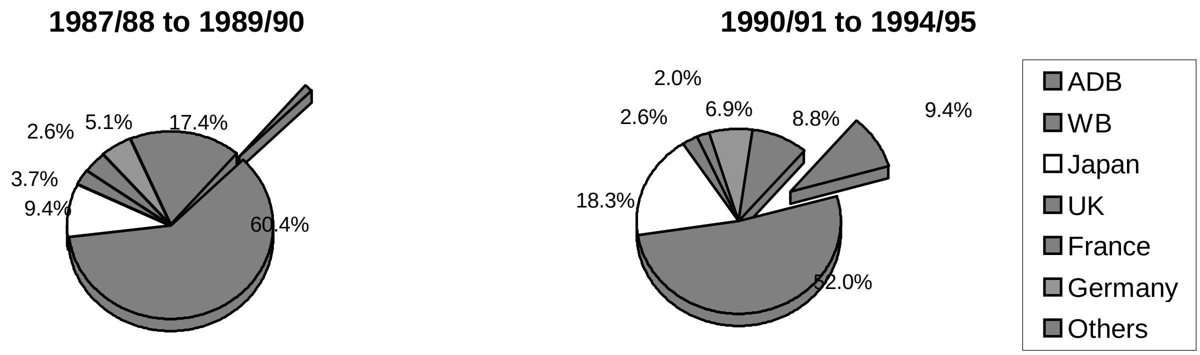
B. Experience of the Bank’s Assistance

1. Overview

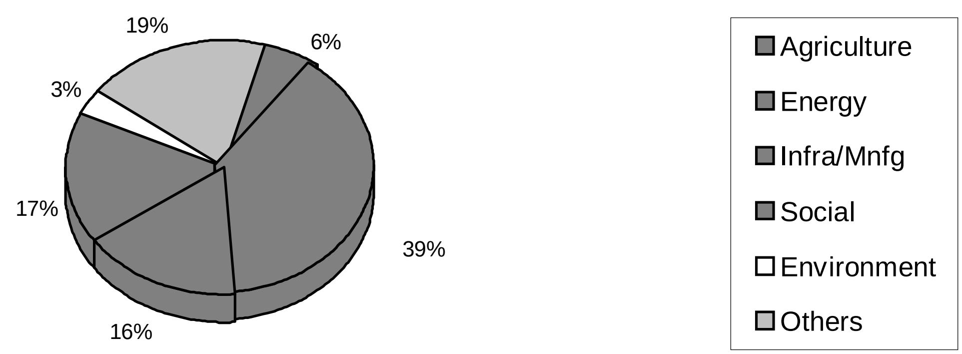
32. The Bank began operations in India in 1986. So far, the Bank has approved 28 loans amounting to $5.2 billion. Net of cancellation, the commitments total $4.6 billion as of 31 July 1995. To date, five loans have been closed. Cumulative disbursements have reached $2.1 billion and the undisbursed balance is $2.8 billion for 23 active loans. The Bank’s lending has concentrated primarily in the energy and transport cum communication sectors, each of which received 36 percent of lending. The development finance institutions and financial sector reforms constituted another 16 percent of lending. The subsector level, the highest priority was assigned to power, followed by gas and roads. With greater thrust on policy reforms, the sectoral distribution underwent some changes in the last three years. For instance, the share of lending to the gas subsector grew as the Bank provided a program loan to support hydrocarbon subsector reforms and assisted a few gas projects. In the transport and communication sector, assistance to ports has also risen sharply in recent years. India’s non-access to the Asian Development Fund (ADF) and its reluctance to borrow from ordinary capital resources (OCR) for social sector projects prevented the Bank from lending for the agriculture and social sectors.

[1] Over half of the undisbursed balances is against bilateral commitments and 48 percent against multilateral commitments.

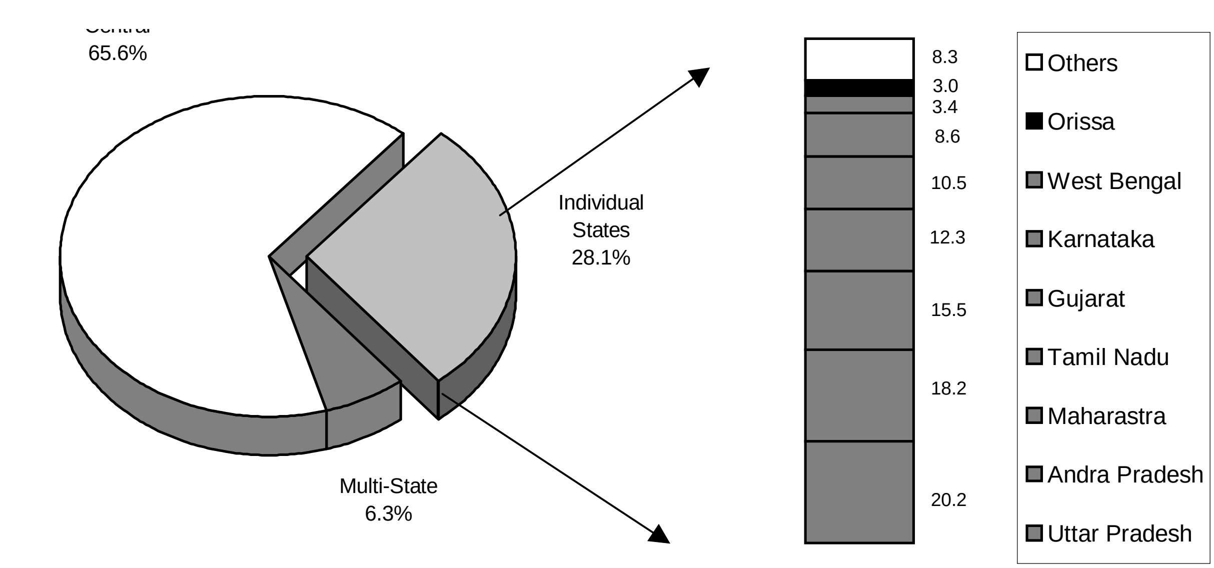
A. External Assistance by Source (Based on Utilization)



B. Sectoral Distribution of External Assistance (Based on Authorizations)



C. Statewise Distribution of External Assistance (Based on Authorizations)



2. Disbursement Performance

33. The Bank's disbursements in India have been low (see Table 3). The annual disbursements of project loans during 1990 to 1993 averaged about $256 million.[1] The Bank disbursements, however, improved substantially and reached a record high of $492 million, (including $150 million program loan) in 1994 and $542 million (including $125 million program loan) in 1995.[2] Disbursements picked up because of a combination of factors, including (i) Government efforts to improve the flow of funds to project entities and streamline project implementation and procedures, (ii) timely coming on stream of large contracts in the hydrocarbon sector, (iii) the maturation of the transport and communication portfolio, (v) rationalization of the project portfolio, and (vi) the timely release of quick disbursement operations.

Table 3: Trends in Bank Disbursements Rates

	Disbursement Ratio Including Program Loans		Disbursement Ratio excluding. Program Loans and Imprest Account Balances	
	Bankwide[a]	India	Bankwide[a]	India
1990	20.5	13.8	16.3	5.7
1991	21.6	20.8	16.9	7.7
1992	16.0	13.6	11.3	1.4
1993	15.7	7.1	13.1	3.3
1994	18.6	15.0	15.8	7.8
1995	18.1	17.6	15.7	11.5

[a] Refers to OCR only.

34. Keeping in perspective disbursement trends, the lending levels for India, which had increased steadily from $250 million in 1986 to $982 million in 1992, were scaled back to $150 million in 1994.[3] This helped bring down the rising undisbursed levels to a more manageable level of $2.6 billion.[4] The existing portfolio is now relatively mature with 11 loans (or half of ongoing loans) expected to be closed in 1996.

35. Consequently, disbursements are projected to rise to about $600 million for 1996.[5] The project disbursement ratio will rise to 19 percent, possibly equivalent to the Bankwide average, if not above it. Beyond 1996, the more advanced maturity of ongoing loans (and corresponding reduced level of disbursements under these loans at that time) coupled with an expected increase in commitments over the years would determine the trends in the disbursement ratios. The benefits accrued from improved portfolio management and better quality at entry should counterbalance any possible

[1] The disbursement ratio dipped from 20.9 percent in 1991 to 7.1 percent in 1993.

[2] The disbursement ratio rose to 15.0 percent (compared to average trend of 13.9 percent during 1990 to 1993) though it is still slightly below the Bank average.

[3] The decline in the 1994 lending level is also attributable to the weaknesses of project pipeline.

[4] Of the undisbursed balance, 45 percent is outstanding for transport and communication projects, and rest for the energy sector.

[5] Projected on the basis of contract awards.

negative effects of the Bank's old portfolio and increased commitments in 1997 and 1998.

3. Project Implementation Issues

36. To date, 7 of 32 loans have been completed. Of the 25 active loans,[1] 5 are not yet effective and 20 are under implementation. On an overall basis, the project implementation and disbursement performance of the Bank portfolio in India appears lower than average. However, of the projects under implementation, 18 are classified as "satisfactory," and 2 as "partially satisfactory." The ratio of satisfactory projects in the Bank's portfolio in India is 89 percent, which is the same as the current Bank average. About 8 projects or one third of the total approved projects required an extension of 3 years. At a disaggregated level, some sectors fared better than others. For instance, the Bank's experience in hydrocarbon and financial sectors has been good compared to its experience in the rest of the portfolio.

37. Primary reasons for the slow disbursements were (i) initial teething problems of EAs unfamiliar with Bank procedures, compounded by the systemic procedural and technical problems at operational and policy levels; and (ii) problems with project design and implementation arrangements. A number of generic issues, which will require further attention of the Bank and the Government, are as follows:

(i) **Start up Delays**: These are primarily due to delays in Public Investment Board and environment clearances, and issues pertaining to land acquisition, procurement, and project management. These problems can be avoided provided that (a) project quality is ensured at entry, (b) Bank's processing and approval steps are well synchronized, and (c) more upfront implementation and policy compliance is built-in.

(ii) **Project Management and Institutional Development**: Performance in this area varies between EAs, with the track record of central PSUs being better than that of others. Project management practices in EAs suffer because of (a) delays in establishing and staffing project implementation units (PIUs) and/or inappropriate quality of PIU staffing and their subsequent high turnover resulting in lack of continuity and accountability; (b) lack of autonomy and authority of the PIU, and highly hierarchical and cumbersome decision processes; and (c) lack of forward planning and coordination capacity in EAs and PIUs.

(iii) **Availability of Funds at the Project Level**: Excluding fully disintermediated loans, all project expenditures (including the Bank's portion), have to be financed initially from an allocated rupee budget agreed between the Central Government, states and line ministries. Since sector allocations are made on the basis of national priorities and requirements, allocations to implement the foreign-aided projects are often below requirements and delayed. Although external assistance is treated

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[1] Of these, eleven loans are in the power and hydrocarbon sectors, nine in the transport and telecommunication sectors, one in the industry sector, and two each in the finance and social infrastructure sectors.

as an additionality for EAs, counterpart funding for foreign-aided projects remains a component of normal budgetary allocation. This acts as a major disincentive for states and PSUs to implement centrally funded projects.

(iv) **Procurement and Contract Management**: Inordinately long delays are common at all stages of the procurement cycle, i.e., prequalification, preparation of bid documents, evaluation of bids, and signing of contract agreements. Procurement delays average about a year and arise because of an overly complex and hierarchical decision making process, pressures to pursue domestic procurement, lack of delegation by the EA/ PIU, and need for EAs to seek review and approval from an outside agency whose decision making process is prolonged because the EA is often unfamiliar with the Bank's procurement procedures. Delays are worse for projects implemented by state or line ministries than for those implemented by Central PSUs, which have a higher degree of autonomy. The implementation difficulties also stem from weaknesses of domestic contractors, and perhaps more International Competitive Biddings should be permitted as this may be the better strategy for developing the domestic contracting industry.

C. Government and Bank Initiatives to Enhance Aid Utilization

38. To improve project implementation and sustain the momentum of disbursements, the Bank has provided a small-scale technical assistance (TA) to the Department of Economic Affairs for Project Monitoring and Procedure Streamlining.[1] In addition, discussions are under way on Bank projects with the Government to (i) simplify internal approval procedures, (ii) improve project management, and (iii) delegate procurement authority down the line to divisional/regional levels. The Ministry of Finance recently issued new standard bidding documents for inviting tenders for aided projects and has advised EAs to adhere to these procurement procedures to speed up aid utilization. For the power subsector, Central Government approval is no longer required for contracts less than Rs1 billion ($36 million). In 1993, the Government also decided to take the following measures:

(i) Ensure quality at entry point for new projects, both in terms of project design and advance actions, to facilitate timely drawdown of disbursements;

(ii) Encourage disintermediation of future external assistance to Central PSUs[2] on terms agreed between the borrower and lender. The disintermediation allows (a) funding sources to onlend the terms and conditions of their assistance, (b) makes external transfers simple and transparent while inducing EAs to be accountable, (c) paves the way for introducing incentive mechanisms whereby EAs qualify for assistance on

[1] TA No. 1862-IND, for $100 million approved on 30 March 1993.

[2] The Government is also considering to allow external agencies to lend directly to states.

a need and performance basis, and (d) saves commitment charges by the Government, as the liability of borrowing is passed on to project entities.

(iii) Prefinance onlending by releasing 25 percent of projected expenditures in April annually and subsequently ensuring timely release of outstanding expenditures. For new commitments, advances[1] would be released to EAs immediately on credit effectiveness.

39. To improve project supervision and monitoring, the Project Management Unit (headed by the Joint Secretary, External Finance in the Ministry of Finance) was set up in 1993 to remove operational impediments affecting foreign-aided projects. Concurrently, the Government and external agencies have undertaken an overall review of the aided-projects portfolio and its rationalization. The review has focused on redeployment of unutilizeable surplus arising from exchange rate adjustments or changes in project scope and the portfolio problem. The portfolio review of World Bank, whose undisbursed balances stood at $11.6 billion,[2] has identified about $2.8 billion, of which $1.8 billion was canceled in 1993.

40. The intensive supervision and monitoring of the Bank's portfolio has played a critical role in expediting disbursements. Following a portfolio review by the Country Portfolio Review Mission and India Resident Mission, about $33.7 million loan savings were canceled in 1994 and another $20.7 million[3] in 1995. These measures, coupled with the decline in lending level in 1994 and an increased pace of disbursements, have assisted in lowering the undisbursed balance in India from $3.2 billion at the end of February 1994 to $2.8 billion by the end of February 1995.

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[1] Such advances would remain with the project authorities as revolving funds and the actual expenditures would be reimbursed on a monthly basis.

[2] Includes IBRD $7.1 billion and IDA $4.5 billion.

[3] Subject to further review by Projects Department and EA.

III. OVERALL STRATEGIC THRUST

A. Existing Strategy

41. The present operational strategy, introduced in 1989, recommended that the Bank promote industrialization by supporting efficiency in physical, human and financial resource use. This overall objective was to be achieved through three initiatives:

(i) strengthening the industrial policy environment in order to encourage greater private sector participation,

(ii) supporting the development of physical and financial infrastructure through public and private sectors, and

(iii) identifying private investment to serve a catalytic role in areas where the policy environment was being improved or where new technology was being introduced.

42. The existing strategy has allowed the Bank to widen its operations across all key infrastructure sectors and support the Government's development program. On this basis, a substantial degree of experience has been accumulated across key infrastructure sectors. Nevertheless, since the Bank has only nine years of experience in India, it took some years for the EAs in the different sectors to gain familiarity with the Bank's operations and procedures, and for the Bank to build up its understanding of the sector issues and policy dimensions. Now that the teething problems of implementation are being resolved, the Bank and the Government can consolidate the experience gained and develop a strategy to respond better to the emerging country and sector requirements.

43. The major lessons emerging from the Bank's experience in India[1] are difficulties of project execution without a supportive policy, regulatory, and institutional environment and the procedural complexities of the associated administrative setups involved. Furthermore, since a large component of Bank assistance under the existing strategy assisted public sector investments and institutions, the Bank operations, with some important exceptions, have confronted problems of absorptive capacity and had a limited impact on sector policy and institutional development. Also, there have been instances where lack of specificity in strategic, sector, and location focus has diffused the impact of the Bank's operations.

44. Finally, thus far the Bank has largely supported national-level policy reforms, such as in the hydrocarbon subsector and financial and capital markets, that fall exclusively under the Center's jurisdiction. While continued support is warranted in these areas, for the Bank to play a more catalytic role in the unfinished economic reforms agenda, the Bank's strategy must be reoriented in its overall strategic focus to support the growth and development process. Also, the strategy should be fine tuned across

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[1] See also Appendix 3.

sectors to better integrate and address more systematically the root problems of the infrastructure subsectors, which largely fall under state domains. An example of this is the problem of SEBs, which has ailed the overall sector performance and affected prospects for private investment. Consequently, the strategy needs reorientation to support the present day needs of the country as well as to respond better to the shifts in the Government's priorities and development agenda after 1990/91, while keeping in perspective the fundamental elements of the Bank's Medium Term Strategic Framework including policy initiatives associated with the General Capital Increase IV.

B. Proposed New Strategic Thrust

45. India is at a crucial juncture in its reform process. Sound macroeconomic policies have assisted the country to attain a fair degree of financial stability and economic liberalization to stimulate industrial recovery. To realize full dividends of economic reforms, it is important to hasten the process of economic growth and transformation. Consistent with the Government's development strategy and policy reforms and the priorities of Medium Term Strategic Framework, ***the Bank's overall strategic emphasis will be to promote efficiency and higher sustainable growth to improve employment opportunities, while reducing poverty.*** To set India on this growth path, fundamental policy changes must be extended to address inefficiencies at state and sector levels, and to promote more aggressively industrial restructuring and private sector participation. This is to be achieved keeping in perspective macroeconomic stabilization and social concerns without which the process of economic growth will not be sustained, because adverse financial and social developments could threaten stability.

46. As the economic reform gains momentum and deepens, the investment requirements and the cost of adjustments (in financial and social terms) are expected to grow. In view of the Government's limited resources and implementation capacity relative to the country's vast requirements, the significance of private sector and external flows in India is envisaged to rise concurrently. The Bank's involvement, while small in quantitative terms in contrast to the country's development requirements, is perceived by authorities as pivotal in supporting India to embark on a high growth path. This stems from a qualitative significance and impact of the Bank's assistance which, if targeted well on the main pressure points, will address state- and sector-level inefficiencies, encourage policy change, create synergies and a multiplier effect, and leverage other assistance. These factors would yield benefits to the economy far greater than are obvious by the absolute levels of assistance provided.

C. Main Priorities to Attain the Strategic Objective

47. To achieve the overall strategic objective, the Bank will provide support to:

(i) improve macroeconomic stability and reduce sector inefficiencies to sustain and implement structural reforms effectively;

(ii) promote competition and private sector involvement by supporting establishment of the policy, regulatory and institutional frameworks at the state level;

(iii) corporatize and restructure the public sector; and

(iv) enhancing resource mobilization through further reforms of financial and capital markets.

48. In the interest of manageability and developmental impact, a sharper focus is recommended for the Bank's strategy in India, among and within sectors and the region, in order to:

(i) generate greater synergy and the multiplier effect of assistance on growth and its sustainability,

(ii) play a catalytic role to mobilize sector reforms as well as leverage other assistance to stimulate policy reforms, and

(iii) avoid a thin spreading of the Bank's limited resources across the country by developing more state-focused operations (see paras. 50 to 58).

49. To serve the overall strategic objective and priorities, the focus of the Bank's sector strategies (see Chapter IV) needs to be reoriented to support the policy and institutional reforms. At the same time, sector strategies are being changed to incorporate the lessons of the Bank's portfolio review.[1] The portfolio review essentially highlights the need for selectivity in project intervention based on progress attained on sector policy and the regulatory front, and the EA's record of implementation.

D. State-focused Interventions

50. To achieve the proposed strategic objective and priorities identified above, the Bank needs to shift its focus to state level operations, which have lagged behind in the reform process. The states play a predominant role in the provision of infrastructure and social services and in executing Central Government policies and programs (see Box 3). However, the significant variations in their resource endowments, as well as in their socioeconomic level of development coupled with differences in structural features of their economies and growth patterns, have made more complex, if not impossible, the Central Government's task of planning and policy coordination to encourage reforms and development process at state level.

51. Furthermore, increasingly the sustainability of the Central Government's macroeconomic adjustment and long-term development strategy is being affected by the weaknesses of state finances and sector inefficiencies. The states' public finances are under stress because of sluggish growth in central tax transfers; weak states' own revenue performance (including low cost recovery); rising wage bill and unproductive

[1] See Appendix 3.

expenditures; and dependence of uneconomic enterprises.[1] The fiscal squeeze at the state level is further compounded as the Central Government and the Reserve Bank of India have in recent years ceased ad hoc fiscal transfers. The growing fiscal problems have created a shortage of counterpart funding and limited states' abilities to implement projects on schedule. The structural problems of states' public finances and associated rising financial stress on the economy underscores the need for the following:

(i) A review of the prevailing fiscal arrangements under which the Central Government ends up picking up the revenue deficits and debt liabilities of defaulting states. As a result, the central fiscal transfers have perpetuated the states' fiscal indiscipline and penalized the states that adopt more prudent fiscal management. The review of intergovernmental fiscal arrangements is the subject of the National Finance Commission, which meets every five years, and the National Development Council (with representation of State Chief Ministers), which meets more frequently. The Tenth Finance Commission, which concluded its deliberation in 1994, has recommended rationalizing of the tax devolution pool,[2] although this may not necessarily ease the resource squeeze at the state level.

(ii) Reforms of states' public expenditures and taxation structure. On the expenditure side, there is a need to rationalize current expenditures to allow for more substantive levels of development outlays. In addition, states need to exploit the key revenue sources under their domain. These include sales tax, property tax, and other taxes, which, if appropriately exploited, offer a good avenue to augment the states' own resources.

52. Delays in strengthening state finances and extending economic liberalization across sectors at the state level carry dual risks: (i) frustrating the states' development goals for infrastructure and human resource development, and (ii) adversely affecting the Central Government's overall development agenda by spilling over its fiscal slippage and sector inefficiencies. The latter, among other things, refers to the SEB's poor performance which is making it difficult for India to address the problems of the power subsector more effectively.

53. Consequently, the states, which now need substantial support to reform their economy and restructure their ailing industrial sector, are keen to play an effective role in advancing the reform process that so far has been largely centrally driven. In its nine years of operations in India, the Bank has mainly supported the Central Government or its public sector entities to promote macroeconomic and sectoral reforms. While maintaining its involvement in nationwide programs and central public utilities, from the Bank's perspective there are clear advantages to gradually shifting a part of its operation to the state level over the medium term. These include the:

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[1] State Electricity Boards and states transport and other commercial and promotive undertakings.

[2] Two alternates have been suggested by the National Finance Commission: raising the states' share in the existing divisible pool (which currently includes income tax and excise duty); or enlarging the divisible pool base by adding to it corporate tax and custom duties and the Central Government's sharing with the states about 29 percent of the proceeds of all taxes in the divisible pool.

Box 3: Role of States in Development Process

The 25 states of India are heterogeneous and diverse entities. The states have diverse geographic features and resource endowments and vary significantly in their social and economic profile (see Appendix 2). The two low income states, Uttar Pradesh and Bihar, have the largest population (140 and 86 million, respectively); while the population in 4 states ranges between 60 million to 80 million and another 5 states between 40 million to 55 million, with the rest below it. About 5 states have per capita incomes above the all-India average and rest are below it. Growth and its structural composition has widely differed across states. Over the years, the progressive and reform-oriented states (e.g., Gujarat, Maharashtra, and Punjab) have achieved increases in per capita incomes, while per capita incomes in less progressive states (e.g., Bihar, Orissa, Uttar Pradesh, and West Bengal) remained below the all-India average. Higher income states are, however, not always the most developed or industrialized, as some of them are highly dependent on agriculture (e.g., Haryana and Punjab) and have achieved limited success in structural transformation. Also, there are some developed states (e.g., Gujarat and Maharashtra) that have managed a rise in industrialization but continue to perform at low levels of efficiency and higher rural-urban disparities. At the same time, there are comparatively underdeveloped states (e.g., Rajasthan and Uttar Pradesh) that with low per capita incomes have high (above the all-India average) per capita consumption or high social indicators (e.g., Kerala). While these peculiarities exist, there are clearly pockets where the level of development has been low and poverty incidence high.

The states have been entrusted with significant functions[1] and revenues. The states handle 54 percent of expenditure obligations, while their share in overall revenues is 43 percent. The degree of expenditure obligations varies significantly across sectors: for instance, states handle over 80 to 90 percent of expenditures of public health, family welfare, social security areas, education, housing and urban development, power, and irrigation and flood control and 50-60 percent in agriculture and allied services, public work, and transport and communications sectors. While the state have heavy obligations, they are heavily dependent on the Central Government for resource transfers and its allocation as well as borrowings. Article 293 of the Constitution allows the states to borrow from the market. However, a state that is indebted to the Central Government, has to seek permission from the Government for exercising its borrowing powers. Furthermore, States have to rely on Central Government for external borrowing. The National Finance Commission awards tax and grant transfers to allow states to attain a surplus on the recurrent account to meet a part of their capital expenditures, the plan transfers by the Planning Commission through a Gadgil formula. This is distributed as follows: 60 percent on a population basis, 25 percent on a per capita income basis, 7.5 percent on fiscal management, and the rest on special considerations. A part of these transfers finances states' plans and a part is tied to centrally-sponsored schemes and foreign-aided projects. Despite these transfers, the Central Government provides loans to finance almost half of the states' fiscal deficit.

While the states are heavily dependent on the Central Government, they are fairly autonomous in the areas under their jurisdiction. However, the continued high states fiscal deficit, averaging over 3.5 percent of GDP in 1990s, and structural inefficiencies have affected their prospects for development. The states are presently using most of their resources, including a component of plan transfers and borrowings, to meet their recurrent expenditures, which now constitute over 80 percent of the state total expenditures. The rising recurrent obligations have squeezed states' capital expenditures, which presently constitute barely 3 percent of GDP. These levels of capital outlays are insufficient to alleviate the growing infrastructure constraint. Unless addressed, this will adversely affect the states' growth prospects and inhibit their ability to reduce poverty.

1/ This excludes strategic sectors (such as defense, foreign relations and assistance, shipping and navigation, banking and insurance, and minerals) that are handled by the Central Government because of security and macroeconomic considerations.

(i) ease and efficiency of dealing with and processing projects with a smaller administration;

(ii) manageability of the scale of operations because loan size could be aligned to demands;

(iii) possibility of better integration and feedback between the policy and project operations, if these mutually reinforcing operations are adopted in a state; and

(iv) impact of Bank operations on a regional dimension.

54. The selection of states for Bank operations is, however, a complex process, and difficulties are compounded by the central government's concern that external assistance to one or two states may have unintended effects on the resource allocation and equity considerations.[1] This issue is now receiving less emphasis as the Central Government has treated external assistance as "additionality" over the planned allocations since early 1990 and is encouraging states to secure external assistance on the basis of their performance and absorptive capacity.

55. Nevertheless, from the Bank's perspective the selection of each state ought to be based on a set of sound criteria. At the outset, it may be feasible to approach this via an exclusion process. For example, states that are receiving comprehensive support from other sources (in particular, the World Bank) should not be targeted in the initial phase of the Bank's state-level intervention. Among those that may be considered eligible, the Bank ought to gradually target a few states over the next few years.

56. In the selection, the Bank will have to focus on states that exhibit:

(i) strong intentions and are willing to undertake reforms,

(ii) high demand needs in terms of population and infrastructure,

(iii) a satisfactory record of implementation and are not receiving any major assistance from other donors,

(iv) capacity and willingness to take OCR terms and foreign exchange risks and the capability of repayment.

It is also recommended that the Bank target, to the extent possible, both high and low income states. Those criteria, and a variety of states, would balance the state-level political and implementation risks for the Bank operations. The states' willingness to seek Bank support would, of course, vary depending on their political and fiscal constraints, level of labor stability, state of infrastructure, and terms and conditions of external assistance. The Government channels external assistance to the states on a

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1 Currently these concerns are addressed through an allocation mechanism that provides adequate weights to regional disparities among states.

loan-grant ratio of 70/30, with loans carrying an average interest rate of 11.8 percent and 15 years maturity. The exchange rate risk is assumed by the Central Government. Some states would have preferred to see disintermediation of external assistance to avail of concessional terms and conditions of IDA and bilateral grants. However, complete disintermediation of external assistance to the States is not foreseeable as under the Constitution states are not permitted to borrow directly external loans. Any attempt to disintermediate external assistance would also serve as a setback to the less developed states, which do not have the capability to bear the terms and conditions of foreign loans and their exchange risks.

57. In designing state-level interventions, the Bank's broad approach will be to develop a well-integrated package of macroeconomic and sector policy reforms with the required project assistance. On the policy side, the Bank can play an effective role in supporting fiscal adjustment; restructuring state-owned enterprises; and strengthening state-level policy, regulatory, and institutional frameworks for infrastructure sectors. The key objective of these Bank initiatives ought to be to support states in:

(i) achieving fuller transition from centrally controlled plans to market-oriented policies to improve the efficiency of resource allocation and investments and encourage domestic and foreign competition,

(ii) removing all impediments to the factor and product mobility in the economy that have hampered the process of economic restructuring, and

(iii) ensuring efficiency and cost effectiveness in delivery of public services.

IV. SECTOR STRATEGIES AND PRIORITIES

A. Role of the Bank in Infrastructure Sector Development

1. Energy

58. Development of commercial energy sources is crucial for meeting the growing needs of industry, agriculture, and transport sectors. Annual per capita energy consumption is expected to rise from its current level of 226 kilograms of oil equivalent (kgoe)[1] to 544 kgoe by the year 2010 — about 2.5 times the present levels — to support a higher sustainable economic growth. To meet this substantial rise in energy demand, India needs to augment energy supplies quickly, while improving energy efficiency and introducing demand-side management. Coal is the main source of primary commercial energy (both for industry and power generation) and India has actively exploited its substantial coal reserves. The country's oil and gas resources, which are limited relative to coal, have not yet been fully exploited. There is considerable scope for developing and using gas resources. To meet its energy demand, India can also encourage exploitation of regional energy resources and trade, including importation of gas and power exchanges with neighboring countries.

59. Given its size and complexity, the development of the energy sector, is critically dependent on the effectivity of the underlying institutional arrangements. In the hydrocarbon subsector, both policy and development, are largely handled by the Central Government in close collaboration with the Central sector gas utilities and refining companies that are being restructured to respond to the emerging requirements. In contrast, the power subsector, which falls under concurrent jurisdiction of Central Government and the states, has been adversely affected by the lack of progress on reforms at the state level. The key issues are financial and operational difficulties of the SEBs. These are not only holding back public sector investments but are also making it difficult for private investment to materialize, although investors (both local and foreign) have shown strong interest in India's power sector. Active support to reform the weak institutions and public utilities will assist in effective development of the sector.

60. The role of the Bank in the hydrocarbon and power sectors will be to support (i) improvements in sector efficiency through policy, regulatory, and institutional reforms; (ii) promotion of private sector participation; (iii) pricing reforms, particularly those of both bulk and retail electricity tariffs;[2] and (iv) use of environment friendly primary energy sources, in particular gas.

61. While continuing to support development of traditional sources of energy such as gas and coal, the Bank will also assist in the exploitation of renewable energy sources (RESs), given India's potential and comparative advantage in this area.[3] RESs

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[1] India's per capita commercial energy consumption presently is lower than that in most Developing Member Countries. However, the energy intensity of the economy is high because of low cost of electricity, predominance of heavy industries, and intensive agriculture irrigation.

[2] At the retail level, distortions in electricity tariffs include effectively free supply to the agriculture sector, and highly subsidized supply to households.

[3] India appears to have a potential of about 3000 Megawatts of bagasse-based cogeneration and 20,000 MW of wind power.

can play a significant role in supplying rural areas and small-scale industrial consumers. RESs may be economically attractive in the Indian context when compared with commercial energy sources if due consideration is given to the economic and environmental costs of inputs. The Bank's role in the development of RESs in India, however, may depend on the availability of concessional cofinancing to blend the terms of the Bank's OCR loans, as well as supportive financial mechanisms to keep the cost of intermediation low.

62. In view of India's large size, strategic location, and enormous energy needs, and the significant energy resource potential of adjoining countries, there are ample opportunities to develop, in the long run, cross-border energy trade and network links consisting of power transmission lines and gas pipelines. As such, the Bank will assist in the exploitation of regional energy resources, promotion of energy trade, and development of the related infrastructure. This appears feasible as there is relative abundance of clean primary energy sources in the region, such as hydropower in Nepal and Bhutan, natural gas in Bangladesh and eastern Indian states, hydropower and natural gas in Central Asia, and natural gas across the Arabian Sea. In view of the nature and large scope of these ventures (including the need for thorough examination of economic and technical viability), such initiatives can only be realized over the longterm, and the Bank's intervention will be sequenced accordingly.

a. Hydrocarbon Subsector

63. The supply and demand gap for natural gas and oil in India is expected to widen by about 17 percent by the year 2010. Unless supplies keep pace, availability of these energy sources could emerge as a major constraint to economic growth. While there are proven reserves of oil and gas in India, these have as yet to be fully exploited. Natural gas constitutes more than 50 percent of India's hydrocarbon resources. With remaining recoverable gas reserves in excess of 730 billion cubic meters and the possibility of importing gas from neighboring countries in the long term, there is significant scope to enhance gas supplies. In this context, a potentially significant option for India is to meet rising energy demand by accelerating the supply and utilization of gas resources. Beside being a cleaner fuel, natural gas can be substituted for petroleum to help relieve the foreign exchange burden as imports of crude oil and petroleum products absorb one third of export earnings.

64. Since gas resources are concentrated in isolated locations,[1] their use is constrained by the lack of adequate transmission and distribution infrastructure and the relative underdevelopment of the gas markets, which thus far has been limited to essentially selective industrial uses. The development of the gas subsector has been heavily influenced by the management, operations and practices of the Central Government, which controlled sector policies and interfered in the operations of the gas entities. These include (i) the Oil and Natural Gas Corporation Limited (ONGC), which is responsible for exploration and exploitation of the natural gas in the country;[2] and (ii) the Gas Authority of India Limited, which is primarily responsible for gas transmission and marketing concurrently with ONGC and Oil India Limited.

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[1] About 80 percent of the gas resources are in the western shore region, 10 percent in mountainous regions of Assam, and the remaining 10 percent in Cambay basin in Gujarat.

[2] Except Assam region where gas production is split between ONGC and Oil India Limited.

65. The situation has, however, rapidly changed in the recent years. The Government, supported by the Bank,[1] has launched significant hydrocarbon subsector reforms since 1992. These reforms have managed to increase the role of the private sector in exploration,[2] production, and marketing as well as improve the performance and efficiency of the gas PSUs that have been corporatized. The Government is now diluting its ownership in these entities. At the same time, these gas PSUs are being reorganized to allow them to respond better to the requirements of the sector. As part of the sector reforms, the Government has offered exploration and development blocks to private and foreign investors, allowed additional refineries in private and joint sector companies, and started an accelerated program for exploration.

66. To meet the oil and gas demand for the year 2010, substantial investments are required for exploration, production, refining, and other downstream facilities. Concurrently, there is need to (i) improve access to state-of-the-art technology, to increase exploration success, and to lower development costs and time; (ii) augment risk capital, both domestic and international, by encouraging private sector and strategic joint ventures for exploration and exploitation; (iii) develop distribution infrastructure such as pipelines and port terminals; and (iv) encourage hydrocarbon technology and its research and development. Since the indigenous gas production will not be sufficient, the country needs to import gas either through transnational pipelines or in the form of liquefied natural gas (LNG).

67. To make headway on these fronts, it is critical to maintain the momentum of hydrocarbon subsector policy and institutional reforms that have been supported by the Bank (see para. 66). In this context, emphasis needs to be continued to support (i) development of an appropriate regulatory framework for an enhanced private sector role in the hydrocarbon subsector, and (ii) reforms of oil and gas PSUs that will continue to be major players given their size and significance. Development of a regulatory framework calls for streamlining guidelines and processing of contract awards and bids to dispense these expeditiously and with uniform standards. With the entry of the private sector, the public utilities need more autonomy in investment, financial, and administrative areas to, among other things, enter into joint ventures to spread risks, evolve strategic partnerships to bring in advanced technology and research, and divest some of their noncore activities.

68. In the hydrocarbon subsector, the Bank's primary emphasis will be to support development of cleaner fuels, such as natural gas and LNG, by assisting in programs to:

(i) augment subsector reforms, including the privatization and restructuring of major gas PSUs;

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1 Loan No. 1148-IND: *Hydrocarbon Sector Program Loan*, for $250 million, approved on 17 December 1991.

2 Of the 242 exploration blocks offered to the private sector, the Government received 45 bids and has awarded contracts for 11 blocks, and negotiations are at advanced stage with another 30 parties. Further contracts have been awarded for 5 medium-sized and 13 small-sized fields amounting to $1.5 billion, and 54 bids have been received for development of additional 8 medium and 33 small-sized fields.

(ii) enhance the efficiency and effectiveness of exploration, production, and utilization;

(iii) exploit gas fields in an efficient and cost effective manner by supporting adequate pricing and contract arrangements;

(iv) ease transportation and delivery bottlenecks in the subsector through development of (a) domestic gas infrastructure such as natural gas grids and LNG facilities, and (b) transmission networks that are carefully planned and integrated based on expectations for future sources and the long-term analysis of gas markets and utilization;

(v) augment importation of gas through transnational pipelines or in the form of LNG; and

(vi) adopt and enforce environmental regulations.

69. In the case of oil, the Bank's role will be limited to supporting joint ventures in exploration and exploitation. Concurrently, on a selective basis, emphasis will be on upgrading equipment to improve energy efficiency and demand management.

b. Power

70. India has a large power subsector[1] that is served, managed, and coordinated by multiple Central Government and state sector utilities. However, the available generation capacity is well below requirements and this situation could aggravate as generation is anticipated to fall short by 40 percent of the EFYP target. Chronic power shortages and poor quality of power supply continue to plague the economy in almost all parts of the country. If not remedied, insufficient power will be the single most important constraint to economic development in the coming years and will thwart the Government's efforts to attract domestic and foreign investment.

71. Beside the resource and institutional capacity constraints facing the public sector,[2] the problems of the power sector emerge from the difficulties of centrally managing a large and complex system that is jointly under the Central Government and the states responsibility. Under the current arrangements, the center regulates the entire power sector and controls one third of total power generation capacity, while the SEBs and electricity departments (controlled by state governments) generate 62 percent of capacity, provide transmission and distribution facilities, and set retail tariffs.

72. The power supply is further constrained by (i) technical problems, including frequent unscheduled outage of plant, underinvestment and distribution, and inadequate power system coordination and control facilities; (ii) inadequate tariff and commercial arrangements among SEBs to coordinate their power purchases and generation in line with merit order operations within each regional grid; and (iii) an

[1] With an installed generating capacity (including captive generation) of over 80,000 MW.

[2] Private sector involvement in the power sector is currently limited to generation of 3,554 MW (only 4.0 percent of total generation capacity) and five private distribution utilities.

inappropriate regulatory system to control the multiplicity of Central Government, joint, and state generation and transmission entities. The latter has compounded problems of coordination, resulting in losses and suboptimal use of generation capacity. As such, while augmenting generation capacity, national and regional transmission links should be strengthened to enhance operational efficiency and improve interregional coordination and cooperation.

73. In view of the dualistic structure of the subsector, the development of the power subsector and improvements in its efficiency can only be realized if the Central Government and the states evolve a consensus on policy reforms and undertake mutually reinforcing initiatives. To coordinate, the Central Government has taken a number of initiatives, such as (i) evolving the policy framework for private sector participation in power,[1] (ii) tapping the National Development Council forum to obtain a consensus on the reforms needed for the power sector, (iii) establishing commercial arrangements between central sector utilities and SEBs, (iv) developing the National Power Transmission Company (POWERGRID), and (v) formulating a more rationalized structure of bulk supply tariffs. However, the states are lagging seriously in implementing the power sector reforms.

74. The major issue affecting subsector performance is the SEB's chronic operational and financial difficulties and their rising deficits. The SEBs also have high accounts payable to Central utilities, thereby straining the financial viability of these entities, too. The problems of SEBs stems from inappropriate tariffs, overstaffing, lack of commercialization, and subsidized agriculture tariffs which together have resulted in high power plant outage rates, low capacity factors, and high transmission and distribution losses. As most of the SEBs' abilities to raise resources are limited, financing capacity expansion in the power subsector is a problem. The power generation target for the Ninth Plan (1997 to 2002) is placed at 56,000 MW. The investment requirements for this additional power generation are estimated to be $70 billion and for associated transmission and distribution to be over $35 billion.

75. Given public resource constraints, a more aggressive involvement of the private sector is necessary to develop the power subsector. Encouraging increased involvement is largely contingent on the ability of SEBs to (i) restructure themselves to improve their operational efficiency and solvency to compete effectively, and (ii) integrate private power in their systems. To be able to achieve this, state governments must allow SEBs more operational autonomy to commercialize and restructure themselves by unbundling their generation, transmission, and distribution functions, while allowing for greater private sector participation in these areas and for independent regulatory bodies to set retail tariffs.

76. Based on the subsector profile and issues highlighted above, the Bank's major strategic thrust in power will primarily be to leverage its assistance to support, directly and indirectly, reforms of the state power subsector with emphasis on restructuring and commercializing SEBs. As such, Bank support for rehabilitation and new generation and reinforcing and expanding existing transmission and distribution systems will be in states that have undertaken or are willing to adopt power sector reforms.

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[1] See para. 10.

77. To summarize, the Bank's power sector strategy will focus on:

(i) launching direct initiatives to reform the state power subsector, with particular emphasis on restructuring and commercializing SEBs;

(ii) promoting foreign and domestic private investments, particularly in generation and distribution, in states that have financially sound SEBs or are adopting substantive reforms to turn their SEBs around;

(iii) rehabilitating existing and constructing new generation facilities at the state level, subject to agreements on (i);

(iv) rationalizing power tariffs, both at the bulk and retail level; and

(v) improving demand management and efficiency.

78. While supporting state-level initiatives, the Bank will leverage Central-level assistance to promote commercialization of SEBs and continue its support for reinforcing and expanding existing transmission and distribution systems relating to existing or new generation, and establishing regional and national grids.

79. The Bank will support development of new generation primarily in private sector and exploit wherever possible credit enhancement facilities. In the public sector support for generation will be restricted and conditional on SEBs' restructuring. Beside the standard techno-economic viability, assistance for additional private power projects will be conditional on sponsors being selected through a transparent competitive bidding process. All projects must also be part of the least-cost power system expansion plan.

2. Transport

80. India has an extensive and diversified transport system.[1] The relative proportions of traffic carried by road and rail, the two dominant transport modes, have changed markedly since the 1950s. Road traffic has increased and now accounts for 55 percent of freight and 80 percent of passenger traffic whereas rail traffic has decreased to about 40 percent of freight and 20 percent of passenger traffic.[2] The high density corridor transport network, formed by a parallel system of over 30,000 kilometers (km) of road and rail links, connects major cities and ports. This high density corridor forms the backbone of the transport system and carries about three quarters of intercity passenger and freight traffic. The high density corridor network is, however, severely congested because of bottlenecks and other capacity constraints affecting roads, railways, and ports.

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[1] This includes 62,570 route-kilometers (km) of railways, 2.1 million km of roads, 12 major ports and 139 intermediate and minor ports, airports, inland waterways, and pipelines.

[2] The passenger traffic handled by other transport modes such as air and inland waterways is very small.

81. If India's GDP grows by 5 to 6 percent per annum, traffic will double over the coming decade. Increased economic activity, accompanied by demographic, urbanization, and international trade pressures, will constrain economic development unless the already overstrained transport system is developed expeditiously and systematically.[1] While the EFYP has allocated Rs561 billion for the transport sector, future investment requirements of the sector are much higher. Therefore, the Government has recognized the vital importance of securing private sector participation in financing, developing, and operating elements of the transport system. The public sector will retain its key role in strategic planning for and managing and regulating the system as a whole. Further policy reforms, together with deregulation and commercialization of public transport undertakings, will be needed to secure private sector participation on a large scale. There is also great potential for innovative financing mechanisms to facilitate closer cooperation and appropriate risk sharing between the public and private sectors.

82. The expected traffic growth underscores the need for the Government to evolve an overall transport strategy that seeks to improve the system's efficiency and reduce total transport costs. This will call for an integrated multimodal and intermodal[2] transport system in order to improve efficiency and door-to-door service. Recent initiatives in this direction include the establishment of the Container Corporation of India (CONCOR)[3] by IR and the passing of the Multimodal Transportation of Goods Act of 1993.[4] The Government is expected to establish an intermodal planning cell for this purpose.

83. Over the medium term, the Bank's transport sector strategy will support the Government's efforts to develop and maintain an efficient and dynamic multimodal transport system. The Bank, focusing on roads, railways, and the intermediate/minor ports, will support:

(i) the policy reforms to implement transport strategy efficiently and economically,

(ii) the removal of critical bottlenecks and capacity constraints on the high density corridor,

(iii) commercialization of public transport undertakings,

(iv) private sector participation,

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1 See World Bank Report No. 13191-IN: *India: Transport Sector - Long Term Issues*, Infrastructure Operations Division, Country Department II, March 1995.

2 Intermodalism here refers to the transport of unitized freight consignments from origin to destination by combining the use of different transport modes.

3 Supported by the World Bank, this entity acts as a wholesaler for unitized cargo management and transport and serves as a link between IR and the trucking industry and their shipper clients. See World Bank Report No. 12780-IN: *India - Container Transport Logistics Project*, May 9, 1994. Containerization, however, remains essentially a port-to-port/terminal movement with containers being stuffed or destuffed at ports and freight terminals.

4 Under this Act, 55 of India's transport and freight forwarding companies, and a foreign company, have been designated multimodal transport operators, and rules have been framed to facilitate their trade transactions.

(v) upgrading of technology, and

(vi) minimization of transport-related externalities by promoting public safety and addressing environment and resettlement concerns.

a. Roads and Road Transport

84. The road network and dependence upon it have grown. This dependence is anticipated to rise substantially.[1] To meet the increase in traffic demand, road capacity will need to be increased by removing bottlenecks, widening roads, constructing bypasses and expressways, and rehabilitating and improving existing roads.

85. Even though national highways are generally in better condition than other roads, transport on these key arteries is constrained by severe congestion. This is partly because the national highway network, which carries about one third of road traffic, constitutes only 1.6 percent of the total road network. The capacity of the existing network is further constrained by inadequate pavement widths and the rough riding quality of pavements. In addition, development of the road subsector has been constrained by the limited absorptive and implementation capacity of public sector agencies. Furthermore, in the absence of effective regulations, road transport has become energy intensive, polluting, and unsafe.

86. To augment road capacity, the Government has invited the private sector (including foreign investors) to develop, operate, and maintain selected national highways, expressways, and bypasses. The policy framework for allowing private sector involvement in roads sector on a larger scale is being developed (see para. 12).

87. In line with the Bank's overall transport strategy (see para. 83), the Bank's strategy for the road and road transport subsector will focus on supporting the:

(i) policy reforms to promote private sector participation and allow public sector agencies to implement transport strategy efficiently and economically;

(ii) funding of initiatives to attract significant private sector funds for the development of national highways and expressways;

(iii) public sector to remove bottlenecks and rehabilitate, improve, and maintain existing road networks within the high density corridor and providing access to it; and

(iv) adoption of appropriate measures to preserve and enhance environment and safety standards.

[1] The Planning Commission forecasts that road traffic will double by the year 2001.

b. Railways

88. In terms of size and output, India's railway is the second largest railway in Asia after the railway system on the People's Republic of China (PRC). IR currently operates as a departmental undertaking managed by the Railways Board, which also functions as the Ministry of Railways. IR's network productivity, measured in traffic units per route-kilometer, is higher than that of other countries, with the exception of the PRC and Russia. Labor productivity, however, is low. Most rail links on the high density corridor network are severely congested and this negatively affects the quality of services.

89. IR's financial performance has been affected over the years by increasingly strong competition from road transport for certain commodities and distances. This has been compounded by the fact that over half of railway traffic is now passenger traffic and the increases in local and suburban passenger traffic have adversely affected the railway system's capacity, particularly its capacity to carry long-haul traffic. In addition, about 90 percent of IR freight business comprises PSU bulk cargo[1] hauled at subsidized rates. The labor wage bill now constitutes 65 percent of IR's expenditures, and this burden has reduced IR's ability to maintain and replace assets such as rolling stock and ancillary equipment. Moreover, IR relies on obsolete technology for such equipment, largely because the manufacturing facilities are "in-house," and its commercial survival does not depend on keeping abreast of technological improvements. Corporatization and/or privatization of IR's manufacturing units, as well as technology and efficiency improvements, would accordingly have beneficial impacts.

90. Increasingly, IR needs to focus on its core business — transport services — and adapt to changing market requirements. IR's viability is contingent on how effectively it can capture and compete for long-haul bulk traffic on a commercial basis and successfully manage the less profitable passenger services. As in a number of countries, IR's policies for investment, tariffs, employment, and other aspects are subservient to social and public sector obligations, and these policies need to be reviewed. For freight, this means that business strategies need to be revised in line with the (i) reforms of PSUs and other major clients, (ii) development of new specialized port and oil terminal facilities for handling and transporting bulk commodities such as coal and petroleum products, and (iii) increasing importance of intermodal transport systems. For passenger traffic, IR needs to concentrate on long distance intercity traffic and gradual transfer of responsibility for local and suburban services to state and local government bodies.[2] Moreover, IR needs to be restructured over the long term.

91. In view of this, and based on the Bank's experience in the sector,[3] a major change is advocated for the Bank' strategy in the railway subsector. Support to railways will be conditional on IR's adoption of significant structural reforms. The key elements of this reform should include:

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1 Including strategic commodities such as coal, iron, steel, petroleum products, fertilizer, and foodgrains.

2 Such local or suburban services can be commercialized or operated on a service contract basis. They can also be devolved to state and local governments as, for instance, for Bombay suburban rail services. See World Bank Report: India *Second Bombay Urban Transport Project (BUTP-II)*, July 1994.

3 See Appendix 1.

(i) a review of IR's role so as to grant it greater autonomy and to improve its accountability;

(ii) development of strategies to restructure IR;

(iii) formulation and implementation of business plans, organizational restructuring,[1] new pricing tariffs, and rationalization of human resources to support (i) and (ii);

(iv) technological upgrading;

(v) adoption of a restructuring program for IR's ancillary activities; and

(vi) encouragement of greater private sector involvement in developing, constructing, operating, and financing railway infrastructure and related facilities.[2]

92. Within the context of these policy changes, the assistance to IR will support developing rail links and related facilities and their technological upgradation along the high density corridor network within the overall multimodal transport strategy.

c. Ports

93. India has 6,000 km of coastline serviced by 11 major ports (which handled of 187 million tons of cargo which is 93 percent of total of total cargo handled in 1994),[3] and 139 intermediate/minor ports. Major ports have general cargo berths, but few have dedicated bulk or purpose built container terminals. Of all major ports, 5 handled 90 percent of the containerized traffic and half of the port traffic. The standards of ports, however, vary widely, with some major ports (such as Madras and Jawaharlal Nehru Port Trust, Bombay) having modern container facilities, while others have limited large-scale cargo handling capacity and outdated facilities in terms of configuration and lay out. The major ports are managed by the Port Trusts, a semiautonomous statutory body administered by the Board of Trustees and appointed by the Government.

94. Indian ports' productivity is low by international standards. While overutilized, the layout and berth facilities of ports and their poor maintenance have caused their condition to deteriorate. The productivity of ports is further affected by the (i) capacity constraints and inadequacy of draughts at the berths and narrow aprons limiting operational flexibility to handle equipment, storage, and transport links for clearance of cargo; (ii) lack of inland transport infrastructure logistics; and (iii) overstaffing with low attrition rate and strong resistance to changes. Beside these problems, the lack of autonomy of Port Trusts has

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[1] See Ministry of Railways: *Report of the Committee to Study Organizational Structure and Management Ethos of Indian Railways.* March 1994.

[2] Such as terminals, depots, warehouses, freight forwarding, and inland container operations and manufacturing units.

[3] Over 90 percent of the cargo is liquid and dry bulk of which 40 percent is oil, and 37 percent is other bulk commodities such as iron ore, coal, and fertilizers.

created managerial and operational inefficiencies resulting in suboptimal use of resources. In addition, the financial position of ports[1] has been affected by low tariffs.[2]

95. Despite these problems, in recent years, productivity at major ports has improved by 30 percent in terms of ship time at berth, turnaround time, and average output per ship berth-day. However, the seaport costs (in terms of waiting and working period) and throughport costs in Indian ports is higher than in other ports.[3] Therefore, it is critical to reorient port operations towards an integral terminal concept to allow for optimal use of resources and facilities and to respond to growing external trade. Additionally, there is need to change Port Trusts from service to landlord ports by leasing their facilities with the objective of inducing competition, commercialization, and upgrading and modernization to enhance efficiency and productivity. These objectives can be realized if the Port Trusts are provided adequate autonomy and are strengthened to improve their accountability and financial management.

96. The ports subsector has great potential to develop projects with closer cooperation and risk sharing between the private and public sector, and the Bank could catalyze this development. In this context, the Bank's emphasis will be to support:

(i) policy reforms to improve the operations and efficiency of ports and their capacity to involve the private sector,

(ii) the private sector to develop new port facilities,

(iii) privatization and commercialization of most of the existing facilities of ports, and

(iv) rehabilitation, modernization, and upgrading of the existing ports to improve their productivity and utilization.

97. Within this strategic framework, the Bank should gradually shift its focus to the development of minor and intermediate ports, as major ports will be able to attract resources for their development. The selection and prioritization of projects for the development of minor ports could be based on a broad-based multimodal transportation study to optimize door-to-door transport costs. However, the primary responsibility for the minor ports lies with the state governments, which lack the financial and administrative ability to launch systematic port development keeping in perspective coastal and environmental management concerns. While reducing the congestion of the major ports and roads used for long hauls, the development of minor and intermediate ports will also help the hinterlands develop. In this context, the Bank's support for minor

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1 In general, the major ports have reported operating surpluses, though their financial position varies with some yielding low rates of return.

2 Port tariffs are set in agreement with Ministry of Surface and Transport. These tariffs are not related to costs and do not encourage efficiency. Breakbulk cargo is levied on an ad valorem rate, while other cargo is assessed on weight or volume basis with overcharging of specific commodities.

3 For instance, estimates for four major ports (Bombay, Calcutta, JNPT, and Madras) suggests that the through port costs alone were about 45 to 50 percent higher than the Bangkok, Singapore and Colombo ports. See World Bank Report No. 14059: *India Port Sector - Strategy Report*. Infrastructure Operations Division, South Asia Department II, March 1995.

and intermediate ports would be useful if the states are willing to address policy constraints and are prepared to evolve a well conceived coastal and environmental strategy to develop the port facilities.

3. Telecommunications

98. Although India has a large telecommunication network, its coverage is limited[1] and is marked by regional disparities. Telecommunications is integral to the supply of financial businesses and other infrastructure, and inadequate service significantly adds to transaction costs and inhibits business development. The productivity and efficiency of the subsector have been affected by public sector monopoly[2] and centralization of service delivery, emphasis on indigenization of technology, and lack of internal resource generation.

99. The total demand for telephones (working connections plus waiting list) rose from 7 million in 1992 to 10.5 million in 1994. Adjusting recent growth trends for rising economic activity, the demand for telephone connections will rise to over 16 million by 1997. To meet this demand, the Perspective Plan for Telecommunication Services (1990-2000) envisages doubling the network, from the current 9 million direct exchange lines to 20 million, and providing a telephone in each village by the year 2000. To attain this objective, the EFYP allocated Rs200 billion to provide 7.5 million connections. Despite an impressive effort by the Department of Telecommunications (DOT) to double the network size in the past five years, network expansion has fallen short of the targets of Perspective Plan.

100. Recognizing these inadequacies, the National Telecommunication Policy aims to provide telephone on demand and extend the coverage to all villages by 1997. To achieve this objective, the private sector has been allowed to provide basic as well as value-added telecommunication services. While easing entry, the Government is (i) evolving guidelines, regulations, and modalities for private sector involvement; (ii) setting up an independent regulatory authority and framework covering the scope and areas of operations, etc.; and (iii) restructuring DOT to separate the two functions of operator and policymaker.

101. To realize the targets of National Telecommunication Policy, an additional Rs300 billion is required. To meet the desired targets for investment and supply of service, the private sector has been invited to provide value-added services such as mobile phones, paging services, voice mail, etc. Licenses have been awarded to private sector companies to provide mobile service in four major cities (Bombay, Calcutta, Delhi, and Madras) and radio paging services in 26 other cities. In the near future, licenses are expected to be issued to private companies including foreign partners to provide services in 22 states and metropolitan areas. With regard to basic services, in addition to DOT, one private operator is now allowed in each of 22 telecom circles, which are obligated to have 10 percent of their operations in uneconomic routes. Connectivity and revenue sharing among the operators and the DOT network has yet to be worked out on

1 Telephone density, at 0.8 direct exchange lines per 100 persons, is the lowest in the region.

2 The telecommunication system until recently has been largely served by Department of Telecommunications and two public corporations that manage and operate metropolitan networks and provide international services.

commercial lines, and operators need more flexibility to extend business to long distance calls and to configure the best interconnection options in line with the available technologies.

102. In view of the nature of business and state of technological developments in the telecommunications industry, attracting local and foreign private initiative for the development of telecommunication network need not be difficult in India provided the policy and regulatory constraints are resolved. Given this, the Bank's strategy in telecommunications needs to be reoriented to address policy gaps to strengthen the subsector environment and better serve areas that the private sector may not wish to serve. In line with this, the Bank's strategy in telecommunications will focus on two broad areas, including assistance for:

(i) implementing the policy reforms, including the (a) development of regulatory framework and authority, and (b) restructuring of DOT so that it will be able to compete effectively with the private sector and meet its mandate of providing a national public network; and

(ii) meeting the goal of extending rural telecommunication coverage where hesitancy of private sector to enter may make it difficult for the Government to achieve its targets; this is especially true in the near term, when the private sector is expected to concentrate on more lucrative areas (urban) and higher value services (cellular).

B. Addressing Social Dimensions[1]

103. The Bank has so far not been involved in social dimensions in India. The strategy recommends development of new initiatives, in selected sectors/areas, to support social concerns keeping in perspective Bank funding limitations. In evolving the Bank's role in social dimensions, consideration has to be given to three factors:

(i) authorities' commitment to finance social sector programs from Government resources, and their record of poverty reduction and human resource development;

(ii) the feasibility and extent of using OCR funds for such programs when the Government is reorienting its public expenditures to release budgetary resources for social, rural development, and employment generation and poverty reduction programs; and

(iii) India's access to alternate and cheaper resources, including the World Bank's IDA and bilateral concessional funds, and the external agencies' shared approach to address social concerns in India (see Box 4).

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1 Strategy in this area is being drawn up on the assumption that India will continue to be unable to use the Asian Development Fund. If this constraint eases, the strategy will need to be revised.

Box 4: Shared Approach to Social and Poverty Programs

The World Bank and bilateral agencies have been active in social sectors and are increasingly reorienting their support to enhance and better target their support in this sector. The most strategic initiative is the World Bank's Social Safety Net Credit ($500 million) to mitigate the impact of ongoing structural adjustment through support for efficient and cost-effective social and anti-poverty programs. In parallel, the World Bank has supported agriculture, urban development, sanitation, etc., focusing on relatively poor areas, occupations, and vulnerable groups including women and children. Furthermore, support the health (blindness control, leprosy control, health education services), child development services, rural water supply and sanitation, and irrigation improvements has benefited the poor.

The United Nations Development Programme (UNDP) poverty-related programs have supported formal and non-formal education; area development including integrated rural development, village and community development and settlements; social development such as urban, drinking water and sanitation; housing and social legislation, health including primary health care, immunization and disease control, family planning, hospitals and clinics.

United States Agency for International Development (USAID) projects have supported programs to promote contraceptive prevalence, private health, and family planning services and reduce the level of malnutrition in high-risk groups. The USAID Title II food aid grant reaches high-risk children, pregnant women, and impoverished families with food supplements, nutrition education, and primary health care. The New Title II Program will be used to alleviate some the short-term dislocations of the reform effort, particularly among the ultrapoor.

The central objective of the United Kingdom is to help support Indian capacity to reduce poverty and to tackle environmental problems. It seeks to promote the economic, social and political and legal status of women in all sectors, and incorporates men's and women's needs and interests during project design and implementation. United Kingdom programs' strategic approach is to support reproductive health and "Children by Choice" program; and address health problems (in particular Tuberculosis, Malaria and Sexually Transmitted Diseases/Human Immunodeficiency Virus (STDs/HIV)) in Orissa, Andhra Pradesh and West Bengal; and primary education in Andhra Pradesh. In addition, United Kingdom has supported high slum improvement projects in Calcutta, Indore, Visag, Vijayawada, and Hyderabad; and a state-wide urban poverty alleviation program. United Kingdom is further involved in projects which help develop improved approaches and techniques for farmers in rainfed areas on a participatory basis.

Japan attaches high significance to poverty alleviation programs with focus on medicare and health, agriculture and rural development, population and HIV/AIDS programs. In addition, Japan has provided support for improvement of urban water supply and sanitation conditions including in Bangalore. Japan has provided a credit line to support establishment of small business by women.

Canada's priority has been to promote the role and status of women through dissemination of information on the social and economic impact of Government policies. Future programs are to place greater emphasis on strengthening capacity to address environmental problems to generate poverty-alleviation benefits. German support is for watershed development, rural water supply, basic health projects, and low cost housing/slum development.

Dutch assistance, concentrated in five states (Andhra Pradesh, Gujarat, Karnataka, Kerala, and Uttar Pradesh), is for four sectors i.e., rural drinking water, land water management (irrigation), environment, and water transport. Denmark's poverty alleviation programs are focusing on agriculture, water supply, and health. They target populations below the poverty line as defined by the Government. These programs are designed mainly to increase the income of target groups.

104. The Government has been committed to improving the welfare of its population and has relied on a mix of two approaches: the indirect route by using resources to accelerate economic growth to enhance incomes and hence the living standards of the poor; and the ***direct*** route by providing education, health, nutritional supplements, etc., to meet minimum needs. A combination of these policies has enabled a reduction in the poverty incidence[1] and improvements in socioeconomic indicators.[2] Nevertheless, India continues to face heavy demographic pressures, overwhelming poverty, and wide regional disparities because of "...inadequate and distorted growth (not because growth was the wrong strategic choice) and incapability of anti-poverty programs to effectively target large segments of poor."[3]

105. In light of the above, the Bank's strategy in India will be to improve incomes and reduce poverty by promoting a higher sustainable economic growth path and efficiency gains. In parallel, the Bank will integrate social concerns within states-focused operations. The Bank will help achieve these aims by supporting the development of urban infrastructure including provision for housing finance, sustainable financing for social services, and a social safety net.

1. Urban Infrastructure Development

106. The urban population growth in India is almost double the average annual growth rate of the overall population. The demographic pressures and distress of cities with growing squatter and slum areas have aggravated the stress on the urban poor. With the urban population projected to grow at an increased pace, the urban poverty incidence and environmental degradation will overstretch available infrastructure and basic services. To address these concerns, the Bank strategy in urban infrastructure will focus on:

(i) Encouraging balanced urban regional development with the objective of supporting economic growth: These urban interventions will be undertaken primarily in states for which the Bank plans to target a more comprehensive policy reform support. The key focus will be to:

  (a) develop cities and towns with potential for industry and growth so as to facilitate decentralization, diversification, and diffusion of congestion away from major cities; and

  (b) provide integrated urban development support, including infrastructure and basic services to attract population.

(ii) Reducing urban poverty and environment concerns: Aside from improving the availability of employment opportunities arising from the development of the urban infrastructure, this objective is to be achieved through support for upgrading of slums, rehousing of affectees, provision of low income housing and sanitation, solid waste management, water supply, and sites and services, etc.

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1 See Chapter I(E) and Appendix 2 for further discussion on these aspects.
2 See Table 1, p. 10.
3 Bhagwati, Jagdish. 1993. *India in Transition -Freeing the Economy***.** Oxford: Clarendon Press.

(iii) Develop sustainable mechanism for urban infrastructure financing: This is viewed critical as isolated urban infrastructure project could be unsustainable if the municipalities are financially and operationally weak. To develop sustainable urban financing mechanisms there is need to build capacity of suitable financial intermediaries, particularly at the state level, to stimulate urban sector policy reforms by providing funding for urban infrastructure development subject to the compliance of municipalities with agreed performance criterias. While supporting such urban infrastructure financing mechanism, the Bank could leverage its assistance to encourage financial intermediaries to tap capital market and other sources of funding.

107. For effective implementation of urban infrastructure projects and to ensure their sustainability, the Bank will need to address policy and institutional issues affecting urban development. The major issues affecting prospects for urban development are problems of tax and cost recovery, land acquisition, and institutional inadequacies of urban sector agencies. To ensure sustainability of investments and benefits, the Bank's urban infrastructure projects should include direct or indirect support to introduce changes in land and taxation policies, and to build the technical and administrative capacities of municipalities, town authorities, and local governments. Bank support in this sector will depend on the states' financial capability to service OCR liabilities and bear foreign exchange risks as well as urban agencies' willingness to adopt aggressive taxation, cost recovery, land acquisition, and settlement policies. In light of these requirements, Bank support for urban infrastructure will be only appropriate for states that the Bank targets for more fundamental state-level policy reforms that help generate greater pressure and urgency for reforms of local and urban finances and institutions.

2. Sustainable Financing Mechanism for Social Services

108. The intergovernmental fiscal relationship places a high degree of responsibility on states to develop social and human resources. As highlighted in paragraphs 51-52, the state public finances are under severe stress because of the inherent structural weaknesses of their taxation system and heavy expenditure obligations, and the recent slowdown in states' access to ad hoc grant transfers from the center and Reserve Bank of India. Unless states adopt prudent fiscal management, their ability to address social and poverty concerns will suffer. The Bank can play an effective role by supporting states to encourage resource mobilization and rationalization of public expenditures to release resources for social services, and to reduce ad hoc and poorly targeted subsidization of social services that unintentionally benefit the advantaged. Within this, the Bank will explore possibilities of assisting state governments to build capabilities for developing sustainable financing mechanisms to meet funding requirements of social services.

3. Social Safety Net Within Industrial Restructuring Process

109. The Government has set up the National Renewal Fund (NRF)[1] to finance voluntary separation and training schemes for workers laid off during industrial restructuring. However, a binding constraint to this process, particularly at the state level, which so far has no access to NRF, is the shortage of funding for adequate severance payments or retraining support to retrenched workers. The Bank can play an effective role in assisting states to develop well integrated industrial restructuring programs that support disinvestment, closure, and/or rehabilitation of the viable units. Within this context, the Bank can support the development of a social safety net for the affected workers.

110. In designing support for direct interventions of poverty reduction it is proposed that the Bank seek from bilateral sources concessional cofinancing that could blend the terms of Bank loans and induce greater acceptability of its programs. At the same time, such initiatives need to be accompanied by capacity building programs to ensure sustainability. The Bank has undertaken background work in India to develop a better understanding of the poverty, its magnitude and dimensions,[2] and women-in-development aspects.[3] Work is under way to evaluate prospects of the Bank's involvement in the social sectors.[4]

C. Environment Dimensions and Bank Initiatives

111. Broadly, there are two distinct generic causes of environmental degradation in India: (i) the effect of poverty, characterized by unsustainable exploitation of the natural resource base for subsistence including land, water, forests, fisheries, etc.; and (ii) the effects of economic growth, characterized by industrial pollution, unplanned urban growth, and unsustainable or inefficient depletion of natural resources for meeting demands of changing life styles. The environment concerns are not effectively addressed because of the weaknesses of the policy framework, and the continued rapid population increase. The environmental deterioration in India has affected about 174 million hectares of land; furthermore, 70 percent of surface water is seriously polluted and most major cities suffer from serious air pollution. The environment and its dimensions in India are highlighted in Box 5.

112. Recognizing the magnitude of the problem, the Government has adopted an elaborate policy and legislative framework[5] and multipronged approach to arrest environment deterioration. The Ministry of Environment and Forest formulated in 1993, the Environment Action Program which outlines environmental priorities and programs and recommends support for (i) conservation and sustainable utilization of biodiversity in selected ecosystems; (ii) afforestation, development of wastelands, conservation of soil

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1 In 1992, the World Bank provided a Social Sector Adjustment Credit ($500 million) to support the NRF as well as reforms of social programs.

2 See the Operational Research Paper: *India: Poverty and It's Regional Dimensions*. August 1993.

3 INRM: *Women-in Development Briefing Paper*. September 1993.

4 The 1995 program includes a TA No. 2495 for $400,000 approved on 21 December 1995 to assist Bank in formulating a medium-term assistance strategy for human resource development in India.

5 Besides the overall National Conservation Strategy and Policy Statement on Environment and Development in June 1992, the Government has policy statements for forestry and abatement of pollution; the umbrella Environment (Protection) Act of 1986; and supportive legislation such as the Forest (Conservation) Act of 1980, Wild Life (Protection) Act of 1980, Air (Prevention and Control Pollution) Act of 1981, and Water (Prevention and Control of Pollution) Act of 19974.

Box 5: An Overview of the Environment and its Dimensions

Air Pollution. The air in major cities and industrial areas is polluted by the high concentration of suspended particulate matter, oxides of sulfur and nitrogen, and heavy metals. Contributing to the growing air pollution is the (i) rapid growth of capital and energy intensive chemical, petrochemical, fertilizer, and engineering industries that have high use and discharge of toxic, flammable and explosive chemicals; and (ii) rapid growth of 2 million or so small-scale industries accounting for about 60 percent of the total industrial pollution. The problem of pollution is aggravated by uncontrolled emissions from obsolete and inefficient technologies and delays in adopting pollution abatement equipment because of lack of awareness, finances etc. The major causes of air pollution in urban areas are vehicles, coal-fired thermal power plants, and biomass and coal burning traditional stoves used for cooking. Air pollution has important policy linkages: for example, subsidies for commercial energy sources and the lack of a regulatory and incentive framework for demand-side management and energy efficiency, and not-enforcing or monitoring emission/ambient standards.

Water pollution. Water is polluted by four kinds of substances: traditional organic waste, industrial waste, chemical agents for crop protection and silt from degraded catchments. Three fourths of waste comes from municipal sources, and industrial waste contributes one half of the total pollutant load. Dumping of wastewater is fast contaminating groundwater, salinizing land, and breeding water-borne diseases. The Central Pollution Control Board evidence suggests that water is polluted in 90 percent of about 241 Class-II towns with only 2 percent of this being treated. Few municipalities have facilities for sewage treatment. The problems of water pollution have been aggravated because of lack of policy actions such as inadequate cost recovery for water supply, sewage, and waste disposal; subsidies on chemicals fertilizers and pesticides that encourages extensive use leading to contamination of surface water and groundwater, and absence of control of industrial effluents discharge.

Hazardous/Solid Waste. Considerable solid waste is generated in municipal areas and huge quantities of toxic and hazardous waste are generate from industries and power plants. This has contaminated groundwater and surface water and used up available landfill sites. Although recycling of household waste is widespread, the problem of waste management has not been adequately addressed because of a weak regulatory and policy framework that does not discourage waste generation or encourage recycling of industrial materials such as flyash, ferrous slag, etc.

Degradation of Forest, Land, and Soil. Overgrazing and overexploitation have depleted and degraded forest, soil, and water resources. About 6,000 million tons of topsoil with essential nutrients flow into the sea annually. More than 235 million cubic meters of fuelwood is removed from the forest, compared with the sustainable level of production of only 48 million cubic meters. Forest degradation has occurred because of ill-defined property rights, unsustainable commercial fuelwood operations that are highly profitable, and inadequate policing of timber fellings and forest encroachments.

Biodiversity. India has a wide variety of wild biological resources: over 75,000 species of fauna, and 45,000 of flora. Being densely populated, most of the natural habitat has given way to land use changes including agriculture, industry, and human settlements, affecting large tracks of forest and natural vegetation. A sizable component of biological resources are under threat. Only about 28 percent of 93 wetland sites are under protection. Others are affected by weeds, siltation, agriculture, encroachments, chemical and organic pollution, etc.

Other Concerns. Other major environmental concerns include deterioration of the urban environment due to unplanned growth; coastal marine pollution; depletion of marine and freshwater fisheries; damage to historical/archaeological sites from air pollution; loss of wildlife resources; salinization of agricultural land; and depletion of groundwater aquifers.

and moisture, and reduction of water pollution; (iii) control of industrial pollution and waste reduction/management; (iv) access to clean technologies; (v) urban environment issues; (vi) strengthening of environment understanding, creation of awareness, and assessment and management of resources; and (vii) an alternative energy plan. Concurrently, the Government has initiated measures such as education, voluntary, and information campaigns to address environmental problems. Key issues in implementing the Environment Action Plan are (i) the weak enforcement of environment legislation, regulation, and guidelines; and (ii) lack of resources (including budgetary as well as external assistance, such as the Global Environment Facility[1]) to implement environment programs.

113. The Bank's strategy in environment will support selective aspects of Environment Action Plan by ensuring that Bank projects incorporate environment benefits and emphasis is placed on adoption of environment friendly, clean, and efficient technologies. Adequate support will also be built into Bank projects for initial environment examinations and/or environment impact assessments as required under the Bank policies, and monitoring to ensure adoption of environmental measures and compliance with environmental standards/conditionalities. Depending on the needs, Bank projects will include specific support for the required institutional strengthening of the executing agencies and/or ministries for environment assessment, enforcement, and monitoring.

114. In financing projects with primary or secondary environmental benefits within limitations of OCR terms, the Bank's environment strategy will include three important aspects:

(i) The use of environment friendly resources will be supported by promoting: (a) increased use of natural gas, which is cleaner than other fossil fuels; and (b) demand-side management, with a focus on industrial energy efficiency and commercial and household lighting.

(ii) The use and dissemination of alternate renewable energy technologies will be encouraged. For effective involvement in this, the Bank needs to evolve a niche for itself. One possible approach is for the Bank to focus on disseminating renewable energy technologies in rural areas where needs are high and appropriate concessional financing can be attracted, to reduce the dependence of rural electrification based on grid systems, which rely on coal-generation, and have proved to be expensive, unreliable, and difficult to manage.

(iii) Industrial pollution prevention and control is to be supported by providing assistance for the Government, with emphasis on state and regional programs to address pollution problems of industrial clusters of small scale industries or those located in industrial estates. Bank assistance could promote appropriate measures such as fuel switching (e.g., for foundries); common effluent treatment plants (e.g., in leather tanning, and distilleries); power use efficiency (e.g., in scrap steel plants); and

[1] Allocation for Global Environment Facility are $2 billion for developing member countries over the next three years.

retrofitting older coal-fired thermal power plants. These programs need to be supported by regulatory and monitoring measures. In developing such programs, the Bank will also need to support strengthening the institutional capabilities of central and state pollution boards to enhance their environment policy making, monitoring, and enforcement capabilities and to equip them with training and hardware necessary for environment management and monitoring capabilities.

(iv) The Bank will support improving the urban environment, focusing on developing programs for municipal solid waste management and sewage treatment within the context of Bank's urban infrastructure projects (see paras. 106-107).

D. Private Sector Promotion

115. India has a large private sector with high entrepreneurial and commercial skills. As an enabling policy and regulatory environment is evolving, the private sector is gearing to extend its involvement in infrastructure development in order to contribute to growth and efficiency. The Bank's private sector strategy in India is proposed to (i) be in line with strategic and sectoral thrust (see Chapters III and IV); (ii) respond to the emerging requirements of the country and the Bank's strategy for private sector operations;[1] and (iii) reinforce the Bank's public sector operations. Considering the huge funding requirements for private investment in India, the Bank needs to expand and diversify, and yet focus, its assistance more meaningfully to play an effective and catalytic role.

116. In terms of sectoral prioritization consistent with overall strategic thrust, the Bank's private sector operation in India will focus on the development of infrastructure as well as financial and capital markets and support industrial restructuring and competition. Within these areas, emphasis will be placed on developing an adequate interface between the Government and the private sector by enhancing policy, regulatory, and institutional frameworks, and mechanisms (including public sector management capacities and skills) to facilitate involvement of the private sector in a viable and desirable manner.

117. With its ability to provide direct financing limited, the Bank has to evolve new approaches and modalities as well as leverage its resources to be able to meet the large and long-term funding needs of infrastructure. Available options include the following:

(i) The Bank could support a credit enhancement facility to mobilize additional resources through private initiative and cofinancing and through the Bank's recently introduced guarantee operations,[2] which provide cover to commercial lenders for longer dated maturities and for risks arising from Government actions and regulatory framework. In addition, the Bank could consider providing loans from its public sector window (with or

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1 R56-95: *Strategy For the Bank's Assistance for Private Sector Development*. 17 February 1995.

2 *Review of the Bank's Guarantee Operations*, March 1995.

without the support from private sector window or cofinancing) to support private foreign and domestic investments in infrastructure. These loans would have to be guaranteed by the Government for sovereign and default risks. Sponsors seeking the Bank's lending modality would have to abide by the Government's selection process and the Bank's project evaluation, environment, and procurement standards.

(ii) Bank funds could be pooled with contributions from foreign and domestic private investors or lenders, in a fund or credit facility structures, with appropriate sector and regional focus, to provide equity and/or debt financing for infrastructure projects. Special funds or facilities could also be organized to address specific needs such as seed capital to develop bankable infrastructure projects.

118. In the infrastructure sector, the Bank could also play a catalytical role in mobilizing support for development of (i) build-own-operate and/or build-own-operate and transfer projects to develop power, roads, expressways, bridges, ports, etc.; (ii) private infrastructure funds or facilities with lead financial institutions that have adequate infrastructure project appraisal capabilities; and (iii) direct equity or financing support for infrastructure projects with local or foreign joint ventures in the private sector. In line with the proposed sector strategies, the Bank's assistance for the private sector is envisaged to support (i) establishment of new electricity generating and transmission capacity and privatization of existing power stations to enhance efficiency and resource mobilization, (ii) establishment of capital intensive basic telecommunication services in conjunction with support for improvements in the policy environment, and (iii) development of highways, expressways, and ports.

119. To support industrial restructuring in public and private sectors, Bank assistance is envisaged for (i) further deregulating the industrial sector to allow firms to enhance outward orientation and competition by liberalizing trade and exchange regimes, (ii) relaxing entry and exit barriers, and (iii) streamlining regulatory as well as administrative procedures and mechanisms for closure, liquidation, or rehabilitation of sick industrial firms. Support for industrial and corporate restructuring could also involve developing systematic mechanisms for turning around unprofitable, but viable units, both at the Central and state levels.

120. Strategically, Bank support is not envisaged for industrial projects with short gestation periods and for which commercial financing is available. The Bank could, however, consider supporting equity and debt facilities or venture capital funds that provide for the development of small/medium-sized export-oriented and agro-based industries.

121. The key to developing the private sector is well-functioning financial and capital markets. A competitive and healthy financial and capital market could expand financial resources for private sector investments (including infrastructure projects). While India has one of the most extensive capital markets in the Asian and Pacific Region, the Indian capital market still has weaknesses, e.g., fragmented exchanges, antiquated trading and settlement systems, weak supervision, and the absence of a viable and long-term debt market. Apart from continued support for policy and regulatory

reforms, the Banks' focus will be to make selective investments to help create and build institutions and schemes necessary to fill gaps in the market. In this context, Bank support for the development of long-term debt market will be most critical.

122. In operational terms, the Bank's strategy in finance and capital markets will do the following:

(i) Finance Markets

(a) Assist in the development of monetary policy and a healthy financial system conducive to efficient mobilization and allocation of resources. Among other things, this would involve reducing priority credit programs, liberalizing interest rates, and reforming the agriculture credit and housing finance that form an important component of systems' nonperforming portfolio.

(b) Enhance competition in the financial sector by supporting development of new private sector banks.

(c) Restructure and recapitalize the public sector banks by providing support to reduce the Government's shareholding in state-owned banks and financial institutions, and to reform their management and banking practices.

(d) Strengthen policy framework, supervision, and regulation for non-bank financial institutions to allow them to play a more effective role in financial intermediation.

(ii) Capital Market

To improve the capacity and depth of capital market, there is need to increase the demand for and supply of securities in the Indian capital market and remove impediments to capital growth. This could include support to do the following:

(a) Develop an integrated national market system.

(b) Modernize the infrastructure through support for developing of depository systems and reforming of stock exchanges.

(c) Facilitate access by foreign investors and international financial institutions into the local market.

(d) Remove prohibitions on large traditional fund sources from participating actively in the capital market by (i) deregulating the insurance sector, and traditional long-term sources of investment funds such as contractual savings and institutions and pension and provident funds; and (ii) facilitating the privatization of the associated state-owned enterprises. To further develop the long-term debt market, the Bank will support development of credit enhancement institutions or housing loan securitization, and establishment of a domestic bond insurance company.

(e) Address institutional gaps to develop the primary and secondary markets by strengthening capital market regulation and its enforcement.

123. The role of the Private Sector Group in India is vast and as such needs to be prioritized and concentrated in catalyzing public sector policy reforms in infrastructure sectors and development of long-term debt market. Within this, effort should be made in developing more interface between private sector operations and public sector interventions at state level. To play its role effectively, with limited financial and manpower resources, there will be need for PSG to work in close coordination with relevant public sector division.

V. AID COORDINATION

124. Excluding the Bank, preliminary aid commitments to India are likely to be around $5.3 billion per annum over the next three years, -- implying a significant increase of about 24 percent over the past levels. A large component of this increase is likely to come from the World Bank, which plans to raise its commitments for India substantially, from the present level of $5.7 billion for the last three years to $8.6 billion during 1996 to 1998. Responding to the reform agenda and based on lessons drawn from portfolio reviews, external agencies have revised their country assistance strategies to expand support for (i) social and urban development; (ii) infrastructure development through structural adjustment programs, sector loans, credit lines, and guarantees; and (iii) direct state interventions. With respect to (i), the external agencies have opted for a shared approach (see Box 4, p. 41).

125. In line with these shifts, the World Bank plans to allocate about 40 percent of its lending for population, urban, and social programs. Germany will triple the share of the social sector (including support for microenterprise programs) allocation, from 25 percent to 75 percent of its assistance by 1996; and Japan will double its share, from 10 to about 20 percent.[1] In addition to social and antipoverty programs, external agencies are assigning high priority to environment and natural resource management programs. The World Bank plans to direct about three fourths of its assistance to the states. The states planned to be targeted over the medium-term include Haryana, Orissa, Rajasthan, Uttar Pradesh, and West Bengal.

126. In view of the substantial investment requirements and the relatively modest share of external assistance, external agencies have generally operated in India without any conflict of interest or overlapping. Effective collaboration (through field offices) has further assisted in evolving a more focused role for each external agency and a shared approach in selected areas. To some extent, demarcation of the roles of external agencies in India is circumscribed by the terms and conditions of the funding offered. For instance, IDA and bilaterals are active in the social and agriculture sectors, while the Bank, because India does not currently have access to ADF, has not been active in this area. Over the medium term, collaborative or cofinancing ventures with softer windows to blend the terms and conditions of Bank's OCR, will allow the Bank to support selected social sectors, environment, and energy efficiency/conservation programs.

127. Aid coordination in India has developed effectively through systematic Government efforts and formal dialogue among external agencies. Aid coordination at the sector level is as follows:

(i) **Finance, Industry, and Trade.** Demarcation is clear in these areas as the Bank is active in financial and capital market reforms and corporate and industrial restructuring, while the World Bank has focused on recapitalization and restructuring of public sector banks, strengthening of banking supervision, trade and investment liberalization, and restructuring

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[1] The rest of the Japan's assistance is envisaged to support infrastructure programs, a component of which is to finance a mass transit system in Delhi.

of individual sector or public enterprises such as heavy engineering, cement, paper, etc.

(ii) **Energy.** A high degree of complementarity is observed in the power sector among external sources with a geographic division of operations. In the case of the Central sector utilities, external agencies have adopted close interactions of projects to reinforce reforms. A unanimous and coordinated approach is envisaged to support private power projects, with the Bank supporting them directly with credit enhancement facilities or indirectly through debt or equity infrastructure funds/facilities. Meanwhile, the International Finance Corporation is providing loans or equity support without Government guarantees. The World Bank plans to launch a large national-level infrastructure facility and guarantee operations to support, among other sectors, power projects. A coordinated approach is also evolving on the fundamental importance of restructuring SEBs to generate strong synergies critical for power sector reforms. A clear geographic division will further emerge, with the World Bank supporting the restructuring of SEBs in Haryana, Orissa, Punjab, Rajasthan, Uttar Pradesh, and Bihar while the Bank plans to support similar reforms in other states starting with Gujarat and Andhra Pradesh.

(iii) **Hydrocarbon Subsector**. The Bank is to continue its lead role in policy reform and support for the development of gas infrastructure, while the World Bank may provide parallel financing for the Bombay High Offshore Oil and Gas Field and ONGC's Gas Flaring Reduction project. The World Bank’s primary focus in the hydrocarbon subsector, however, will be to support reforms of the coal subsector.

(iv) **Transport and Communications**. With the policy and regulatory reforms maturing, the World Bank plans to support transport and communication projects through its infrastructure facility. While providing a similar facility, the Bank will additionally build upon its experience in these sectors and evolve a niche for itself in these areas; for instance, in roads, with key external agencies jointly providing support for developing the National Highway Authority of India, the Bank, in close coordination with the World Bank, will support its institutional strengthening. The Bank is to help the Authority to develop a framework for promoting build-operate-transfer and build-own-operate road and bridge projects and for privatization measures relating to the domestic road engineering consulting and contracting industry. The World Bank plans to expand its role by providing a new loan for a national highway fund in 1996 to support the reform and upgrading of engineering and construction procurement practices; privatization of engineering investigation, design, and supervision services; and transfer of modern road design and construction technologies to domestic construction firms. In the ports subsector, the Bank will support public sector projects, selected privatization of port activities, and an umbrella national and state-supported infrastructure facility.

(v) **Urban and Water Supply Development.** As a new comer, the Bank will focus on developing integrated urban infrastructure and municipalities in Gujarat, Karnataka, and Rajasthan. Traditionally, the World Bank has played a lead role in this sector with ongoing projects in Bombay, Gujarat, Madras, Tamil Nadu, and Uttar Pradesh. Expanding its role, the World Bank is planning new activities for the Water Supply and Sewerage Disposal project in Bombay and Madras, a municipal infrastructure facility, and water resource conservation projects in Orissa and Tamil Nadu. In view of the emerging concurrent involvement of external agencies, geographic division is critical while a coordinated approach could be adopted for strengthening and using the urban bodies' resource base, and developing a system of intergovernmental capital transfers.

(vi) **Environment**. Cumulative external assistance for the environment has ranged around $2.5 billion over the last few years.[1] External funding sources are envisaged to at least maintain these levels. The World Bank will continue to be an active participant, providing almost half of the environmental assistance for environment projects. Most of the Canadian Institute for Development Agency support will be for institutional strengthening and capacity building, and energy efficiency and conservation; the United Kingdom for energy efficiency improvements and ecological and environment rehabilitation; and the United States Agency for International Development (USAID) and the Netherlands, for environment education and awareness programs. As in the past, a significant part of the external assistance will be to support environment problems at the state level.[2]

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1 Of this, over 23 percent of environment assistance has been directed to forestry and biodiversity conservation, 16 percent to urban infrastructure (sanitation and water supply) projects, another 13 percent to industrial pollution control projects, and 12 percent to rural infrastructure projects. The external support for institutional strengthening and capacity building (including preparing the Environment Action Plan, environment enforcement, monitoring, and audit) has been only 12 percent, while support for air and industrial pollution, rural infrastructure, and cogeneration and renewable energy sources has been virtually insignificant. INRM: *Environment Projects Supported by Multilateral and Bilateral Donor Agencies*, Vol I and II. February 1995.

2 Maharashtra and Rajasthan received over 40 percent of the environment assistance, another 18 percent supported national programs, and the rest was for Delhi, Haryana, Karnataka, Orissa, Tamil Nadu, and Uttar Pradesh.

VI. SOUND DEVELOPMENT MANAGEMENT AND CAPACITY BUILDING

128. In line with the recently adopted policy,[1] the Bank will take a more explicit and active interest in promoting sound development management and building supportive capacities of borrowing governments to fulfill their development role effectively. In pursuance of sound development management, governments need to establish an institutional environment conducive to performing their key functions, including (i) maintaining macroeconomic stability, (ii) developing infrastructure, (iii) providing public goods, (iv) preventing market failures, and (v) promoting equity. To deliver these functions, it is critical for the Government to develop adequate institutional capacities to adopt sound and stable economic policies, flexibility in responding to market signals, and effective management to facilitate the development process.

129. India with its long tradition of a strong democracy has a good record of governance and development management. In recent years, further steps have been taken to introduce decentralized governance systems. For instance, in 1993 the Government introduced the 73rd and 74th amendments to the Indian Constitution to mandate rural and urban local bodies, respectively, as a means of empowering the people. A major function of rural bodies, as contemplated in the constitutional amendment, is to undertake development of rural economy by involving more systematically the Panchayats (generic term for local institution constituted at a village level). This village council is to have one-third of seats reserved for women and representation of scheduled caste and tribes. Corresponding to the emerging political and administrative structure of rural and urban local bodies, the State Government's have set up State Finance Commission to develop greater fiscal devolution and decentralization of planning system at local level.

130. The Bank's strategy in India attempts to integrate effective development management dimensions into its operations to support:

(i) macroeconomic and public resources management reforms,

(ii) public enterprise reforms,

(iii) enhancement of infrastructure sector policies and legal frameworks for private sector development, and

(iv) development of technical and implementation capabilities of Executing Agencies.

131. To attain these objectives, it is proposed that the Bank provide technical advisory support to the Central Government to improve its (a) macroeconomic management and policy formulation, assessment and analysis; and (b) resource mobilization effort, by developing the tax administration's capacity to implement the income tax reforms and the transition from sales tax to value-added tax.

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[1] Report No: R151-95: *Governance - Sound Development Management*, 3 October 1995.

132. In addition, Bank assists state governments to pursue sound economic policies and development management. The Bank will provide a combination of policy-based TA to build capacities at the state-level to achieve prudent management of public finances (including restructuring of taxation and expenditure policies and associated administrative reforms), reforms of public enterprises, and improvements of the sector policy and the regulatory environment. Beside imparting financial stability at the state level, these initiatives will feed into the macroeconomic adjustment being pursued by the Central Government. Coordinated sector reforms undertaken by the Center and states will encourage efficiency and sustained involvement of private participation in the development process. Provided states are willing to pursue such a development agenda, the Bank will extend the necessary project assistance within its strategic framework of operations in India.

133. The Bank needs to also encourage use of build-operate-transfer techniques for infrastructure, including power, roads, bridges, ports, and telecommunication. Beside stimulating policy, regulatory and legislative frameworks in different sectors and at Central and state levels, the Bank will support upgrading of management and technological skills and development of capabilities of the Central Government and state governments. In the context of development of infrastructure in the private sector, the Bank could (a) help develop the public sector's capability to adopt and implement innovative financing, and (b) support a credit enhancement facility, including the Bank's new Guarantee Operation Policy.

134. However, to extend more comprehensive and systematic support, the Bank may consider central and/or state-level advisory technical assistance for law and development improvements and streamlining of sector policy and regulations in India to implement economic liberalization. The Government has taken a number of initiatives in this area. These include (i) implementation of the umbrella program of Legal Adjustments for Reform for the Global Economy (funded by the United Nations Development Programme and to recommend reforms of Central legislations and judicial system, administered by the National Law School in Bangalore); (ii) passing of debt recovery legislation in 1993 and setting up of six debt recovery tribunals to speed court processing of large debt collections; (iii) proposals for amendments to company, labor, and land legislations and reforms of the administrative mechanisms for corporate restructuring; (iv) a recently established advance tax ruling authority to benefit foreign investors and Indian businesses; and (v) an arbitration bill that is soon to be brought into force to provide investors in large projects an alternative to the slow moving courts.

135. To carry forward these initiatives and legal reforms, the Bank could provide TA for workshops and training to familiarize Government lawyers and policymakers with commercial laws and businesses, private sector infrastructure development (including Government regulation and credit support), and privatization. The proposed TA could support lead institutions, such as the National Law School, to sponsor training programs and/or provide in-service legal training to concerned staff.

136. To maximize the impact and sustainability of these capacity building initiatives and their influence on economic and sector policies, the Bank will need to integrate them effectively within its operations and ensure Government and Executing Agencies ownership of such programs through greater involvement of the concerned entities in conceptualization and formulation of technical support and well-targeted training programs for the management and concerned staff.

Appendix 1

SOCIOECONOMIC INDICATORS BY STATE

	Population Total millions 1991	Urban %	Per Capita SDPb Rs 1993/94	Agric. in SDP (%) 1988/89	Literacy %b 1991	INFI	HDI	Poverty Incidence % 1987/88
ALL INDIAa	846	26	8,102	33d	52	n.a.	n.a.	30
High Income States	158	35	10,723	n.a.	n.a.	n.a.	n.a.	n.a.
Gujarat	41	34	7,800	31	61	125	545	18
Goa	1	41	11,858	n.a.	76	n.a.	n.a.	n.a.
Haryana	16	25	10,359	46	56	152	600	12
Maharashtra	79	39	10,964	21	65	111	643	29
Punjab	20	30	12,319	48	59	205	713	7
Middle Income States	264	29	7,024	n.a.	n.a.	n.a.	n.a.	n.a.
Andhra Pradesh	66	27	6,651	40	44	103	340	32
Karnataka	45	31	7,029	37	56	97	477	32
Kerala	29	26	6,242	100	90	140	775	17
Tamil Nadu	56	34	7,352	24	63	138	487	33
West Bengal	68	27	6,055	31	58	113	418	28
Low Income States	367	19	4,928	n.a.	n.a.	n.a.	n.a.	n.a.
Bihar	86	13	3,650	38	38	96	133	41
Madhya Pradesh	66	23	5,485	41	44	75	186	37
Orissa	32	13	4,726	51	49	89	213	45
Rajasthan	44	23	5,220	47	39	80	229	24
Uttar Pradesh	139	20	4,744	44	42	109	110	35

n.a. = not available/not applicable.
INFI = infrastructure index.
HDI = human development index (1992/93).
SDP = State Domestic Product
a Excludes ten (10) Special Category States.

b Percentage of literates to estimated population aged 7 years and above.

Sources: Ministry of Finance: Economic Survey 1995-96 and Public Finance Statistics; Ministry of Human Resource Development: Annual Report. 1994-95; Planning Commission: Report of the Expert Group on Estimation of Proportion and Number of Poor. July 1993;

SOCIAL AND HUMAN RESOURCE DIMENSIONS

A. Education Attainment and Policies

1. Literacy rate in India stood at 52.2 percent in 1991: 64.2 for males and 39.2 percent for females. Underlying these aggregates are substantial regional variations, with literacy rates varying from 90 percent in Kerala to about 39 percent in Rajasthan and Bihar. Among major states, nine have literacy rates above the all-India average and six below it. The differences in literacy rates are sharper for women. For example, 86 percent of Kerala women are literate, which is four times the level in Rajasthan (20 percent). In line with these differences, there are notable variations in the level of education attainment across states. While the Central Government handles overall policy formulation and planning and higher and technical education, the states bear primary responsibility for education.[1]

2. At the policy level, India's Constitution has for long advocated universalization of compulsory and free education up to middle school. This goal has as yet not been realized because of the magnitude of problem and resource constraints. Every year, the growing population base adds to the number of children eligible for education. Meanwhile, public expenditure devoted for education has been low, making it difficult to attain universal education. The Government has only managed a modest increase in education outlays from 3.1 in 1980/81 to 3.9 percent of GNP in early 1990s. These levels of public expenditures are inadequate to meet requirements and are low by international standards.[2] Moreover, the growing recurrent obligations (of which 90 percent goes for teachers salaries) have squeezed development spending. At the same time, the spending for primary education has been adversely affected as over one fourth of the total education expenditure is devoted for higher education, which could be largely self-financed. While streamlining public expenditures, the Government needs to pay increased attention to cost recovery to allow for part financing of recurrent obligations so that a larger component of the budget is spend on development programs.

3. While a part of the population has no access to education, those who do have access suffer from the weaknesses of the education system. The quality of education has been affected by the lack of proper management and administration and inadequate teaching standards. This, coupled with the prevalence of child labor and negative social attitude towards educating girls, has encouraged high drop out rates.[3]

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[1] Of the total public outlays States bear 90 percent of the spending for primary, secondary, and vocational education, while the Central Government invests mainly in areas under its domains such as higher and technical education and setting/coordinating standards.

[2] On aggregate, the education expenditure constitutes 10 percent of total Central Government and state expenditures. The comparable figure for low income countries has averaged 17.5 percent.

[3] The drop out rate in 1990 was 48 percent (boys 41 and girls 50 percent). As a result, only one third of enrolled children completed middle school (age group 5 to 14 years) and one fourth completed high school education.

4. To improve access to and the quality of education, the Government revised the National Education Policy in 1992.[1] This policy reiterates the goal of providing education for all up to 14 years by the year 2000. To achieve this goal, emphasis is being placed on developing at the district level primary and adult literacy programs that will focus on increasing enrollment and retention by promoting teachers training and decentralized planning and management. In line with this, the Central Government has sponsored the District Primary Education Program (DPEP) in 1993. The DPEP aims at extending the primary education coverage from 42 to 300 districts of the country. The program is to cost $3.5 billion and is being supported largely by the Central Government through grants. In the first phase of DPEP, the Government has allocated $620 million, of which 80 percent is to be funded by the external sources, including the World Bank. Partial implementation of the first phase of DPEP has assisted in extending coverage of primary education to an additional 46 districts.

5. Besides these district-level programs, the National Education Policy is focusing on (i) promoting total literacy campaigns in 345 districts to make 100 million adults functionally literate; (ii) emphasizing reduction in gender disparities through free education for girls, provision for women's education and empowerment in the education system, and recruitment of rural women as teachers in various schemes and areas; (iii) upgrading of secondary education and diverting 25 percent of higher secondary students to the vocational stream by the year 2000; and (iv) improving the capacity and quality of technical education by allocating block grants to technical institutions while seeking greater accountability, economy, and cost effectiveness of expenditures.

B. Health Standards and Policies

6. The health of India's population has improved significantly. The life expectancy at birth rose from 46 to 61 years and the infant mortality rate fell from 129 to 74 per 1000 live births from 1971 to 1991. However, the progress in improving basic health status indicators is below international standards. For instance, India has a high maternal mortality rate of 470 per 100 thousand compared to the world average of 187 per 100 thousand. Also, India's population is generally exposed to a higher incidence of communicable diseases: (i) the risk of tuberculosis is now 15 per 1,000, which is as high as in the Sub-Saharan Africa; (ii) diarrhea diseases a cause half a million infant deaths annually; (iii) leprosy afflicts 2 million people, who constitute almost one third of the World's leprosy victims; and (iv) Acquired Immuno Deficiency Syndrome has spread to 2 million people who are high risk segments of population. Equally widely prevalent are noncommunicable diseases (mainly cardiovascular, nutritional and endocrine, and neuropsychiatric problems) that account for half of the total loss of disability adjusted life years.

7. The high prevalence of communicable and noncommunicable diseases is associated with epidemiological polarization in India whereby (i) low income groups have a high incidence of infectious diseases owing to their high fertility rates, low living conditions resulting from poor access to water supply and sanitation, and weaknesses of the

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[1] Ministry of Human Resource Development: *Annual Report.* 1994/95.

preventive and primary health care (PHC) delivery system; but (ii) high and middle income groups are not very susceptible to infectious diseases. However, as life spans have increased all income groups are exposed to higher incidence of degenerative diseases.

8. India has developed a fairly elaborate three-tier health infrastructure including PHC, first referral and secondary hospitals, and tertiary hospitals to cater to its population. Publicly funded and managed hospitals, despite the growing importance of private providers, are the main source of health care. The public health system is mainly managed and run by the states. In addition to their own health programs, the states manage centrally sponsored disease control programs dealing with ailments (such as malaria, tuberculosis, AIDs, leprosy, blindness, etc.) that are either fully or partially funded from the Central Government's budget.

9. Health spending in India is estimated to be 6 percent of Gross Domestic Product (GDP).[1] Of this, three fourths is incurred by private households, while rest is government spending. Of the latter, states implement 90 percent of health expenditures, while the rest is handled by the Central Government and used on family planning, health, and nutrition schemes. Public health expenditure, of around 1.3 percent of GDP, is low by international standards. As in the case of the education sector, there are interest distortions in public health expenditures. For instance, only one third of the states' spending is devoted to primary services (including PHC and public health). Meanwhile, a large component of health expenditures is being used for curative care services, with relatively inadequate allocation for preventive and promotive care services. The public health expenditures, which are already low, have been further cut in recent years. These cuts have squeezed outlays for disease control programs that benefit the poor, and recurrent obligations that will undermine the capacity of the existing facilities to deliver adequate service.

10. The National Health Policy of 1983 emphasizes significant expansion in the coverage of PHC and community health care to improve health status. The health policy underscores the need for an increase in life expectancy to 64, and a reduction in the IMR to below 60 and the crude death rate to 9 per 1,000 by the year 2000. To meet these targets, the Government, while supporting its conventional programs, is operating special community-based preventive programs. These include the centrally sponsored Minimum Needs Program which consists of a dozen propoor programs for primary and adult education, rural health, water supply and sanitation, roads, electrification, housing, domestic cooking energy, urban slum improvement, nutrition, and food security; and the Integrated Child Development Services program, which provides basic health, nutrition, and preschool education services to children (up to age six) and to pregnant and lactating mothers in roughly half of the 5,500 rural blocks in India.[2] India also needs to pay greater attention to PHC and community-based preventive programs to cater to the poor. This

[1] World Bank Report No: 13042-IN: *India Policy and Finance Strategies for Strengthening Primary Health Care Services*. Population and Human Resource Division, South Asia Country Department II. May 1995.

[2] Blocks are geographic areas with around 110,000 people.

could be achieved through enhanced cost recovery[1] and privatization of selective health care service at referral hospitals.[2]

C. Poverty Incidence and its Magnitude

11. India has made steady progress in reducing poverty. According to the Planning Commission, poverty incidence was about 29.9 percent in 1987/88 compared to 50 percent in 1970s. In view of the data and methodological problems, however, alternate estimates tend to suggest that poverty incidence is much higher in India (ranging from 39 to 43 percent in 1987/88). The estimates are highly sensitive to the choice of poverty line. Notwithstanding these differences, there is broad confirmation of country's progress at reducing poverty over the years.

12. In general, rural poverty (at 33.4 percent in 1987/88) has been observed to be higher than urban poverty (20 percent). Over 80 percent of the poor live in rural areas. The rural poor tend to be landless and concentrated in rainfed agriculture and arid zones. While urban poverty is lower, the high urban population growth has resulted in massive strain on the labor market, and on the availability of shelter, infrastructure, and other services.[3] Compounding these problems are labor market rigidities that have held down the growth in employment,[4] forcing the work force to opt for casual labor. A larger proportion of the workers are now resorting to casual work. Employment generation has been affected by the industrial as well as labor policies that have encouraged high capital intensity and restricted labor mobility. While access to socioeconomic services may be better in urban than in rural areas, the pressures continue to grow leading to a rise in the slum pockets and population.

13. Geographically, the poor are concentrated in the eastern and central parts of the country, where over 60 percent of the poor can be found. The proportion of poor in these regions rose from 56 percent in 1972/73 to 61 percent in 1987/88, although its population share has stagnated at around 54 percent. The poverty incidence, however, is highest in Bihar and Orissa (almost 30 percent above the all-India levels), where about 17 percent of the poor[5] are located. In contrast, poverty incidence is lowest in the northern region (about 60 percent lower than the all-India levels), with Punjab exhibiting the lowest poverty incidence. In general, the poverty level bears a strong correspondence to the

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[1] Cost recovery in the health sector has fallen from 6 percent in 1975/76 to 1.6 percent of the health outlays in 1991/92.

[2] From a welfare point of view, a recent study of 100 referral hospital has recommended only partial cost recovery (up to 20 percent of costs) while deferring privatization of health facilities in the absence of health insurance and a regulatory body to address issues of health management and pricing. See S.K. Sanyal and V.B. Tulasidhar: *A Report on Utilization Pattern and Financing of Public Hospitals*. National Institute of Public Finance and Policy, New Delhi, February 1995.

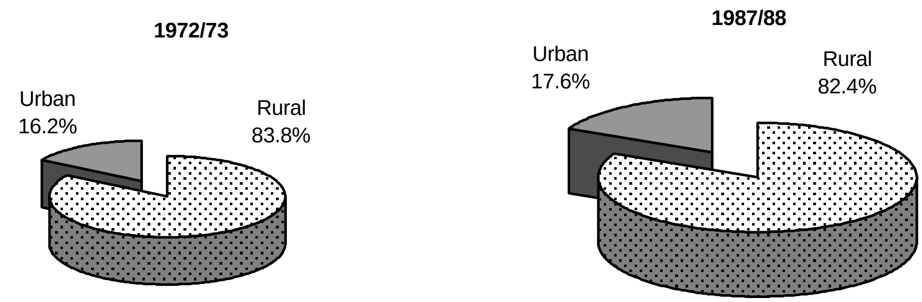
[3] Om Prakash Mathur: "The State of India's Urban Poverty." The Asian Development Bank, Research Project on Critical Issues and Policy Measures to Address Urban Poverty. July 1993.

[4] The limited size and growth of employment in the organized sector (particularly manufacturing) is reflected by the fall in the employment elasticity from 0.90 in 1978-83 to 0.30 during 1983-88. See Ajeet Mathur: "Industrial Restructuring in India and the National Renewal Fund," prepared for the Asian Development Bank, January 1993.

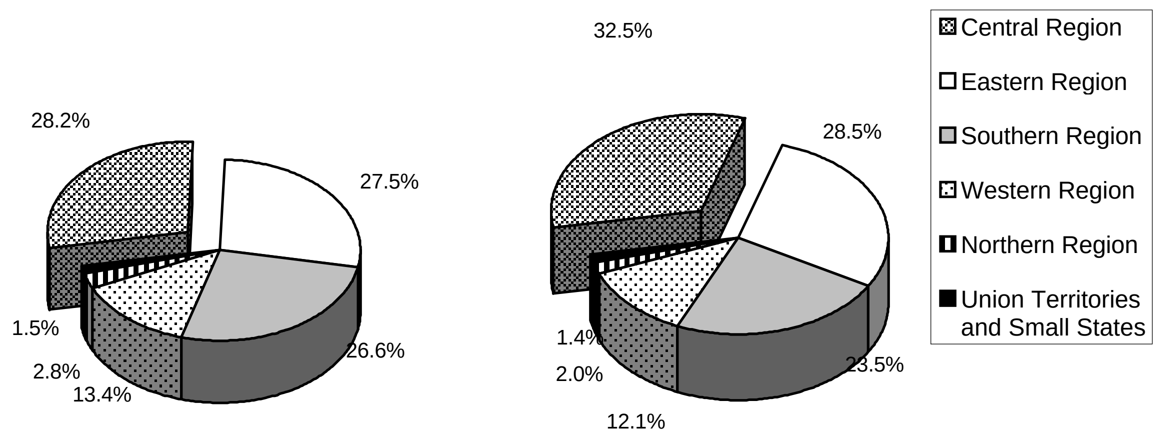
[5] Of which over 20 percent are very poor, residing mostly in Bihar.

India: Poverty and Its Regional Dimension[a]

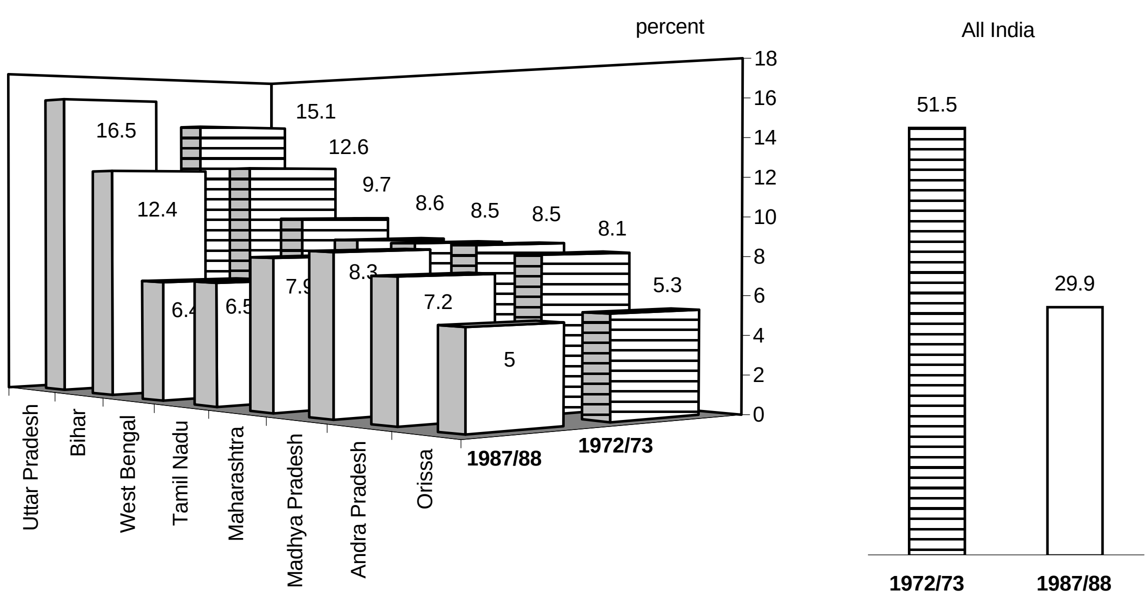
A. Rural-Urban Distribution of Poor



B. Regional Distribution of Poor



C. Trends in Poverty Incidence



[a] Based on official figures estimated by the Planning Commission. The spatial distribution changes if alternate measures of poverty are used.

Source: Planning Commission: *Report of the Expert Group on Estimation of Proportion and Number of Poor.*

structure of the economy and to the social and demographic profile of the states. Bihar, with extreme high poverty incidence, has the lowest social indicators and low agriculture growth and productivity; while Punjab and Haryana have a low incidence of poverty and relatively higher standard of living, largely because of a strong agriculture base and its good performance.

D. Status of Women

14. Women in India are recognized as essential contributors to economic activity and as being primarily responsible for domestic maintenance. The poorer the household, the more it depends upon a woman's economic productivity for survival, although most of her activities being in the non-market or non-wage sectors of the economy is rendered statistically invisible.[1] As a result, women's contribution to economic activity is less visible to policymakers, and this along with cultural ideologies of gender roles in society and the family, determines the relative access of men and women to productive resources and support services for human development.

1. Educational Attainment

15. Despite progress in recent years, almost 60 percent of India's illiterates are girls or women. Illiteracy is more pronounced among rural women. School enrolment ratios for girls have increased faster in recent years, but overall female enrollment rates are lower than boys. Education attainment is very low in nine states.[2] The retention of girls in schools, particularly at the primary level is low.

2. Health

16. The sex ratio in India has been adverse over the decades and it stood at 927 females per 1000 men in 1991. The poor health infrastructure, high maternal mortality; and relative deprivation of younger girls of nutrition, health, and medical care, are some of the responsible factors. The mortality rate for women is high compared to men and this differential is more pronounced in rural areas. Maternal mortality is affected by the heavy reproductive burden borne by women and their poor nutrition, weak health status, and high fertility. There is a positive correlation between women's education, work participation, and nutritional status of the family, and of girl children.

3. Women's Participation

17. About 75 percent of females over age 5 are working as compared to 64 percent of the males. Female labor participation rates are noticeably higher among scheduled caste/tribe groups and, at the regional level, participation rates are higher in the south, western, and central states. The wheat-producing states of Haryana and Punjab

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1 This is largely because the definitions of work that do not capture the multiplicity, seasonality, and often nonmonetized nature of women's work.

2 Andhra Pradesh, Assam, Bihar, Jammu and Kashmir, Madhya Pradesh, Orissa Rajasthan, Uttar Pradesh, and West Bengal.

have low rates of female labor force participation, similar to the trends observed for West Bengal and Bihar. Eighty-five percent of all economically active women are employed in agriculture and a large proportion of them are unpaid workers. Over the years, the steady growth in the proportion of women in agricultural work and the associated rise in dependence on paid work has had important implications for intrahousehold dynamics and women's control over resource allocation. There is need to increase employment opportunities for women, but also to reach rural housewives, and unpaid female family workers with agricultural extension, credit, and other information, and support services for productive self employment.

18. The female participation rate in urban areas is lower (40 percent) and is predominantly confined to the informal sector. Micro studies also point to women's increased involvement in industrial subcontracting, which is largely home-based and low paying work.

19. Policy measures to promote overall employment growth in the formal and informal sectors, combined with better access of women to financial services, and training in non traditional skills, organization, support services etc. should contribute to alleviation of women's status.

4. Government and Nongovernmental Organization Activities for Women's Development

20. The policymakers and planners in India are devoting increased attention to elevating women's status and moving away from a primary concern for welfare orientation through isolated interventions to the systematic incorporation of gender perspectives into the entire portfolio of development programs across all sectors. The several commissions and reports[1] have created greater awareness of the problems of women. Recent policies have advocated major changes in women's programs emphasizing economic independence for women, along with access to health care and family planning services and antipoverty programs for the promotion of self-employment through access to credit and other support services, as well as creation of an asset base for self-employment.

21. The National Perspective Plan for Women (1988-2000) called for enhancement of women-in-development programs by empowering women through education and awareness creation, and training, and access to resources. NGO activity to support women's programs is long standing and has expanded in geographical spread, numbers, and budgets, over the last decade. However, the collective reach of NGOs in terms of numbers of women they serve is small relative to the Government programs. The role of NGOs, nonetheless, has been significant and qualitatively has had more impact. There is need to promote, identify, induct, train, and deploy women cadres, particularly from the rural and semirural areas, by women's NGOs.

22. The Government, NGOs, and international agencies are playing an important role in promoting women in the management of natural resources, and their participation in efforts at enlisting community participation in joint forest management,

[1] The Report on the Status of Women in India: Towards Equlity.

watershed development, and rural water supply and sanitation. The World Bank has assisted a West Bengal forestry project and the United Nations International Children Emergency Fund (UNICEF) has supported rural water and sanitation programs.

5. Possible Areas for Bank Support for Women In Development

23. The Bank could support women's integration in the development process through incorporation of gender analysis and inputs into projects (such as urban infrastructure) and state-level interventions. The state-level interventions could focus on supporting sustainable financing mechanism for social services. The Bank could support a participatory approach based upon gender analysis and inputs that would contribute to greater relevance and sustainability of projects, and targeting of poverty groups. In upgrading of slums, rehousing of affectees, provision of low income housing and sanitation, solid waste management, water supply, sites and services, participatory approaches and gender inputs would be extremely important in ensuring (i) community participation in design and management, and (ii) implementation and cost recovery in a socially relevant manner. In these areas, NGO involvement in the design and implementation of project activities and in benefit monitoring would improve the achievement of the strategic objectives. In support of capacity building in municipalities and local authorities, it would be useful to include training and sensitization of staff on gender and development, and on participatory approaches. The ongoing Bank-assisted regional technical assistance (RETA) on Low Income Women Entrepreneurs has India as a participating country and aims at strengthening the productivity and expanding the scale of their business, through institutional strengthening and capacity building of women's organizations serving the needs and priorities of low income women entrepreneurs operating in the informal sector. Given the importance of credit and other support services for the development of micro enterprises in the informal sector, another RETA (in which India is a participating country) looks at micro enterprise institutions, programs, and policies with the aim of helping NGOs and the Bank future programs.

24. In its support for the Environment Action Plan, the Bank may encourage alternative renewable technologies, and their dissemination in rural areas. In this context, gender perspectives as regards technologies to be developed/supported, and mechanisms for their dissemination to women through access and training, would be important areas to focus upon. A RETA (including India) is being proposed for strengthening the incorporation of gender issues into forestry and watershed development programs.

SECTOR PORTFOLIO REVIEW OF PROJECTS

1. The Bank's experience in India is confined to selected projects and sectors. While the portfolio is still to fully mature, some important lessons are emerging. At the broader level, evidence suggests that there is greater ownership of policies and programs in India. However, the administrative processing of projects can be complex and more lead preparatory time and upfront actions can help minimize project implementation and disbursement concerns. The Bank has had a good experience in the financial sector, where both policy-based operations and development finance institutions' support, have contributed to the reforms of monetary and banking system, the capital market, and improved the performance of development finance institutions. The first phase of reforms has been completed. There is now a need to deepen the Bank's involvement in the financial and capital markets to augment liberalization, support the recapitalization of public sector banks, and develop and strengthen the long-term debt market and the regulatory and supervisory oversight for the financial and capital market institutions.

2. In the energy sector, the performance has been mixed. The aid utilization in the hydrocarbon subsector has been satisfactory and the Executing Agencies concerned (including Oil and Natural Gas Commission, Gas Authority of India Limited, Indian Oil Corporation) have implemented investment programs efficiently. At the commencement of Bank assistance, the hydrocarbon subsector was reserved solely for the public sector, despite the substantial reforms introduced in other areas. Bank assistance has been instrumental in transforming the hydrocarbon subsector through reforms aimed at liberalizing the investment climate and introducing market forces into all segments of subsector. The increased private sector participation has raised the much needed investments for oil and gas exploration and the development of proven reserves as joint ventures and as production sharing contracts. This also enhanced the sector's operational efficiency through increased competition. The reforms have further laid the ground work for the corporatization and divestiture of the Oil and Natural Gas Corporation and other public enterprises. These reforms have encouraged other lenders to provide the financial and technical support required for the sector. The Bank's support for the hydrocarbon subsector has also played a role in promoting energy conservation and enhancement of environmental protection.

3. The power subsector has received about $1,040 million[1] assistance from the Bank, $110 million cofinancing under the Complementary Financing Scheme and $4.1 million for seven technical assistance (TA) projects, a significant part of which has assisted the Central Government and state power entities to augment generation capacity. Power subsector loans and TAs have also emphasized policy reforms and included support (i) for introducing agreed financial and operational action plans for the state utilities, and (ii) to review/revise the power tariffs (bulk and retail). The portfolio performance of power projects is mixed. Most projects are implemented on schedule; however, a few have had long delays, including the Unchahar Thermal Power Project (Loan No. 907)[2], approved in September 1988, which has been substantially delayed by the financial difficulties of the Executing Agency, the Uttar Pradesh Rajya Vidyut Utpadan Limited. This subsequently necessitated the selling the Unchahar Power Station (for which Bank was to finance the

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1 Includes two private sector projects.
2 For $160 million, approved on 29 September 1988.

generating units) to the National Thermal Power Corporation. This further required a change in the Bank loan agreements to designate the new owner of the power plant as the borrower.

4. The implementation of the Power Efficiency Sector Project (Loan No. 1161)[1] has also been affected by (i) lack of compliance by state electricity boards (SEBs) with the operational and financial action plan, which disqualifies the SEBs from borrowing from the Power Finance Corporation; and (ii) management weaknesses in the Power Finance Corporation, which are being addressed with TA from the United States Agency for Industrial Development (USAID). The problems of the power portfolio largely stem from the institutional weaknesses of the SEBs, which control end-user tariffs, all electricity distribution, and 70 percent of the generation. In view of portfolio experience, future assistance to the power sector should explicitly support restructuring of SEB's, and be directed to Central Government power utilities (Power Grid Corporation) largely for improving sector efficiency.

5. The Bank's experience in transport and communications is confined to a maximum of two or three projects in each subsector. Most projects have faced delays and implementation difficulties. Of the four road projects,[2] the first two were delayed by two years and the quality of construction suffered from the packaging of numerous, scattered, and relatively small state and national roads in the project. The complex implementation arrangements, compounded by the inherent procedural and institutional inefficiencies in the sector, contributed to the implementation difficulties.

6. The Bank's assistance to the port subsector has included three loans[3] and five TAs. The first port project is completed, although with two years lag because of delays in the loan effectivity and subsequent clearances and the release of project related expenditures. The second project is proceeding satisfactorily. However, initial start-up delays have affected the pace of implementation of the third port project. The port projects have, in general, met the objectives of Bank assistance. From a policy and capacity building perspective, the impact of Bank assistance in the road and port subsectors has been positive, particularly in the areas of port privatization and institutional restructuring in the road sector.

7. The two railway projects have focused on augmenting the capacity of Indian Railways (IR) for freight traffic by upgrading technology and providing freight locomotives, facilities and equipment, and electrification of lines, etc. The Railways Project (Loan No. 857)[4] has experienced a time overrun of over 4 years in view of strong political resistance outside IR to the switch from exclusive reliance of IR on indigenous equipment to imported locomotives. Over the period, the Project has facilitated transfer of technology and training, and assistance for establishing processes and techniques for manufacture of the latest state of art electric locomotives. In the case of Second Railways Project (Loan No. 1140)[5], the IR's emphasizes on domestic contract awards because of

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1 For $250 million, approved on 26 March 1992.
2 Loan No. 918-IND: *Road Improvement Project*; Loan No. 1041-IND: *Second Road Project*; Loan No. 1274-IND: *National Highways Project*; and Loan No. 1279-IND: *Bombay-Vadodara Expressway*.
3 Loan No. 842-IND: *Ports Development Project*, Loan No. 1016-IND: *Second Ports Project*, and Loan No. 1181-IND: *Coal Ports Project*.
4 For $190 million, approved on 10 November 1987.
5 For $225 million, approved on 5 December 1991.

competitive prices in India and nonmember countries,[1] and the lower bids on some components of contracts have necessitated a reformulation of the project scope. This resulted in large cancellations, equivalent to $108 million[2] or 26 percent of the total railway assistance. The Bank is providing advisory support through TAs (totaling $1.9 million).[3] This is to assist IR to enhance operational efficiency, rationalize the nonbulk general goods traffic, and improve traffic costing and financial management reporting systems. Discussions are under way with IR to implement the recommendations of these TAs. In line with the Bank's and other external agencies' experience, as well as the needs of the subsector, it is pragmatic to focus efforts to enhance IR's productivity and efficiency so that it can respond better and compete with other modes of transportation.

8. The two telecommunications projects,[4] have focused on general network expansion and its modernization and financed the provision of plant, machinery and equipment to a domestic company for manufacturing cables and telephone equipment. The implementation of the telecommunication projects has been delayed by 2 to 2.5 years primarily because the Department of Telecommunications did not understand the Bank's *Guidelines for Procurement.* The complexities arose in the preparation of tender documents and the routine use of the two envelope bid evaluation procedure by the Department even for relatively simple components with proven technologies. About $75 million, or onethird of the total telecommunication assistance, had to be canceled. The cancellations were needed largely because of loan savings stemming from lower bids than originally estimated, and partly because of a change in project scope owing to developments in technology as well as emergence of additional productive capacities for manufacture of cables in joint and private sector. Despite implementation delays, the first telecommunication project has made a positive contribution by supporting the establishment of a modern and a more efficient international telephone exchange. Bank interventions in the telecommunication subsector would have more pronounced impact if supportive of the much needed implementation of the Telecommunication Policy announced in May 1994.

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1 About 73 percent of the total contracts to date (amounting to $35.8 million) for the Second Railways Project were awarded to domestic contractors.

2 About $58 million loan cancellation occurred because the Ministry of Railways found it more economical to manufacture BOXN wagons indigenously with procurement of materials from nonmember countries. The remaining $50 million was canceled because bids were lower than estimates.

3 In addition, the World Bank is also providing TA to railways.

4 These are Loan No. 886-IND, *Telecommunications Project,* for $135 million, approved on 7 April 1988; and *Second Telecommunications Project* (Loan No. 954), approved in February 1989 ($118 million).